INTERNAL REVENUE
BULLETIN

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2016–15
April 11, 2016

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2016–10, page 545.

Fringe benefits aircraft valuation formula. For purposes of section 1.61–21(g) of the Income Tax Regulations, relating to the rule for valuing non-commercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the first half of 2016 are set forth.

Notice 2016–27, page 576.

This notice provides that statements required under section 6035, regarding the basis of property distributed from the estate of a decedent, need not be filed or furnished until June 30, 2016, rather than the current March 31, 2016 deadline.

Notice 2016–28, page 576.

Notice 2016–28 explains how a State or local government amends the nomination of an empowerment zone to provide for a new termination date of December 31, 2016.

T.D. 9759, page 545.

These regulations apply when a corporation that is subject to U.S. income tax acquires loss property tax-free from a liquidating subsidiary, from shareholders or others in a capital contribution, or from another corporation or person in a reorganization, and the loss in the acquired property accrued outside the U.S. tax system. The regulations provide guidance for preventing the importation of loss in such cases by requiring the bases of the assets received to be equal to value.

T.D. 9760, page 564.

These regulations finalize without substantive change temporary and proposed regulations promulgated in 2013 that address outbound transfers of stock or securities in certain nonrecognition transactions. First, the regulations finalize modifications to the indirect stock transfer coordination rule, which generally provides that section 367(a) and (d) apply to any assets transferred in an outbound reorganization before the indirect stock transfer rules. The modifications finalize changes to the exceptions to the coordination rule by providing that – under certain conditions – section 367(a) and (d) will not apply to the transferred assets to the extent those assets are re-transferred to a domestic corporation. Second, these regulations finalize rules governing transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. Finally, these regulations finalize modifications to the procedures for obtaining relief for failures to satisfy certain reporting requirements.

ESTATE TAX

Notice 2016–27, page 576.

This notice provides that statements required under section 6035, regarding the basis of property distributed from the estate of a decedent, need not be filed or furnished until June 30, 2016, rather than the current March 31, 2016 deadline.

ADMINISTRATIVE

Rev. Proc. 2016–22, page 577.

This revenue procedure updates Rev. Proc. 87.24, 1987–1 C.B. 720, which describes the practices for the administrative appeals process in cases docketed in the United States Tax Court.

Notice 2016–27, page 576.

This notice provides that statements required under section 6035, regarding the basis of property distributed from the estate of a decedent, need not be filed or furnished until June 30, 2016, rather than the current March 31, 2016 deadline.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61. Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Rev. Rul. 2016–10

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charge and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
1/1/16 – 6/30/16	$39.19	Up to 500 miles = $.2144 per mile
		501–1500 miles = $.1635 per mile
		Over 1500 miles = $.1572 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Associate Chief Counsel (Tax Exempt/Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 317-6798 (not a toll-free number).

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26 CFR 1.334–1: Basis of property received in liquidations; 26 CFR 1.362–3: Basis of importation property acquired in a loss importation transaction

T.D. 9759

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Limitations on the Importation of Net Built-In Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations

SUMMARY: This document contains final regulations under sections 334(b)(1)(B) and 362(e)(1) of the Internal Revenue Code of 1986 (Code). The regulations apply to certain nonrecognition transfers of loss property to corporations that are subject to certain taxes under the Code. The regulations affect the corporations receiving such loss property. This document also amends final regulations under sections 332 and 351 to reflect certain statutory changes. The regulations affect certain corporations that transfer assets to, or receive assets from, their shareholders in exchange for the corporation's stock.

DATES: *Effective Date*: These final regulations are effective on March 28, 2016.

FOR FURTHER INFORMATION CONTACT: John P. Stemwedel (202) 317-5363 or Theresa A. Abell (202) 317-7700 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations revises a collection of information that has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2019. The revised collection of information in these final regulations is in §§ 1.332–6, 1.351–3, and 1.368–3. By requiring that taxpayers separately report the fair market value and basis of property (including stock) described in section 362(e)(1)(B) and in 362(e)(2)(A) that is transferred in a tax-free transaction, this revised collection of information aids in identifying transactions within the scope of sections 334(b)(1)(B), 362(e)(1), and 362(e)(2) and thereby facilitates the ability of the IRS to verify that taxpayers are complying with sections 334(b)(1)(B), 362(e)(1), and 362(e)(2). The respondents will be corporations and their shareholders.

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

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 section 6103.

Background

Sections 334(b)(1)(B) and 362(e)(1) (the anti-loss importation provisions) were added to the Code by the American Jobs Creation Act of 2004 (Pub. L. 108–357, 188 Stat. 1418) to prevent erosion of the corporate tax base when a person (Transferor) transfers property to a corporation (Acquiring) and the result would be an importation of loss into the federal tax system. Proposed regulations under sections 334(b)(1)(B) and 362(e)(1) were published in the **Federal Register** (78 FR 54971) on September 9, 2013 (the 2013 NPRM). Three written comments were submitted on the 2013 NPRM; no public hearing was requested or held. Additionally, on March 10, 2005, the Treasury Department and the IRS published in the **Federal Register** (70 FR 11903–01) a notice of proposed rulemaking (the 2005 NPRM) that, among other things, proposed amendments to the regulations under sections 332 and 351 to reflect statutory changes. No comments were received with respect to the amendments reflecting statutory changes to section 332 and 351, although several comments were received with respect to other aspects of the 2005 NPRM. The 2005 NPRM's proposed amendments that reflect statutory changes are included in this final rule.

The comments with respect to the 2013 NPRM, and the respective responses of the Treasury Department and the IRS, are described in the Summary of Comments and Explanation of Provisions that follows the Summary of the 2013 NPRM.

Summary of the 2013 NPRM

1. General Application of Sections and Interaction with Other Law

The 2013 NPRM provided specific rules to implement the statutory framework of the anti-loss importation provisions, such as rules for identifying "importation property" and for determining whether the transfer of that property occurs in a transaction subject to the anti-loss importation provisions (designated a "loss importation transaction" under the 2013 NPRM and these final regulations).

a. Importation property

The 2013 NPRM used a hypothetical sale analysis to identify importation property. Under this approach, the actual tax treatment of any gain or loss that would be recognized on a sale of an individual property, first by the Transferor immediately before the transfer and then by Acquiring immediately after the transfer, determined whether that individual property was importation property. If a Transferor's gain or loss on a sale of an individual property immediately before the transfer would not be subject to any tax imposed under subtitle A of the Code (federal income tax), the first condition for classification as importation property would be satisfied. If Acquiring's gain or loss on a sale of the transferred property immediately after the transfer would be subject to federal income tax, the second condition for classification as importation property would be satisfied. If both of these conditions would be satisfied, the property would be importation property.

In general, this determination was made by reference to the tax treatment of the Transferor(s) or Acquiring as hypothetical sellers of the transferred or acquired property, that is, whether the hypothetical seller would take the gain or loss into account in determining its federal income tax liability. This determination had to take into account all relevant facts and circumstances. The 2013 NPRM included a number of examples illustrating this approach. Thus, in one example, a tax-exempt entity transferred property to a taxable domestic corporation, and the determination took into account whether the transferor, though generally tax-exempt, would nevertheless be required to include the amount of the gain or loss in unrelated business taxable income (UBTI) under sections 511 through 514 of the Code. In other examples, a foreign corporation transferred property to a taxable domestic corporation and the determination took into account whether the foreign corporation would be required to include the amount of gain or loss under section 864 or 897 as income effectively connected with, or treated as effectively connected with, the conduct of a U.S. trade or business. Although the examples assumed that there was no applicable income tax treaty, in the case of an applicable income tax treaty, the determination of whether property is importation property would take into account whether the Transferor would be taxable under the business profits article or gains article of the income tax treaty.

i. Property Acquired from Grantor Trusts, Partnerships, and S Corporations

Although the general rule in the 2013 NPRM looked solely to the tax treatment of the Transferor(s) and Acquiring as hypothetical sellers, a look-through rule applied if a Transferor was a grantor trust, a partnership, or a small business corporation that elected under section 1362(a) to be an S corporation. In these cases, the determination of whether gain or loss from a hypothetical sale was subject to federal income tax was made by reference to the tax treatment of the gain or loss in the hands of the grantors, the partners, or the S corporation shareholders.

If an organizing instrument allocated gain or loss in different amounts, including by reason of a special allocation under a partnership agreement, the determination of whether gain or loss from a hypothetical sale by the entity was subject to federal income tax would be made by reference to the person to whom, under the terms of the instrument, the gain or loss on the entity's hypothetical sale would actually be allocated, taking into account the entity's net gain or loss actually recognized in the tax period in which the transaction occurred.

ii. Anti-Avoidance Rule for Certain Entities

In certain circumstances, the Code permits an entity that would otherwise be subject to federal income tax to shift the incidence of federal income taxation to the entity's owners. For example, under sections 651 and 652, and sections 661 and 662, distributions made by a trust are deducted from the trust's income for federal income tax purposes and included in the beneficiary's (or beneficiaries') gross income. Certain domestic corporations, including regulated investment companies (RICs, as defined in section 851(a)), real estate investment trusts (REITs, as defined in section 856(a)), and domestic corporations taxable as cooperatives (Cooperatives; see section 1381) are also able to shift the incidence of federal income taxation by distributing income or gain.

The Treasury Department and the IRS were concerned that disregarding the ability of these entities to shift the incidence of federal income taxation could undermine the anti-loss importation provisions. However, the Treasury Department and the IRS were also concerned that applying a look-through rule in all of these cases would impose a significant administrative burden.

Accordingly, the 2013 NPRM included an anti-avoidance rule that applied to domestic trusts, estates, RICs, REITs, and Cooperatives that directly or indirectly transferred property (including through other such entities) in a transaction described in section 362(a) or 362(b) (a Section 362 Transaction). The rule applied if the property had been directly or indirectly transferred to or acquired by the entity as part of a plan to avoid the application of the anti-loss importation provisions. When the look-through rule applied, the entity was presumed to distribute the proceeds of its hypothetical sale and the tax treatment of the gain or loss in the distributees' hands would determine whether the gain or loss was taken into account in determining a federal income tax liability. If the distributee were also such an entity, the principles of this rule applied to look to the ultimate owners of the interests in the entity.

iii. Gain or Loss Affecting Certain Income Inclusions

Prior to the publication of the 2013 NPRM, questions were raised regarding the treatment of property transferred by or to a controlled foreign corporation (CFC), as defined in section 957 (taking into account section 953(c)). The general rules of the 2013 NPRM would not treat gain or loss recognized on a hypothetical sale by a CFC as subject to federal income tax; however, because practitioners raised concerns prior to the publication of the 2013 NPRM, the 2013 NPRM expressly provided that gain or loss recognized on a hypothetical sale by a CFC is not considered subject to federal income tax solely by reason of an income inclusion under section 951(a). The 2013 NPRM similarly provided that gain or loss recognized by a passive foreign investment company, as defined in section 1297(a), was not subject to federal income tax solely by reason of an inclusion under section 1293(a).

iv. Gain or Loss Taxed to More than One Person

If gain or loss realized on a hypothetical sale would be includible in income by more than one person, the 2013 NPRM treated such property, solely for purposes of the anti-loss importation provisions, as tentatively divided into separate portions in proportion to the allocation of gain or loss from a hypothetical sale to each person. Tentatively divided portions were treated and analyzed in the same manner as any other property for purposes of applying the anti-loss importation provisions.

b. Loss importation transaction

Under the 2013 NPRM, once property had been identified as importation property, Acquiring would determine its basis in the importation property under generally applicable rules (disregarding sections 362(e)(1) and 362(e)(2)) and, if that aggregate basis exceeded the aggregate value of all importation property transferred in the Section 362 Transaction, the transaction was a loss importation transaction subject to the anti-loss importation provisions. If the aggregate basis of the importation property did not exceed such property's value, the anti-loss importation provisions had no further application.

i. Aggregate, Not Transferor-by-Transferor, Approach

By their terms, section 362(e)(1) and the provisions of the 2013 NPRM apply in the aggregate to all importation property acquired in a transaction, regardless of the number of transferors in the transaction. This rule differs from the transferor-by-transferor approach of section 362(e)(2), which is concerned with whether a transferor would otherwise duplicate loss by retaining loss in stock and transferring property with a net built-in loss.

ii. Valuing Partnership Interests

In response to concerns raised by practitioners prior to the publication of the 2013 NPRM, a special valuation rule for transfers of partnership interests was included in the 2013 NPRM. Under that rule, the value of a partnership interest would be determined in a manner that takes partnership liabilities into account. Specifically, the 2013 NPRM provided that the value of a partnership interest would be the sum of cash that Acquiring would receive for such interest, increased by any § 1.752–1 liabilities (as defined in § 1.752–1(a)(4)) of the partnership that were allocated to Acquiring with regard to such transferred interest under section 752. The 2013 NPRM included an example that illustrated the application and effect of this rule. The 2013 NPRM also clarified that any section 743(b) adjustment to be made as a result of the transaction was made after any section 362(e) basis adjustment.

c. Acquiring's basis in acquired property

If a transaction was a loss importation transaction under the 2013 NPRM, Acquiring's basis in each importation property received (including the tentatively divided portions of property determined to be importation property) was an amount equal to the value of that property, notwithstanding the general rules in sections 334(b)(1)(B), 362(a), and 362(b). This rule applied to all importation property, regardless of whether the property's value was more or less than its basis prior to the loss importation transaction.

Immediately following the application of the anti-loss importation provisions (and prior to any application of section 362(e)(2)), any property that was treated as tentatively divided for purposes of applying the anti-loss importation provisions ceased to be treated as divided and was treated as one undivided property (reconstituted property) with a basis equal to the sum of the bases of the portions determined under the anti-loss importation provision, and the bases of all other portions determined under generally applicable provisions (other than section 362(e)(2)).

If the transaction was described in section 362(a), the transferred property was then aggregated on a transferor-by-transferor basis to determine whether further adjustment would be required to the bases of loss properties under section 362(e)(2). The 2013 NPRM included a cross-reference to section 362(e)(2) as well as examples illustrating the application of both section 362(e)(1) and (e)(2) to situations involving multiple transferors and multiple properties that were not all importation properties.

2. Filing Requirements

To facilitate the administration of both the anti-loss importation provisions and the anti-duplication provisions in section 362(e)(2), the 2013 NPRM modified the reporting requirements applicable in all affected transactions (section 332 liquidations and transactions described in section 362(a) or section 362(b)) to require taxpayers to identify the bases and values of properties subject to those sections.

3. Modifications to Liquidation Regulations

The 2013 NPRM also included several modifications to the regulations applicable to corporate liquidations. These modifications were not substantive changes to the law; they were solely to update the regulations to reflect certain statutory changes, including the repeal of the *General Utilities* doctrine (reflected in the modification of sections 334(a) and 337(a), and the repeal of sections 333 and 334(c)), the removal of former section 334(b)(2) (replaced by section 338), and the relocation of former section 332(c) (subsidiary indebtedness) to current section 337(b). In response to certain regulatory changes, the 2013 NPRM also added several cross-references to regulations under section 367 and 897 to highlight the treatment of certain transfers between foreign corporations.

Summary of Comments and Explanation of Provisions

In general, the commenters agreed with the general framework prescribed in the 2013 NPRM and the positions taken therein by the Treasury Department and the IRS. Accordingly, the final regulations generally adopt the provisions of the 2013 NPRM. However, the final regulations also adopt certain modifications and include certain clarifications in response to comments. These comments, and the respective responses of the Treasury Department and the IRS, are described in the following paragraphs.

1. Comments Related to Partnership Matters

The majority of comments received in response to the 2013 NPRM related to issues involving partnerships.

a. Items taken into account to determine treatment of hypothetical sale

As described previously, under the 2013 NPRM, the determination of whether gain or loss on property transferred by a partnership is subject to federal income tax would be made by reference to the treatment of the partners, taking into account all partnership items for the year of the Section 362 Transaction. One commenter suggested a closing-of-the-books rule instead, asserting such an approach would be more administrable for transferor partnerships. The Treasury Department and the IRS are concerned that the allocation of partnership items as of the date of the transfer could differ from the allocation of such items at the end of the partnership tax year. In such a case, the partner to whom gain or loss on the hypothetical sale of the transferred property would be allocated as of the transfer date (using a hypothetical closing-of-the-books method) may not be the partner to whom the allocation would be made as of the end of the year, taking all items for the year into account. The Treasury Department and the IRS believe that the latter approach more accurately identifies the partner to whom the gain or loss on a sale of the property would be allocated, and thus more accurately determines whether such amounts would be subject to federal income tax. Accordingly, these final regulations do not permit using a closing-of-the-books method.

In response to questions about how to determine to which partner an item would be allocated, and thus its federal income tax treatment, the final regulations clarify that the partnership agreement as well as any applicable rules of law are taken into account.

b. Widely-held partnerships and publicly traded partnerships

Another commenter requested that widely held partnerships (WHPs) and publicly traded partnerships (PTPs) not be subject to the look-through rule applicable to all partnerships for determining whether gain or loss on a hypothetical sale is subject to federal income tax. Instead, the commenter requested these entities be afforded treatment similar to that of domestic estates, trusts, RICs, REITs, and Cooperatives (and therefore be subject to look-through treatment only in abusive situations). The commenter's reasons for this suggested modification included that look-through treatment would impose a substantial administrative burden on WHPs and PTPs and that these entities are not generally vehicles for abuse. However, the statute explicitly contemplates that partners, not partnerships, are the focus of the inquiry under section 362(e)(1). WHPs and PTPs are already required to apply a look-through approach to track and report information to their partners. For purposes of determining whether there is an importation of loss for PTPs, the Treasury Department and the IRS will respect determinations derived by applying generally accepted conventions in determining allocable income. *See*, for example, the conventions set forth in § 1.706–4(c)(3)(ii). Accordingly, the Treasury Department and the IRS do not believe it is necessary or appropriate to treat these partnerships as other than partnerships, and the final regulations retain the approach used in the 2013 NPRM.

c. Interactions of sections 362(e) and 704(c)(1)(C)

Commenters also requested clarification of the interaction of the regulations proposed under section 362(e)(1), the regulations under section 362(e)(2), and regulations proposed under section 704(c)(1)(C) (79 FR 3041 (January 16, 2014)). The Treasury Department and the IRS agree that such clarification would be appropriate. However, the interaction of these provisions cannot be addressed independently of the promulgation of final regulations under section 704(c)(1)(C). Accordingly, these issues will be addressed as part of the finalization of regulations under that section.

d. Partnership allocations in the case of a section 362(e)(2)(C) election

The 2013 NPRM, like the final regulations under section 362(e)(2), included examples involving partnership transferors and allocation to partners of resulting adjustments under section 362(e)(1) and (2), including adjustments in the case of a section 362(e)(2)(C) election. The examples direct allocations to the partners that contributed the property transferred by the partnership in order to comply with the legislative purpose of section 362(e)(1) and (2) and to prevent distortions. Commenters agreed with the results provided in the examples but requested a clarification of the authority on which the analyses were based. The analysis reflected in the examples is based on general aggregate and entity principles of partnership tax law, taking into account the aggregate approach reflected in the statutory language of section 362(e)(1), and the purposes and principles of section 362(e)(1) and (2). The rule applying an aggregate approach to partnerships is set forth in § 1.362–3(d)(2) and is illustrated in Example 5 of § 1.362–3(f).

e. Rev. Rul. 84–111 and Rev. Rul. 99–6

One commenter requested that the final regulations clarify the effect of Rev. Rul. 84–111 (1984–30 IRB 6, 1984–2 CB 88) and Rev. Rul. 99–6 (1999–6 IRB 6, 1999–1 CB 432) on a transfer of all the interests in a partnership to a single transferee in a loss importation transaction. The Treasury Department and the IRS recognize that guidance would be helpful in this area but have concluded that resolution of the complex issues implicated by those rulings is beyond the scope of this project. Accordingly, these final regulations do not address this issue.

2. Comments Related to Other Special Entities

a. Anti-avoidance rule

As previously described, the 2013 NPRM would only subject domestic estates, trusts, RICs, REITs, and Cooperatives to look-through treatment in certain abusive situations. One comment suggested that the anti-avoidance rule would be strengthened if the final regulations provided certain operating presumptions or factors to be applied in determining whether the rule would apply. The Treasury Department and the IRS have considered this suggestion but determined that the approach of the 2013 NPRM, focusing on the existence of a plan to avoid the anti-loss importation provisions, is appropriate and administrable. Accordingly, the final regulations do not adopt this suggestion.

b. Foreign non-grantor trusts

Another modification suggested by a commenter would allow a foreign non-grantor trust to prove that its beneficiaries were not foreign, in order to avoid treating gain or loss from its hypothetical sale as being treated as not subject to federal income tax. The Treasury Department and the IRS considered the suggestion and determined that such an approach is inconsistent with the anti-loss importation provisions and the general approach of the regulations because, subject to the anti-abuse rule, all non-grantor trusts, not their beneficiaries, are treated as transferors for purposes of the anti-loss importation provisions. In addition, adopting the commenter's suggestion would lead to inappropriate electivity with respect to the application of the anti-loss importation provisions because such an approach would depend on the identity of the foreign non-grantor trust's beneficiaries rather than a determination of whether the foreign non-grantor trust is subject to federal income tax. Accordingly, the final regulations do not adopt this suggestion.

c. Trusts with no distributable net income

Another commenter suggested that a domestic trust should be excepted from look-through treatment under the anti-abuse rule if it has no distributable net income within the meaning of section 643(a) in the taxable year of the transaction. The Treasury Department and the IRS considered this suggestion and determined that it could lead to inappropriate electivity and abuse because the existence of distributable net income is not controlling in determining whether a transfer furthers a plan to avoid the anti-loss importation provisions. The existence of such a plan is controlling for determining that the transfer is subject to the anti-abuse rule. Accordingly, the final regulations do not adopt this suggestion.

d. Tax-exempt transferors of debt-financed property

Under the 2013 NPRM, if a tax-exempt entity transferred debt-financed property (as defined in section 514), the disposition of such property would be subject to federal income tax and thus the property could not be importation property. This rule applied even if there was only a de minimis amount of indebtedness and so only a small portion of any gain or loss would be subject to federal income tax. Commenters noted the cliff effect and resulting potential for avoidance of the anti-loss importation provisions. The Treasury Department and the IRS agree, and the final regulations adopt an approach that treats debt-financed property as subject to federal income tax in proportion to the amount of such gain or loss that would be includible in the transferor's UBTI on a sale under sections 511–514. The final regulations provide that portions of property determined under this rule are generally treated under the anti-loss importation provisions in the same manner as portions of property tentatively divided to reflect multiple owners of gain or loss on the property (for example, when a partnership transfers property to Acquiring).

3. Interaction with Regulations Under Section 367(b)

The proposed regulations requested comments on the appropriate treatment of transactions subject to section 367(b) and to either section 334(b)(1)(B) or 362(e)(1). Comments were also specifically requested on what effect a basis reduction required under section 334(b)(1)(B) or 362(e)(1) should have on earnings and profits and any inclusion required under § 1.367(b)–3. One comment suggested that if an inbound liquidation or inter-group asset reorganization gives rise to an inclusion of the all earnings and profits amount under § 1.367(b)–3, the basis reduction under section 334(b)(1)(B) or 362(e)(1), respectively, should be reduced to allow the transferee corporation to preserve an amount of built-in loss equal to the all earnings and profits amount. The comment suggested that this reduction is appropriate because the inclusion of the all earnings and profits amount is intended, in part, as a toll charge for importing basis into the U.S. tax system. However, the comment acknowledged that if such a rule was adopted, anti-abuse rules would be needed to address stuffing transactions and consideration should be given to adjusting the reduction for foreign tax credits associated with the inclusion of the all earnings and profits amount.

The Treasury Department and the IRS have determined that the basis reduction should not be affected by an inclusion of the all earnings and profits amount. First, there is no indication in section 334(b) or 362(e), or their legislative history, that the basis reduction should be reduced or otherwise affected by an inclusion of the all earnings and profits amount. Second, such a reduction may be contrary to the policies underlying these provisions. For example, the built-in loss may have arisen before a domestic corporation acquires all the stock of a foreign corporation such that the built-in loss bears no relation to the all earnings and profits amount. Finally, determining the extent to which the built-in loss relates to the all earnings and profits amount would involve undue complexity. Accordingly, the final regulations do not adopt this suggestion. Furthermore, the final regulations affirmatively state that the basis reduction does not affect the calculation of the all earnings and profits amount.

4. Transferred Basis Transaction

Commenters requested clarification of whether a transferee's basis in property continued to be considered determined by reference to its transferor's basis, notwithstanding the application of section 334(b)(1)(B) or section 362(e)(1). One comment specifically related to the application of regulations under section 755; other comments related to the treatment of the transaction more generally, including under sections 1223 (holding periods) and 7701(a)(4) (definition of transferred basis transaction). The Treasury Department and the IRS have concluded that the application of the anti-loss importation provisions to section 332 liquidations or Section 362 Transactions should not be viewed as altering the fundamental nature of the transactions to which section 334(b), or section 362(a) or (b), apply. Similarly, the Treasury Department and the IRS have concluded that the anti-duplication provisions in section 362(e)(2) and § 1.362–4 should not be viewed as altering the fundamental nature of the transactions to which they apply. Accordingly, the final regulations expressly provide that, notwithstanding the application of the anti-loss importation or anti-duplication provisions to a transaction, the transferee's basis is generally considered determined by reference to the transferor's basis for federal income tax purposes.

However, solely for purposes of determining the adjustment to the basis of partnership property under section 755 when a partnership interest is transferred in a loss importation transaction, the transferee's basis in the interest will be treated as not determined by reference to the transferor's basis. The reason for this exception under section 755 is that the treatment prescribed under § 1.755–1(b)(2) and (3) (generally applicable to non-substituted basis transactions and providing for basis increases to built-in gain property and basis decreases to built-in loss property) mirrors that prescribed under the anti-loss importation provisions. Accordingly, in order to align the adjustments to partnership property under § 1.755–1 with those made under the anti-loss importation provisions, the final regulations provide that, solely for purposes of applying section 755, a determination of basis under the anti-loss importation provisions is treated as not made by reference to the transferor's basis.

5. Applicability of Other Provisions for Determining Basis

A commenter noted that certain language in the 2013 NPRM could be read in a way that was not intended. The 2013 NPRM states the general rule that Acquiring's basis in importation property in a loss importation transaction is equal to the value of the property immediately after the transaction, "[n]otwithstanding any other provision of law[.]" The comment indicated that this language could be read to mean that, if the anti-loss importation provisions applied to a transaction, the transaction would not be subject to other provisions of law, such as section 482, that could further affect basis. Any such implication was wholly unintended and would be inappropriate. Accordingly, the final regulations clarify that other provisions of law do in fact continue to apply.

6. Miscellaneous

Immediately following the publication of the 2013 NPRM, a number of questions were raised regarding cross-references to the anti-loss importation and anti-duplication provisions that were proposed to be included in § 1.358–6 (basis in triangular reorganizations). Those cross-references were included solely to put taxpayers on notice that the anti-loss importation and anti-duplication provisions could modify the application of the triangular basis regulations to a transaction subject to those regulations. No substantive rule was intended or effected by the proposed cross-references. However, to clarify the purpose and scope of the cross-references, the final regulations do not include the individual cross-references included in the 2013 NPRM. Instead, the final regulations combine these multiple cross-references into one cross-reference that is included in the general statement of scope in § 1.358–6(a).

Commenters also noted a number of nonsubstantive corrections and clarifications that have been adopted.

Finally, commenters suggested a number of issues that could be the subject of further study, such as the effect of tax treaties, nonfunctional currency, and the application of section 7701(g) (clarification of fair market value in the case of non-recourse indebtedness). These issues are beyond the scope of this project and are therefore not addressed in these final regulations. The Treasury Department and the IRS are considering whether further study of those issues should be undertaken.

In addition, nonsubstantive changes to conform nomenclature with that adopted in these final regulations, as well as to correct obvious errors and clarify cross-references, are made to final regulations under sections 362(e)(2), 705, and 1367 published under TD 9633.

Finally, these final regulations include modifications to §§ 1.332–2 and 1.351–1 that reflect certain statutory changes under sections 332 (relating to ownership of subsidiary stock) and 351 (relating to property permitted to be received by a transferor without recognition of gain or loss) proposed by the Treasury Department and the IRS in the 2005 NPRM (the statutory modifications). As no comments were received with respect to the statutory modifications, the statutory modifications are adopted as final regulations without change.

Effective/Applicability Date

The final regulations under sections 334(b)(1)(B) and 362(e)(1) generally adopt the proposed effective date and thus are applicable to transactions occurring on or after March 28, 2016, unless completed pursuant to a binding agreement that was in effect prior to March 28, 2016, and all times afterwards. The final regulations also apply to transactions occurring before March 28, 2016 resulting from entity classification elections made under § 301.7701–3 that are filed on or after March 28, 2016. In addition, the final regulations provide that taxpayers may apply these rules to any transaction occurring after October 22, 2004.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact 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. Further, it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information requirement in these regulations modifies an existing collection of information by requiring that certain information be reported separately instead of in the aggregate. Although there should be an actual decrease in reporting burden, since taxpayers would no longer be required to aggregate the data they collect, any change is expected to be minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business, and no comments were received.

Drafting Information

The principal author of these regulations is John P. Stemwedel of the Office of Associate Chief Counsel (Corporate), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.334–1 also issued under 26 U.S.C. 367(b).

* * * * *

Section 1.362–3 also issued under 26 U.S.C. 367(b).

* * * * *

Par. 2. Section 1.332–2 is amended by revising the first sentence of paragraph (a) and adding paragraph (f) to read as follows:

§ 1.332–2 Requirements for nonrecognition of gain or loss.

(a) The nonrecognition of gain or loss under section 332 is limited to the receipt of property by a corporation that is the actual owner of stock (in the liquidating corporation) meeting the requirements of section 1504(a)(2). * * *

* * * * *

(f) *Applicability date*. The first sentence of paragraph (a) of this section applies to plans of complete liquidation adopted after March 28, 1985, except as specified in section 1804(e)(6)(B)(ii) and (iii) of Pub. L. 99–514.

Par. 3 Section 1.332–6 is amended by revising paragraph (a)(3) and adding a sentence at the end of paragraph (e) to read as follows:

§ 1.332–6 Records to be kept and information to be filed with return.

(a) * * *

(3) The fair market value and basis of assets of the liquidating corporation that have been or will be transferred to any recipient corporation, aggregated as follows:

(i) Importation property distributed in a loss importation transaction, as defined in § 1.362–3(c)(2) and (3) (except that “section 332 liquidation” is substituted for “section 362 transaction”), respectively;

(ii) Property with respect to which gain or loss was recognized on the distribution;

(iii) Property not described in paragraph (a)(3)(i) or (ii) of this section;

* * * * *

(e) *Effective/applicability date*. * * * Paragraph (a)(3) of this section applies with respect to liquidations under section 332 occurring on or after March 28, 2016, and also with respect to liquidations under section 332 occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such liquidation is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter.

Par. 4. Section 1.332–7 is amended by adding a sentence after the first sentence of the paragraph to read as follows:

§ 1.332–7 Indebtedness of subsidiary to parent.

* * * See section 337(b)(1). * * *

Par. 5. Section 1.334–1 is revised to read as follows:

§ 1.334–1 Basis of property received in liquidations.

(a) *In general*. Section 334 sets forth rules for determining a distributee’s basis in property received in a distribution in complete liquidation of a corporation. The general rule is set forth in section 334(a) and provides that, if property is received in a distribution in complete liquidation of a corporation and if gain or loss is recognized on the receipt of the property, then the distributee’s basis in the property is the fair market value of the property at the time of the distribution. However, if property is received in a complete liquidation to which section 332 applies, including property received in satisfaction of an indebtedness described in section 337(b)(1), see section 334(b)(1) and paragraph (b) of this section.

(b) *Liquidations under section 332*—(1) *General rule*. Except as otherwise provided in paragraph (b)(2) or (3) of this section, if a corporation (P) meeting the ownership requirements of section 332(b)(1) receives property from a subsidiary (S) in a complete liquidation to which section 332 applies (section 332 liquidation), including property received in a transfer in satisfaction of indebtedness that satisfies the requirements of section 337(b)(1), P's basis in the property received is the same as S's basis in the property immediately before the property was distributed. However, see § 1.460–4(k)(3)(iv)(B)(*2*) for rules relating to adjustments to the basis of certain contracts accounted for using a long-term contract method of accounting that are acquired in a section 332 liquidation.

(2) *Basis in property with respect to which gain or loss was recognized*. Except as otherwise provided in Subtitle A of the Internal Revenue Code (Code) and this subchapter of the Income Tax Regulations, if S recognizes gain or loss on the distribution of property to P in a section 332 liquidation, P's basis in that property is the fair market value of the property at the time of the distribution. Section 334(b)(1)(A) (certain tax-exempt distributions under section 337(b)(2)); see also, for example, § 1.367(e)–2(b)(3)(i).

(3) *Basis in importation property received in loss importation transaction*—(i) *Purpose*. The purpose of section 334(b)(1)(B) and this paragraph (b)(3) is to modify the application of this section to prevent P from importing a net built-in loss in a transaction described in section 332. See paragraph (b)(3)(iii)(A) of this section for definitions of terms used in this paragraph (b)(3).

(ii) *Determination of basis*. Notwithstanding paragraph (b)(1) of this section, if a section 332 liquidation is a loss importation transaction, P's basis in each importation property received from S in the liquidation is an amount that is equal to the value of the property. The basis of property received in a section 332 liquidation that is not importation property received in a loss importation transaction is determined under generally applicable basis rules without regard to whether the liquidation also involves the receipt of importation property in a loss importation transaction.

(iii) *Operating rules*—(A) *In general*. For purposes of section 334(b)(1)(B) and this paragraph (b)(3), the provisions of § 1.362–3 (basis of importation property received in a loss importation transaction) apply, adjusted as appropriate to apply to section 332 liquidations. Thus, when used in this paragraph (b)(3), the terms "importation property," "loss importation transaction," and "value" have the same meaning as in § 1.362–3(c)(2), (3), and (4), respectively, except that "the section 332(b)(1) distributee corporation" is substituted for "Acquiring" and "section 332 liquidation" is substituted for "section 362 transaction." Similarly, when gain or loss on property would be owned or treated as owned by multiple persons, the provisions of § 1.362–3(d)(2) apply to tentatively divide the property in applying this section, substituting "section 332 liquidation" for "section 362 transaction" and making such other adjustments as necessary.

(B) *Time for making determinations*. For purposes of section 334(b)(1)(B) and this paragraph (b)(3)—

(*1*) *P's basis in distributed property*. P's basis in each property S distributes to P in the section 332 liquidation is determined immediately after S distributes each such property;

(*2*) *Value of distributed property*. The value of each property S distributes to P in the section 332 liquidation is determined immediately after S distributes the property;

(*3*) *Importation property*. The determination of whether each property distributed by S is importation property is made as of the time S distributes each such property;

(*4*) *Loss importation transaction*. The determination of whether a section 332 liquidation is a loss importation transaction is made immediately after S makes the final liquidating distribution to P.

(C) *Effect of basis determination under this paragraph (b)(3)*—(*1*) *Determination by reference to transferor's basis*. A determination of basis under section 334(b)(1)(B) and this paragraph (b)(3) is a determination by reference to the transferor's basis, including for purposes of sections 1223(2) and 7701(a)(43). However, solely for purposes of applying section 755, a determination of basis under this paragraph (b)(3) is treated as a determination not by reference to the transferor's basis.

(*2*) *Not tax-exempt income or noncapital, nondeductible expense*. The application of this paragraph (b)(3) does not give rise to an item treated as tax-exempt income under § 1.1502–32(b)(2)(ii) or as a noncapital, nondeductible expense under § 1.1502–32(b)(2)(iii).

(*3*) *No effect on earnings and profits*. Any determination of basis under this paragraph (b)(3) does not reduce or otherwise affect the calculation of the all earnings and profits amount provided in § 1.367(b)–2(d).

(iv) *Examples*. The examples in this paragraph (b)(3)(iv) illustrate the application of section 334(b)(1)(B) and the provisions of this paragraph (b)(3). Unless the facts indicate otherwise, the examples use the following nomenclature and assumptions: USP is a domestic corporation that has not elected to be an S corporation within the meaning of section 1361(a)(1); FC, CFC1, and CFC2 are controlled foreign corporations within the meaning of section 957(a), which are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause their property to be subject to any tax imposed under subtitle A of the Code (federal income tax); there is no applicable income tax treaty; and all persons and transactions are unrelated. All other relevant facts are set forth in the examples:

Example 1. Basic application of this paragraph (b)(3). (i) *Distribution of importation property in a loss importation transaction*. (A) *Facts*. USP owns the sole outstanding share of FC stock. FC owns three assets, A1 (basis $40, value $50), A2 (basis $120, value $30), and A3 (basis $140, value $20). On Date 1, FC distributes A1, A2, and A3 to USP in a complete liquidation that qualifies under section 332.

(B) *Importation property*. Under § 1.362–3(d)(2), the fact that any gain or loss recognized by a CFC may affect an income inclusion under section 951(a) does not alone cause gain or loss recognized by the

CFC to be treated as taken into account in determining a federal income tax liability for purposes of this section. Thus, if FC had sold either A1, A2, or A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if USP had sold A1, A2, or A3 immediately after the transaction, USP would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(2).

(C) *Loss importation transaction*. Immediately after the distribution, USP's aggregate basis in the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, be $300 ($40 + $120 + $140) and the properties' aggregate value would be $100 ($50 + $30 + $20). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(3).

(D) *Basis of importation property distributed in loss importation transaction*. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, the basis in each of the importation properties received is equal to its value immediately after FC distributes the property. Accordingly, USP's basis in A1 is $50; USP's basis in A2 is $30; and USP's basis in A3 is $20.

(ii) *Distribution of both importation and non-importation property in a loss importation transaction*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 1* except that FC is engaged in a U.S. trade or business and A3 is used in that U.S. trade or business.

(B) *Importation property*. A1 and A2 are importation properties for the reasons set forth in paragraph (i)(B) of this *Example 1*. However, if FC had sold A3 immediately before the transaction, FC would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Therefore, A3 is not importation property. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(2).

(C) *Loss importation transaction*. Immediately after the distribution, USP's aggregate basis in the importation properties, A1 and A2, would, but for section 334(b)(1)(B) and this section, be $160 ($40 + $120). Further, the properties' aggregate value would be $80 ($50 + $30). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(3).

(D) *Basis of importation property distributed in loss importation transaction*. Because the importation properties, A1 and A2, were transferred in a loss importation transaction, the basis in each of the importation properties received is equal to its value immediately after FC distributes the property. Accordingly, USP's basis in A1 is $50 and USP's basis in A2 is $30.

(E) *Basis of other property*. Because A3 is not importation property distributed in a loss importation transaction, USP's basis in A3 is determined under generally applicable basis rules. Accordingly, USP's basis in A3 is $140, the adjusted basis that FC had in the property immediately before the distribution. See section 334(b)(1).

(iii) *FC not wholly owned*. The facts are the same as in paragraph (i)(A) of this *Example 1* except that USP owns only 80% of the sole outstanding class of FC stock and the remaining 20% is owned by individual X. Further, on Date 1 and pursuant to the plan of liquidation, FC distributes A1 and A2 to USP and A3 to X. A1 and A2 are importation properties, the distribution to USP is a loss importation transaction, and USP's bases in A1 and A2 are equal to their value ($50 and $30, respectively) for the reasons set forth in paragraphs (ii)(C) and (D) of this *Example 1*. Under section 334(a), X's basis in A3 is $20.

(iv) *Importation property, no net built in loss*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 1* except that the value of A2 is $230.

(B) *Importation property*. A1, A2, and A3, are importation properties for the reasons set forth in paragraph (i)(B) of this *Example 1*.

(C) *Loss importation transaction*. Immediately after the distribution, USP's aggregate basis in the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, be $300 ($40 + $120 + $140). However, the properties' aggregate value would also be $300 ($50 + $230 + $20). Therefore, the importation properties' aggregate basis would not exceed their aggregate value and the distribution is not a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(3).

(D) *Basis of importation property not distributed in loss importation transaction*. Because the importation properties, A1, A2, and A3, were not distributed in a loss importation transaction, the basis of each of the importation properties is determined under the generally applicable basis rules. Accordingly, immediately after the distribution, USP's basis in A1 is $40, USP's basis in A2 is $120, and USP's basis in A3 is $140, the adjusted bases that FC had in the properties immediately before the distribution. See section 334(b)(1).

(v) *CFC stock as importation property distributed in loss importation transaction*. (A) *Facts*. USP owns the sole outstanding share of FC stock. FC owns the sole outstanding share of CFC1 stock (basis $80, value $100) and the sole outstanding share of CFC2 stock (basis $100, value $5). On Date 1, FC distributes its shares of CFC1 and CFC2 stock to USP in a complete liquidation that qualifies under section 332.

(B) *Importation property*. No special rule applies to the treatment of property that is the stock of a CFC. Thus, if FC had sold either the CFC1 share or the CFC2 share immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if USP had sold either the CFC1 share or the CFC2 share immediately after the transaction, USP would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Thus, the CFC1 share and the CFC2 share are importation property. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(2).

(C) *Loss importation transaction*. Immediately after the distribution, USP's aggregate basis in importation property (the CFC1 share and the CFC2 share) would, but for section 334(b)(1)(B) and this section, be $180 ($80 + $100) and the shares' aggregate value is $105 ($100 + $5). Therefore, the importation property's aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(3).

(D) *Basis of importation property distributed in loss importation transaction*. Because the importation property (the CFC1 share and the CFC2 share) was transferred in a loss importation transaction, USP's basis in each of the shares received is equal to its value immediately after FC distributes the shares. Accordingly, USP's basis in the CFC1 share is $100 and USP's basis in the CFC2 share is $5.

Example 2. *Multiple step liquidation*. (i) *Facts*. USP owns the sole outstanding share of FC stock. On January 1 of year 1, FC adopts a plan of liquidation. FC makes the following distributions to USP in a transaction that qualifies as a complete liquidation under section 332. In year 1, FC distributes A1 and, immediately before the distribution, FC's basis in A1 is $100 and A1's value is $120. In Year 2, FC distributes A2, and, immediately before the distribution, FC's basis in A2 is $100 and A2's value is $120. In year 3, in its final liquidating distribution, FC distributes A3 and, immediately before the distribution, FC's basis in A3 is $100 and A3's value is $120. As of the time of the final distribution, USP had depreciated the bases of A1 and A2 to $90 and $95, respectively; the value of A1 had appreciated to $160; and, the value of A2 has declined to $0.

(ii) *Importation property*. If FC had sold either A1, A2, or A3 immediately before it was distributed, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if USP had sold either A1, A2, or A3 immediately after it was distributed, USP would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (b)(3)(iii)(A) of this section and § 1.362–3(c)(2).

(iii) *Loss importation transaction*. Immediately after it was distributed, USP's basis in each of the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, have been $100. Further, immediately after each such property was distributed, its value was $120. Thus, the properties' aggregate basis, $300, would not have exceeded the properties' aggregate value, $360. Accordingly, the distribution is not a loss importation transaction irrespective of the fact that, when the liquidation was completed, the properties' aggregate basis was $285 and the properties' aggregate value was $280. See paragraph (b)(3)(iii)(B) of this section and § 1.362–3(c)(3).

(iv) *Basis of importation property not distributed in loss importation transaction*. Because the importation properties, A1, A2, and A3, were not distributed in a loss importation transaction, the basis of each of the importation properties is determined under the generally applicable basis rules. Accordingly, USP takes each of the properties with a basis of $100 and, immediately after the final distribution, has an adjusted basis of $90 in A1 (USP's $100 basis less the $10 depreciation), $95 in A2 (USP's $100 basis less the $5 depreciation), and $100 in A3. See section 334(b).

(c) *Applicability date*. This section applies with respect to liquidations occurring on or after March 28, 2016, and also with respect to liquidations occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such liquidation is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter. In addition, taxpayers may apply this section to any section 332 liquidation occurring after October 22, 2004.

Par. 6. Section 1.337–1 is added to read as follows:

§ 1.337–1 Nonrecognition for property distributed to parent in complete liquidation of subsidiary.

(a) *General rule*. If sections 332(a) and 337 are applicable with respect to the receipt of a subsidiary's property in complete liquidation, no gain or loss is recognized to the liquidating subsidiary with respect to such property (including property distributed with respect to indebtedness, see section 337(b)(1) and § 1.332–7), except as provided in section 337(b)(2) (distributions to certain tax-exempt distributees), section 367(e)(2) (distributions to foreign corporations), and section 897(d) (distributions of U.S. real property interests by foreign corporations).

(b) *Aplicability date*. This section applies to any taxable year beginning on or after March 28, 2016.

Par. 7. Section 1.351–1 is amended by:

1. Adding headings for paragraphs (a) and (a)(1) and revising the first sentence of paragraph (a)(1) introductory text.

2. Adding a sentence after the fifth sentence in paragraph (a)(1) introductory text and removing the phrase "For purposes of this section" at the end of paragraph (a)(1) introductory text and adding in its place the phrase "In addition, for purposes of this section".

3. Revising paragraphs (a)(1)(i) and (ii).

4. Removing the undesignated paragraph immediately following paragraph (a)(1)(ii).

5. Adding a heading for paragraph (a)(2).

6. Adding a heading for paragraph (b) and revising paragraph (b)(1).

7. Adding a heading for paragraph (b)(2).

8. Adding paragraph (d).

The additions and revisions read as follows:

§ 1.351–1 Transfer to corporation controlled by transferor.

(a) *In general*—(1) *Nonrecognition of gain or loss*. Section 351(a) provides, in general, for the nonrecognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock of such corporation if, immediately after the exchange, such person or persons are in control of the corporation to which the property was transferred. * * * For purposes of this section, stock rights and stock warrants are not included in the term *stock*. * * *

(i) Stock will not be treated as issued for property if it is issued for services rendered or to be rendered to or for the benefit of the issuing corporation; and

(ii) Stock will not be treated as issued for property if it is issued for property which is of relatively small value in comparison to the value of the stock already owned (or to be received for services) by the person who transferred such property and the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property.

(2) *Application*. * * *

* * * * *

(b) *Multiple transferors*—(1) *Disproportionate transfers*. When property is transferred to a corporation by two or more persons in exchange for stock, as described in paragraph (a) of this section, and the stock received is disproportionate to the transferor's prior interest in such property, the entire transaction will be given tax effect in accordance with its true nature, and the transaction may be treated as if the stock had first been received in proportion and then some of such stock had been used to make gifts (section 2501 and following), to pay compensation (sections 61(a)(1) and 83(a)), or to satisfy obligations of the transferor of any kind.

(2) *Application*. * * *

* * * * *

(d) *Applicability date*. Paragraphs (a)(1) and (b)(1) of this section apply to transfers after October 2, 1989, for tax years ending after such date, except as specified in section 7203(c)(2) and (3) of Pub. L. 101–239.

Par. 8. Section 1.351–3 is amended by revising paragraphs (a)(3) and (b)(3), and adding a sentence at the end of paragraph (f) to read as follows:

§ 1.351–3 Records to be kept and information to be filed.

(a) * * *

(3) The fair market value and basis of the property transferred by such transferor in the exchange, determined immediately before the transfer and aggregated as follows:

(i) Importation property transferred in a loss importation transaction, as defined in § 1.362–3(c)(2) and (3), respectively;

(ii) Loss duplication property as defined in § 1.362–4(g)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (a)(3)(i) or (ii) of this section); and

(iv) Property not described in paragraph (a)(3)(i), (ii), or (iii) of this section.

* * * * *

(b) * * *

(3) The fair market value and basis of property received in the exchange, determined immediately before the transfer and aggregated as follows:

(i) Importation property transferred in a loss importation transaction, as defined in § 1.362–3(c)(2) and (3), respectively;

(ii) Loss duplication property as defined in § 1.362–4(g)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (b)(3)(ii) of this section);

(iv) Property not described in paragraph (b)(3)(i), (ii), or (iii) of this section; and

* * * * *

(f) *Effective/applicability date*. * * * Paragraphs (a)(3) and (b)(3) of this section apply with respect to exchanges under section 351 occurring on or after March 28, 2016, and also with respect to exchanges under section 351 occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such exchange is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter.

Par. 9. Section 1.358–6 is amended by adding a sentence at the end of paragraph (a), revising paragraphs (c)(4) introductory text, (e), and the first sentence of paragraph (f)(3), and adding paragraph (f)(4) to read as follows:

§ 1.358–6 Stock basis in certain triangular reorganizations.

(a) *Scope*. * * * See also sections 362(e)(1) and 362(e)(2) for further adjustments to basis that may be necessary under either or both of those sections.

* * * * *

(c) * * *

(4) *Examples*. The rules of this paragraph (c) are illustrated by the following examples. For purposes of these examples, P, S, and T are domestic corporations, the property transferred is not importation property within the meaning of § 1.362–3(c)(2) or loss duplication property within the meaning of § 1.362–4(g)(1), P and S do not file consolidated returns, P owns all of the shares of the only class of S stock, the P stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, and the facts set forth the only corporate activity.

* * * * *

(e) *Cross-references*—(1) *Triangular reorganizations involving members of a consolidated group*. For rules relating to stock basis adjustments made as a result of a triangular reorganization in which P and S, or P and T, as applicable, are, or become, members of a consolidated group, see § 1.1502–30. However, if a transaction is a group structure change, stock basis adjustments are determined under § 1.1502–31 and not under § 1.1502–30, even if the transaction also qualifies as a reorganization otherwise subject to § 1.1502–30.

(2) *Triangular reorganizations involving certain foreign corporations*. For rules relating to stock basis adjustments made as a result of triangular reorganizations involving certain foreign corporations, see §§ 1.367(b)–4(b), 1.367(b)–10, and 1.367(b)–13.

(f) * * *

(3) *Triangular G reorganization and special rule for triangular reorganizations involving members of a consolidated group*. Paragraph (e)(1) of this section shall apply to triangular reorganizations occurring on or after September 17, 2008. * * *

(4) *Triangular reorganizations involving importation property acquired in loss importation transaction or loss duplication transaction; triangular reorganizations involving certain foreign corporations*. Paragraphs (a) and (e)(2) of this section apply to triangular reorganizations occurring after October 22, 2004 unless effected to a binding agreement that was in effect prior to that date and at all times thereafter.

Par. 10. Section 1.362–3 is added to read as follows:

§ 1.362–3 Basis of importation property acquired in loss importation transaction.

(a) *Purpose*. The purpose of section 362(e)(1) and this section is to modify the application of section 362(a) (section 351 transfers, contributions to capital, or paid-in surplus) and section 362(b) (reorganizations) to prevent a corporation (Acquiring) from importing a net built-in loss in a transaction described in either section. See paragraph (c) of this section for definitions of terms used in this section.

(b) *Basis determinations under this section*—(1) *Basis of importation property received in loss importation transaction*. Notwithstanding the general rules of section 362(a) and (b), Acquiring's basis in importation property (as defined in paragraph (c)(2) of this section) acquired in a loss importation transaction (as defined in paragraph (c)(3) of this section) is equal to the value of the property immediately after the transaction.

(2) *Adjustment to basis of subsidiary stock in triangular reorganizations*. If a corporation (P) computes its basis in stock of a subsidiary (whether S or T) under § 1.358–6 (stock basis in certain triangular reorganizations), P's basis in property treated as acquired by P in § 1.358–6(c) is determined under section 362(e)(1) and this section to the extent such property, if actually acquired by P, would be importation property acquired in a loss importation transaction. See § 1.358–6(c)(1)(i)(A), (c)(2)(ii)(B), and (c)(3)(i). The subsidiary's basis in the property actually acquired in the transaction is determined under applicable law (including this section), without regard to the amount of any adjustment to P's basis in the subsidiary's stock. Thus, the basis of the property in S's or T's hands may differ from the amount of the adjustment to P's basis in its stock of S or T.

(3) *Acquiring's basis in other property transferred*. In general, Acquiring's basis in property received in a section 362 transaction (as defined in paragraph (c)(1) of this section) that is not determined under section 362(e)(1) and this section is determined under section 362(a) or section 362(b). However, if the transaction is described in section 362(a) (without regard to whether it is also described in any other section), further adjustment may be required under section 362(e)(2). See § 1.362–4.

(4) *Other effects of basis determination under this section*—(i) *Determination by reference to transferor's basis*. A determination of basis under this section is a determination by reference to the transferor's basis, including for purposes of sections 1223(2) and 7701(a)(43). However, solely for purposes of applying section 755, a determination of basis under this section is treated as a determination not by reference to the transferor's basis.

(ii) *Not tax-exempt income or noncapital, nondeductible expense*. The application of this section does not give rise to an item treated as tax-exempt income under § 1.1502–32(b)(2)(ii) or as a noncapital, nondeductible expense under § 1.1502–32(b)(2)(iii).

(iii) *No effect on earnings and profits*. Any determination of basis under this section does not reduce or otherwise affect the calculation of the all earnings and profits amount provided in § 1.367(b)–2(d).

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

(1) *Section 362 transaction*. The term *section 362 transaction* means any transaction described in section 362(a) or in section 362(b).

(2) *Importation property*—(i) *General rule*. The term *importation property* means any property (including separate portions determined under paragraph (d)(4) of this section and separate portions of property tentatively divided under paragraph (e)(2) of this section) with respect to which—

(A) Any gain or loss that would be recognized on its sale by the transferor immediately before the transaction (the transferor's hypothetical sale) would not be subject to tax imposed under any provision of subtitle A of the Internal Revenue Code (federal income tax) (taking into account the provisions of paragraph (d) of this section); and

(B) Any gain or loss that would be recognized on its sale by Acquiring immediately after the transaction (Acquiring's hypothetical sale) would be subject to federal income tax (taking into account the provisions of paragraph (d) of this section).

(ii) *Special rules for applying this paragraph (c)(2)*. See paragraph (d) of this section for rules for determining whether gain or loss on a hypothetical sale would be taken into account in determining a federal income tax liability and paragraph (e) of this section for rules applicable when more than one person would take such gain or loss into account.

(3) *Loss importation transaction*. The term *loss importation transaction* means any section 362 transaction in which Acquiring's aggregate basis in all importation property received from all transferors in the transaction would exceed the aggregate value of such property immediately after the transaction. For this purpose, Acquiring's basis in property received is determined without regard to this section or section 362(e)(2).

(4) *Value*—(i) *General rule*. The term *value* means fair market value.

(ii) *Special rule for transfers of partnership interests*. Notwithstanding the general rule in paragraph (c)(4)(i) of this section, when referring to a partnership interest, for purposes of this section, the term *value* means the sum of the cash that Acquiring would receive for the interest, assuming an exchange between a willing buyer and a willing seller (neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts), increased by any § 1.752–1 liabilities (as defined in § 1.752–1(a)(4)) of the partnership allocated to Acquiring with regard to such transferred interest under section 752 immediately after the transfer to Acquiring. If a partnership has elected under section 754, or if section 743(b) would require a downward basis adjustment to the partnership property, the partnership must apply the rules of § 1.743–1 to determine the amount of the basis adjustment to the partnership property.

(d) *Rules for determining whether gain or loss would be taken into account in determining a federal income tax liability*—(1) *General rule*. In general, any gain or loss that would be recognized on a hypothetical sale described in paragraph (c)(2) of this section is considered to be subject to federal income tax if, taking into account all relevant facts and circumstances, such gain or loss would affect or be taken into account in determining the federal income tax liability of the transferor or Acquiring, respectively. This determination is made without regard to whether such person has or would have any actual federal income tax liability for the taxable year of the transaction.

(2) *Look-through rule in the case of certain pass-through entities*. Notwithstanding the general rule in paragraph (d)(1) of this section, the determination of whether any gain or loss on a hypothetical sale would be treated as subject to federal income tax is made by reference to the person that would be required to include such gain or loss in its taxable income if the hypothetical seller is—

(i) A trust treated as owned by its grantors or others (see section 671);

(ii) A partnership (see section 701); or

(iii) An S corporation (see sections 1363 and 1366).

(3) *Controlled foreign corporation (CFC), passive foreign investment company (PFIC)*. For purposes of this section, gain or loss that would be recognized by a CFC (as defined in section 957(a)) or a PFIC (as defined in section 1297(a)) is not deemed taken into account in determining a federal income tax liability solely because it could affect an inclusion under section 951(a) or section 1293(a).

(4) *Special rule for debt-financed property subject to section 512*. If property is debt-financed property (as defined in section 514(b)) owned by an organization subject to the unrelated business income tax described in section 511(a)(2) and, as a result, a portion of any gain or loss on a sale of the property would be included in unrelated taxable business income (UBTI) under section 512, such property is treated as divided into separate portions in proportion to the amount of such gain or loss that would be includible in UBTI. The rules of paragraph (e) of this section apply to determine the characterization of such portions (as includible in the determination of a federal income tax liability or not), and the tax treatment and consequences of the transaction in which such portions are transferred.

(5) *Look-through treatment in the case of certain avoidance transactions*—(i) *Application of this paragraph (d)(5)*. This paragraph (d)(5) applies if—

(A) The transferor is a domestic entity that is a trust (other than a trust described in paragraph (d)(2)(i) of this section), estate, regulated investment company (as defined in section 851(a)), a real estate investment trust (as defined in section 856(a)), or a cooperative (as described in section 1381); and

(B) The transferor transfers, directly or indirectly, property that was transferred to or acquired by it as part of a plan (whether of transferor, Acquiring, or any other person) to avoid the application of section 362(e)(1) and this section to a section 362 transaction.

(ii) *Effect of application of this paragraph (d)(5)*. Notwithstanding paragraph (d)(1) of this section, if a transferor is described in both paragraphs (d)(5)(i)(A) and (B) of this section—

(A) The transferor is treated as though it distributes the proceeds of the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero);

(B) To the fullest extent possible under the transferor's organizing instrument, the deemed distribution is treated as made to a distributee or distributees that would not take distributions from the transferor into account in determining a federal income tax liability; and

(C) The determination of whether the gain or loss on the hypothetical sale is treated as subject to federal income tax is made by reference to the deemed distributee or distributees.

(iii) *Tiered entities*. If a deemed distributee is an entity described in paragraph (d)(5)(i)(A) of this section, the determination of whether gain or loss on the hypothetical sale is taken into account in determining a federal income tax liability is made by treating the deemed distributee, and any successive such deemed distributees, as a transferor and applying the rules in paragraphs (d)(5)(i) and (ii) of this section to its deemed distribution (and to all successive deemed distributions), until no deemed distributee or successive deemed distributee is an entity described in paragraph (d)(5)(i)(A) of this section.

(e) *Special rules for gain or loss that would be taken into account by multiple persons*—(1) *In general*. If gain or loss from a disposition of property would be includible in income by more than one person, the property is treated as tentatively divided into separate portions in proportion to the amount of gain or loss recognized with respect to the property that would be allocated to each such person. If an entity's organizing instrument specially allocates gain and loss, the tentative division of property under this paragraph (e) must reflect the manner in which gain or loss on the disposition of such property would be allocated under the terms of the organizing instrument and any applicable rules of law, taking into account the net gain or loss actually recognized by the entity in that tax year.

(2) *Application of section*. The rules of this section apply independently to each tentatively divided portion to determine if the portion is importation property. Each tentatively divided portion that is determined to be importation property is included with all other importation property in the determination of whether the transaction is a loss importation transaction.

(3) *Acquiring's basis in property tentatively divided into separate portions*. Immediately after the application of section 362(e)(1) and this section and before the application of section 362(e)(2), each property treated as tentatively divided into separate portions for purposes of applying section 362(e)(1) and this section ceases to be treated as tentatively divided and Acquiring has a single, undivided basis in such property that is equal to the sum of—

(i) The value of each tentatively divided portion that is importation property, if the transaction is a loss importation transaction; and

(ii) Acquiring's basis in each tentatively divided portion that is not importation property received in a loss importation transaction, as determined under section 362(a) or section 362(b), as applicable, and without regard to any potential application of section 362(e)(2).

(f) *Examples*. The examples in this paragraph (f) illustrate the application of section 362(e)(1) and the provisions of this section. Unless otherwise indicated, the examples use the following nomenclature and assumptions: A and B are U.S. citizens. DC, DC1, and P are domestic corporations that have not elected to be S corporations within the meaning of section 1361(a)(1) and that are not members of a consolidated group. F is a foreign individual. FP is a foreign partnership. FC, FC1, and FC2 are foreign corporations. Unless the facts indicate otherwise, the foreign individuals, corporations, and partnerships are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, their partners, or their property to be subject to federal income tax. There is no applicable income tax treaty, all persons' tax years are calendar years, and all persons and transactions are unrelated unless the facts indicate otherwise.

Example 1. Basic application of section. (i) *Section 351 transfer of importation property in a loss importation transaction*. (A) *Facts*. FC owns three assets, A1 (basis $40, value $150), A2 (basis $120, value $30), and A3 (basis $140, value $20). On Date 1, FC transfers A1, A2, and A3 to DC in a transaction to which section 351 applies.

(B) *Importation property*. If FC had sold A1, A2, or A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold A1, A2, or A3 immediately after the transaction, DC would take into account any gain or loss recognized on the sale in determining its federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (c)(2) of this section.

(C) *Loss importation transaction*. FC's transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1, A2, and A3, would be $300 ($40 + $120 + $140) under section 362(a) and the properties' aggregate value would be $200 ($150 + $30 + $20). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the transaction is a loss importation transaction. See paragraph (c)(3) of this section.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value ($150, $30, and $20, respectively) immediately after the transfer.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the transferred properties would not exceed their aggregate value immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to this transaction. DC's bases in A1, A2, and A3, as determined under paragraph (i)(D) of this *Example 1*, are $150, $30, and $20, respectively. Under section 358(a), FC receives the DC stock with a basis of $300 (the sum of FC's bases in A1, A2, and A3 immediately before the exchange).

(ii) *Reorganization*. The facts are the same as in paragraph (i)(A) of this *Example 1* except that, instead of transferring property to DC in a section 351 exchange, FC merges with and into DC in a transaction described in section 368(a)(1)(A). The analysis and results are the same as set forth in paragraphs (i)(B), (C), and (D) of this *Example 1*. However, the analysis in paragraph (i)(E) of this *Example 1* does not apply to these facts because the transaction is not subject to 362(e)(2) and § 1.362–4. Under section 358(a), FC's shareholders will take the DC stock with a basis determined by reference to their FC stock basis.

(iii) *FC's property used in U.S. trade or business*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 1*, except that FC is engaged in a U.S. trade or business and uses all the properties in that U.S. trade or business. In this case, none of the properties would be importation property because FC would take any gain or loss on the disposition of the properties into account in determining its federal income tax liability. Accordingly, this section does not apply to the transaction.

(B) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in the transferred properties would be $300 ($40 + $120 + $140) under section 362(a) and the properties' aggregate value immediately after the transfer would be $200 ($150 + $30 + $20). Therefore, FC has a net built-in loss and FC's transfer of A1, A2, and A3 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $100 net built-in loss ($300 aggregate basis over $200 aggregate value) would be allocated proportionately (by the amount of built-in loss in each property) to reduce DC's basis in the loss properties, A2 and A3. See § 1.362–4. As a result, DC's basis in A2 would be $77.14 ($120 basis under section 362(a) reduced by $42.86, A2's proportionate share of FC's net built-in loss, computed as $90/$210 x $100) and DC's basis in A3 would be $82.86 ($140 basis under section 362(a) reduced by $57.14, A3's proportionate share of FC's net built-in loss, computed as $120/$210 x $100). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $100 basis reduction to FC's basis in the DC stock received in the transaction, DC's bases in A2 and A3 would remain their section 362(a) bases of $120 and $140, respectively. Under section 362(a), DC's basis in A1 is $40 (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $300; if FC and DC do make the election, FC's basis in the DC stock will be $200 ($300 – $100 net built-in loss). See § 1.362–4(b).

Example 2. *Multiple transferors*. (i) *Facts*. The facts are the same as in paragraph (i)(A) of *Example 1* of this paragraph (f), except that FC only owns A1 (basis $40, value $150) and A2 (basis $120, value $30) and F owns A3 (basis $140, value $20). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property*. A1 and A2 are importation properties for the reasons set forth in paragraph (i)(B) of *Example 1* of this paragraph (f). A3 is also an importation property because, if F had sold A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, and, further, if DC had sold A3 immediately after the transaction, DC would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction*. The transfers by FC and F are a section 362 transaction. The transaction is a loss importation transaction for the reasons set forth in paragraph (i)(C) of *Example 1* of this paragraph (f) (notwithstanding that one of the transferors, FC, did not transfer a net built-in loss). See paragraph (c)(3) of this section.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value ($150, $30, and $20, respectively) immediately after the transfer.

(v) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4(b). Taking into account the application of section 362(e)(1) and this section, neither DC's aggregate basis in FC's properties nor DC's basis in F's property would exceed the properties' respective values immediately after the transaction. Therefore neither FC nor F has a net built-in loss, neither transfer is a loss duplication transaction, and section 362(e)(2) does not apply to either transfer. DC's bases in A1, A2, and A3, as determined under paragraph (iv) of this *Example 2*, are $150, $30, and $20, respectively. Under section 358(a), FC's basis in the DC stock received is $160 ($40 + $120) and F's basis in the DC stock received in the exchange is $140.

Example 3. *Transfer of importation and non-importation property*. (i) *Facts*. As in paragraph (i) of *Example 2*, FC owns A1 (basis $40, value $150) and A2 (basis $120, value $30), and F owns A3 (basis $140, value $20). In addition, A2 is a U.S. real property interest as defined in section 897(c)(1). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property*. A1 and A3 are importation properties for the reasons set forth in paragraph (i)(B) of *Example 1* and paragraph (ii) of *Example 2* of this paragraph (f), respectively. However, A2 is not importation property because, if FC had sold A2 immediately before the transaction, FC would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction*. FC's and F's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1 and A3, would be $180 ($40 + $140) and the properties' aggregate value would be $170 ($150 + $20) immediately after the transaction. Therefore, the importation properties' aggregate basis would exceed their aggregate value immediately after the transaction, and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation properties, A1 and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1 and in A3 will each be equal to the property's value ($150 and $20, respectively) immediately after the transfer.

(v) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4(b).

(A) *FC's transfer*. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of $270 in the transferred properties ($150 in A1, as determined under paragraph (iv) of this *Example 3*, plus $120 in A2, determined under section 362(a)), and the properties would have an aggregate value of $180 ($150 + $30) immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A1 and A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $90 net built-in loss ($270 aggregate basis to DC over $180 aggregate value) would be allocated proportionately to reduce DC's basis in the loss property transferred by FC. As a result, FC's entire net built-in loss would be allocated to A2, the only loss property transferred by FC, and DC's basis in A2 would be $30 ($120 basis under section 362(a) reduced by $90 net built-in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would remain its section 362(a) basis of $120. DC's basis in A1 is $150 as determined under paragraph (iv) of this *Example 3* (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $160; if FC and DC do make the election, FC's basis in the DC stock will be $70 ($160 – $90 net built-in loss). See § 1.362–4.

(B) *F's transfer of A3*. Taking into account the application of section 362(e)(1) and this section, DC's basis in A3, the property transferred by F, would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this *Example 3*, is $20. Under section 358(a), F receives the DC stock with a basis of $140.

Example 4. *Multiple transferors of non-importation properties*. (i) *Facts*. DC1 owns A1 (basis $40, value $150). In addition, as in *Example 3* of this paragraph (f), FC owns A2 (basis $120, value $30), a U.S. real property interest as defined in section 897(c)(1), and F owns A3 (basis $140, value $20). On Date 1, DC1 transfers A1, FC transfers A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) *Importation property*. A2 is not importation property and A3 is importation property for the reasons set forth in paragraph (ii) of *Example 3* and paragraph (i)(B) of *Example 1* of this paragraph (f), respectively. A1 is not importation property because, if DC1 had sold A2 immediately before the transaction, DC1 would take into account any gain or loss recognized on the sale in determining its federal income tax liability.

(iii) *Loss importation transaction*. The transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, A3, would be $140 and the value of the property would be $20 immediately after the transaction. Therefore, the importation property's basis would exceed value and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, A3, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in A3 will be equal to A3's $20 value immediately after the transfer.

(v) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4.

(A) *DC1's transfer*. Taking into account the application of section 362(e)(1) and this section, DC's basis in A1 ($40 under section 362(a)) would not exceed its value immediately after the transfer. Therefore, DC1 does not have a net built-in loss, DC1's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to DC1's transfer. DC's basis in A1, determined under section 362(a), is $40. Under section 358(a), DC1 receives the DC stock with a basis of $40.

(B) *FC's transfer*. Taking into account the application of section 362(e)(1) and this section, but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of $120 in A2, which would exceed A2's $30 value immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's $90 net built-in loss (DC's $120 basis in A2 over A2's $30 value) would be applied to reduce DC's basis in A2, the only loss property transferred by FC. As a result, DC's basis in A2 would be $30 ($120 basis under section 362(a), reduced by the $90 net built-in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the $90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would be its $120 basis determined under section 362(a). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be $120; if FC and DC do make the election, FC's basis in the DC stock will be $30 ($120 – $90). See § 1.362–4.

(C) *F's transfer*. F's transfer of A3 is a transaction described in section 362(a). However, taking into account the application of section 362(e)(1) and this section, DC's basis in A3 ($20) would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this *Example 4*, is $20. Under section 358(a), F receives the DC stock with a basis of $140.

Example 5. *Partnership transactions*. (i) *Transfer by foreign partnership, foreign and domestic partners*. (A) *Facts*. A and F are equal partners in FP. FP owns A1 (basis $100, value $70). Under the terms of the FP partnership agreement, FP's items of income, gain, deduction, and loss are allocated equally between A and F. Section 704(c) does not apply with respect to the partnership property. FP transfers A1 to DC in a transfer to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) *Importation property*. If FP had sold A1 immediately before the transaction, any gain or loss recognized on the sale would be allocated to and includible by A and F equally under the partnership agreement. Thus, under paragraph (d)(2) of this section, A1 is treated as tentatively divided into two equal portions, one treated as owned by A and one treated as owned by F. If FP had sold A1 immediately before the transaction, any gain or loss recognized on the portion treated as owned by A would have been taken into account in determining a federal income tax liability (A's); thus A's tentatively divided portion of A1 is not importation property. However, no gain or loss recognized on the tentatively divided portion treated as owned by F would have been taken into account in determining a federal income tax liability. Further, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (DC's); thus, F's tentatively divided portion of A1 is importation property.

(C) *Loss importation transaction*. FP's transfer of A1 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, F's portion of A1, would be $50 under section 362(a) and the property's value would be $35 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, F's tentatively divided portion of A1, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in F's portion of A1 will be equal to its $35 value.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in A1 would be $85 (the sum of the $35 basis in F's tentatively divided portion of A1, as determined under paragraph (i)(D) of this *Example 5*, and the $50 basis in A's tentatively divided portion of A1, determined under section 362(a), see paragraphs (d)(2) and (e)(3) of this section) and A1's value immediately after the transfer would be $70. Therefore, FP has a net built-in loss and FP's transfer of A1 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FP's $15 net built-in loss ($85 basis over $70 value) would be allocated to reduce DC's basis in the loss asset, A1, the only loss property transferred by FP. As a result, DC's basis in A1 would be $70 ($85 basis under section 362(a) and this section, reduced by the $15 net built-in loss). Under section 358, FP's basis in the DC stock received in the exchange will be $100. See § 1.362–4.

(ii) *Transfer with election to apply section 362(e)(2)(C)*. The facts are the same as in paragraph (i)(A) of this *Example 5*, except that FP and DC elect to apply section 362(e)(2)(C) to reduce FP's basis in the DC stock received in the exchange. The analysis and results are the same as in paragraphs (i)(B), (C), (D), and (E) of this *Example 5*, except that the $15 reduction to DC's basis in A1 is not made and, as a result, DC's basis in A1 remains $85, and FP's basis in the DC stock received in the exchange is reduced from $100 to $85. The $15 reduction to FP's basis in DC stock reduces A's basis in its FP interest under section 705(a)(2)(B). See § 1.362–4(e)(1).

(iii) *Transfer by domestic partnership*. The facts are the same as in paragraph (i)(A) of this *Example 5* except that FP is a domestic partnership. The analysis and results are the same as in paragraphs (i)(B), (C), (D), and (E) of this *Example 5*.

(iv) *Transfer of interest in partnership with liability*. (A) *Facts*. F and two other individuals are equal partners in FP. F's basis in its partnership interest is $247. F's share of FP's § 1.752–1 liabilities (as defined in § 1.752–1(a)(4)) is $150. F transfers his partnership interest to DC in a transaction to which section 351 applies. If DC were to sell the FP interest immediately after the transfer, DC would receive $100 in cash or other property. In addition, taking into account the rules under § 1.752–4, DC's share of FP's § 1.752–1 liabilities (as defined in § 1.752–1(a)(4)) is $145 immediately after the transfer.

(B) *Importation property*. If F had sold his partnership interest immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold the partnership interest immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, F's partnership interest is importation property.

(C) *Loss importation transaction*. F's transfer is a section 362 transaction. However, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the partnership interest, determined under section 362(a) and taking into account the rules under section 752, would be $242 (F's $247 basis reduced by F's $150 share of FP liabilities and increased by DC's $145 share of FP liabilities) and, under paragraph (c)(4)(ii) of this section, the value of the FP interest would be $245 (the sum of $100, the cash DC would receive if DC immediately sold the partnership interest, and $145, DC's share of the § 1.752–1 liabilities (as defined in § 1.752–1(a)(4)) under section 752 immediately after the transfer to DC). Therefore, the importation property's basis ($242) would not exceed its value ($245), and the transfer is not a loss importation transaction.

(D) *Basis in property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. As described in paragraph (iv)(C) of this *Example 5*, taking into account the application of section 362(e)(1) and this section, DC's basis in the partnership interest would not exceed its value. Therefore, under § 1.362–4, F does not have a net built-in loss, the transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transfer. DC's basis in F's partnership interest is $242, determined under sections 362(a) and 752. Under section 358, taking into account the rules under section 752, F's basis in the DC stock received in the exchange is $97 ($247 reduced by F's $150 share of FP liabilities). If FP had elected under section 754, or if section 743(b) required a downward basis adjustment to the partnership property, FP would apply the rules of § 1.743–1 to determine the amount of the basis adjustment to the partnership property.

Example 6. *Transactions involving tax-exempt entities*. (i) *Exempt transferor*. (A) *Facts*. InsCo is a benevolent life insurance association of a purely local character exempt from federal income tax under section 501(a) because it is described in section 501(c)(12). InsCo owns shares of stock of DC1 (basis \$100, value \$70) for investment purposes, which are not debt-financed property (as defined in section 514). On December 31, Year 1, InsCo transfers the DC1 stock to DC in exchange for DC stock in a transaction to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) *Importation property*. If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss realized would be excluded from UBTI under section 512(b)(5), and thus no gain or loss recognized on the sale would have been taken into account in determining federal income tax liability. Further, if DC had sold the DC1 stock immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining federal income tax liability. Therefore, the DC1 stock is importation property.

(C) *Loss importation transaction*. InsCo's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, the DC1 stock, would be \$100, and the stock's value would be \$70 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, the DC1 stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the stock will be equal to its \$70 value.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 stock does not exceed its value immediately after the transaction. Therefore, InsCo does not have a net built-in loss, InsCo's transfer is not a loss duplication transaction, and section 362(e)(2) has no application to the transaction. DC's basis in the DC1 stock, as determined under paragraph (i)(D) of this *Example 6*, is \$70. Under section 358, InsCo's basis in the DC stock received in the exchange will be \$100.

(ii) *Transferor loses tax-exempt status*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 6* except that InsCo fails to be described in section 501(c)(12) in Year 1.

(B) *Importation property*. If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, the DC1 stock is not importation property and this section does not apply to the transaction.

(C) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of \$100 in the stock, which would exceed its value of \$70 immediately after the transfer. Therefore, InsCo has a net built-in loss and InsCo's transfer of the DC1 stock is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), InsCo's \$30 net built-in loss (\$100 basis over \$70 value) would be allocated to reduce DC's basis in the loss asset, the DC1 stock, the only loss property transferred by InsCo. As a result, DC's basis in the DC1 stock would be \$70 (\$100 basis under section 362(a), reduced by the \$30 net built-in loss). Under section 358, InsCo's basis in the DC stock received in the exchange will be \$100.

(iii) *Transfer of property that is subject to unrelated business tax*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 6* except that, on December 31, Year 1, instead of the DC1 stock, InsCo transfers A1 (basis \$200, value \$150) to DC. A1 is real property that InsCo owned from January 1 to December 31 of Year 1. During the entirety of this period, A1's basis was \$200, and in the twelve months prior to December 31, Year 1, the highest amount of outstanding principal indebtedness on A1 was \$40. For purposes of the UBTI rules under section 512, A1 is debt-financed property within the meaning of section 514(b).

(B) *Importation property*. If InsCo had sold A1 immediately before the transaction, 20 percent of any gain or loss recognized on that sale (that is, \$40 of acquisition indebtedness on A1 divided by A1's \$200 basis in Year 1) would, under sections 512 and 514, be includible in UBTI at the end of Year 1, and 80 percent would not. Thus, under paragraph (d)(4) of this section, A1 is treated as tentatively divided into two portions, one reflecting the gain or loss that would be taken into account in determining a federal income tax liability in InsCo's hands immediately before the transfer (the 20 percent portion) and one that would not (the 80 percent portion). Further, if DC sold A1 immediately after the transfer, any gain or loss on both portions would be taken into account in determining a federal income tax liability. Accordingly, the 20 percent portion is not importation property, but the 80 percent portion is.

(C) *Loss importation transaction*. InsCo's transfer of A1 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the 80 percent portion of A1, would be \$160 (80 percent of InsCo's \$200 basis) under section 362(a) and the property's value would be \$120 (80% of A1's \$120 value) immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, the 80 percent portion of A1, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section apply and DC's basis in that portion of A1 will be equal to its \$120 value.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in A1 would be \$160 (the sum of the \$120 basis in the 80 percent importation portion of A1, as determined under paragraph (iii)(D) of this *Example 6*, and the \$40 basis in the 20 percent portion of A1 that is not importation property, determined under section 362(a). See paragraph (e)(3) of this section). Further, A1's value immediately after the transfer would be \$150. Therefore, InsCo has a net built-in loss in A1, and InsCo's transfer of A1 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), InsCo's \$10 net built-in loss (\$160 basis over \$150 value) would be allocated to reduce DC's basis in the loss asset, A1, the only loss property transferred by InsCo. As a result, DC's basis in A1 would be \$150 (\$160 basis under section 362(a) and this section, reduced by the \$10 net built-in loss). Under section 358, InsCo's basis in the DC stock received in the exchange will be \$200. See § 1.362–4.

(iv) *Transfer with election to apply section 362(e)(2)(C)*. The facts are the same as in paragraph (iii)(A) of this *Example 6*, except that InsCo and DC elect to apply section 362(e)(2)(C) to reduce InsCo's basis in the DC stock received in the exchange. The analysis and results are the same as in paragraphs (iii)(B), (C), (D), and (E) of this *Example 6*, except that the \$10 reduction to DC's basis in A1 is not made and, as a result, DC's basis in A1 remains \$160; however, InsCo's basis in the DC stock received in the exchange is reduced from \$200 to \$190.

Example 7. Transactions involving CFCs. (i) *Transfer by CFC*. (A) *Facts*. FC is a CFC with 100 shares of stock outstanding. A owns 60 of the shares and F owns the remaining 40 shares. FC owns two assets, A1 (basis \$70, value \$100), which is used in the conduct of a U.S. trade or business, and A2 (basis \$100, value \$75), which is not used in the conduct of a U.S. trade or business. FC transfers both assets to DC in a transaction to which section 351 applies.

(B) *Importation property*. If FC had sold A1 immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (FC's). See section 882(a). Therefore, A1 is not importation property. If FC had sold A2 immediately before the transaction, FC would not take the gain or loss recognized into account in determining its federal income tax liability, but the gain or loss could be taken into account in determining a section 951 inclusion to FC's U.S. shareholders. However, under paragraph (d)(3) of this section, gain or loss is not deemed taken into account in determining a federal income tax liability solely because it could affect an inclusion under section 951(a). Further, if DC had sold A2 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, A2 is importation property.

(C) *Loss importation transaction*. FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, A2, would be \$100 and the property's value would be \$75 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, A2, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A2 will be equal to A2's $75 value immediately after the transfer.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of $145 in the transferred properties ($70 in A1, determined under section 362(a), plus $75 in A2, determined under this section) and the properties would have an aggregate value of $175 ($100 + $75) immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in A1 will be $70, determined under section 362(a), and DC's basis in A2 will be $75, as determined under paragraph (i)(D) of this *Example 7*. Under the general rule in section 358(a), FC receives the DC stock with a basis of $170 ($70 attributable to A1 plus $100 attributable to A2).

(ii) *Transfer of CFC stock*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 7*, except that A transfers its 60 shares of FC stock (basis $80, value $105) and F transfers its 40 shares of FC stock (basis $100, value $70) to DC in an exchange that qualifies under section 351.

(B) *Importation property*. If A had sold its FC shares immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (A's). Therefore, A's FC shares are not importation property. However, if F had sold its FC shares immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Further, if DC had sold F's FC shares immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. Therefore, F's FC shares are importation property.

(C) *Loss importation transaction*. The transfer of the FC shares is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation property, F's shares of FC stock, would be $100 under section 362(a) and the shares' aggregate value would be $70. Therefore, the importation property's aggregate basis would exceed its aggregate value, and the transfer is a loss importation transaction.

(D) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, F's shares of FC stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's aggregate basis in the shares will be equal to their $70 aggregate value immediately after the transfer.

(E) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See § 1.362–4(b).

(*1*) *A's transfer*. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares ($80 under section 362(a)) would not exceed the shares' value ($105) immediately after the transaction. Therefore A does not have a built-in loss, A's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to A's transfer. DC's aggregate basis in A's shares, determined under section 362(a), is $80. Under section 358(a), A receives the DC stock with a basis of $80.

(*2*) *F's transfer*. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares would not exceed their value immediately after the transaction. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's aggregate basis in F's shares, as determined under paragraph (ii)(D) of this *Example 7*, is $70. Under section 358(a), F receives the DC stock with a basis of $100.

Example 8. *Property subject to withholding tax*. (i) *Facts*. FC owns a share of DC1 stock (basis $100, value $70) as an investment. FC receives dividends on the share that are subject to federal withholding tax of 30 percent of the amount received under section 881(a); under section 1442(a), DC1 must withhold tax on the dividends paid. FC transfers the DC1 share to DC in a transaction to which section 351 applies.

(ii) *Importation property*. Although any dividends received with respect to the DC1 stock were subject to withholding tax, if FC had sold the share of stock of DC1, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. See section 865(a)(2). Further, if DC had sold the share of DC1 stock immediately after the transaction, any gain or loss recognized on the sale would be taken into account in determining federal income tax liability. Therefore, the share of DC1 stock is importation property.

(iii) *Loss importation transaction*. FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the share of DC1 stock, would be $100 and the share's value would be $70 immediately after the transaction. Therefore, the share's basis would exceed its value and the transfer is a loss importation transaction.

(iv) *Application of section 362(e)(1) and this section to importation property received in loss importation transaction*. Because the importation property, the DC1 share, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the share will be equal to the share's $70 value.

(v) *Basis of property received in transaction*. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 share would not exceed the share's value immediately after the transaction. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in the DC1 share, as determined under paragraph (iv) of this *Example 8*, is $70. Under section 358, FC's basis in the DC stock received in the exchange will be $100.

Example 9. *Property transferred in triangular reorganization*. (i) *Foreign subsidiary*. (A) *Facts*. P owns the sole outstanding share of stock of FC (basis $1), FC1 owns the sole outstanding share of FC2 (basis $100), and FC2 owns one asset, A1 (basis $100, value $20). In a forward triangular merger described in § 1.358–6(b)(2)(i), FC2 merges with and into FC, and FC1 receives shares of P stock in exchange for its FC2 stock. The forward triangular merger is a transaction described in section 368(a)(2)(D) and, therefore, in section 362(b).

(B) *Determining P's basis in its FC share*. Pursuant to § 1.358–6, for purposes of determining the adjustment to P's basis in its FC shares, P is treated as though it first received A1 in a transaction in which its basis in A1 would be determined under section 362(b) and then it transferred A1 to FC in a transaction in which P's basis in its FC stock would be determined under section 358.

(*1*) *P's deemed acquisition and transfer of A1*. If FC2 had sold A1 for its value immediately before the deemed transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. If P had sold A1 immediately after the deemed transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability (P's). Therefore, with respect to P's deemed acquisition, A1 is importation property. Furthermore, immediately after the deemed transaction, P's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be $100 and A1's value is $20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, P's deemed basis in A1 will be equal to A1's $20 value.

(*2*) *P's FC stock basis*. As a result of P's deemed transfer of A1 to FC (and applying the principles of § 1.367(b)–13), P's basis in its FC stock is increased by its $20 deemed basis in A1. Accordingly, following the transaction, P's basis in its share of FC stock will be $21 (the sum of its original $1 basis and the $20 adjustment for the deemed transfer of A1).

(C) *FC's basis in A1*. FC's basis in A1 is determined under the rules of this section without regard to the determination of P's adjustment to its basis in FC stock. If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. However, if FC had sold A1 immediately after the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, so A1 is not importation property. Accordingly, this section will not apply to the transaction. Although there is a net built-in loss in A1, the transaction is not described in section 362(a), and so section 362(e)(2) and § 1.362–4 will not apply to the transaction. Thus, under section 362(b), FC's basis in A1 will be $100.

(D) *FC1's basis in P stock*. Under section 358, FC1's basis in the P stock it receives in the exchange will be $100.

(ii) *Property transferred to U.S. subsidiary in triangular reorganization*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 9*, except that P also owns the sole outstanding share of DC (basis $1) and, instead of merging into FC, FC2 merged into DC.

(B) *Determining P's basis in its DC share*. As determined under paragraph (i)(B)(*2*) of this *Example 9*, P's basis in its DC share is $21, the sum of its original $1 basis plus the $20 adjustment for the deemed transfer of A1.

(C) *DC's basis in A1*. If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability. However, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a federal income tax liability, so A1 is importation property with respect to DC. Furthermore, immediately after the transaction, DC's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be $100 and A1's value is $20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, DC's basis in A1 will be $20, A1's value immediately after the transaction.

(D) *FC1's basis in P stock*. Under section 358, FC1's basis in the P stock it receives in the exchange is $100.

(g) *Applicability date*. This section applies with respect to any transaction occurring on or after March 28, 2016, and also with respect to any transaction occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such transaction is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter. In addition, taxpayers may apply this section to any transaction occurring after October 22, 2004.

Par. 11. Section 1.362–4 is amended by:

1. Revising the heading to paragraph (c) and adding paragraph (c)(3).

2. Revising the introductory text in paragraph (h).

3. Revising the third sentence of paragraph (h) *Example 4* paragraph (iv)(B).

4. Revising paragraph (h) *Example 11*.

5. Adding a sentence to the end of paragraph (j).

The revisions and additions read as follows:

§ 1.362–4 Basis of loss duplication property.

* * * * *

(c) *Exceptions and special rules*. * * *

* * * * *

(3) *Other effects of basis determination under this section*—(i) *Determination by reference to transferor's basis*. A determination of basis under this section is a determination by reference to the transferor's basis, including for purposes of sections 755, 1223(2), and 7701(a)(43).

(ii) *Treatment as tax-exempt income or noncapital, nondeductible expense*. A determination of basis under paragraph (b) of this section does not give rise to an item treated as a noncapital, nondeductible expense under § 1.1502–32(b)(2)(iii). However, a determination of basis under paragraph (d) of this section does give rise to an item treated as a noncapital, nondeductible expense under § 1.1502–32(b)(2)(iii).

* * * * *

(h) *Examples*. The examples in this paragraph (h) illustrate the application of section 362(e)(2) and the provisions of this section. Unless the facts otherwise indicate, the examples use the following nomenclature and assumptions: X, Y, P, S, S1, and S2 are domestic corporations; A and B are U.S. individuals; FC1 and FC2 are foreign corporations and are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, or their property to be subject to tax imposed under any provision of subtitle A of the Internal Revenue Code (federal income tax); there is no applicable income tax treaty; PRS is a domestic partnership; no election is made under section 362(e)(2)(C); and the transferred property is not importation property (as defined in § 1.362–3(c)(2)) and the transfers are not loss importation transactions (as defined in § 1.362–3(c)(3)), so that the basis of no property is determined under section 362(e)(1). All persons and transactions are unrelated unless the facts indicate otherwise, all taxpayers are on a calendar tax year, and all other relevant facts are set forth in the examples. See § 1.362–3(f) for additional examples illustrating the application of section 362(e)(2) and this section, including to transactions that are subject to section 362(e)(2), and section 362(e)(1).

* * * * *

Example 4. * * *

(iv) * * *

(B) *Analysis*. * * * For the reasons set forth in paragraph (iii)(B) of this *Example 4*, Y would have been required to reduce its basis in the transferred assets by $1.60. * * *

* * * * *

Example 11. *Transfers of importation property with non-importation property*. (*i*) *Single transferor, loss importation transaction*. (A) *Facts*. FC1 transfers Asset 1 (basis $80, value $50), Asset 2 (basis $120, value $110), and Asset 3 (basis $32, value $40) to DC in a transaction to which section 351 applies. Asset 1 is not importation property within the meaning of § 1.362–3(c)(2). Asset 2 and Asset 3 are importation property within the meaning of § 1.362–3(c)(2).

(B) *Application of section 362(e)(1)*. Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2 and Asset 3) would be $152. The aggregate value of the importation property immediately after the transfer is $150. Accordingly, the transaction is a loss importation transaction within the meaning of § 1.362–3(c)(3) and, under section 362(e)(1), DC's bases in Asset 2 and Asset 3 would equal the value of each, $110 and $40, respectively.

(C) *Application of section 362(e)(2) and this section*. (*1*) *Analysis*. (*i*) *Loss duplication transaction*. FC1's transfer of Asset 1, Asset 2, and Asset 3 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be $230 ($80 under section 362(a) + $110 +$40 under section 362(e)(1)), which would exceed the aggregate value of the assets $200 ($50 + $110 +$40) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of $30 ($230 – $200).

(*ii*) *Identifying loss duplication property*. But for section 362(e)(2) and this section, DC's basis in Asset 1 would be $80, which would exceed Asset 1's $50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be $110, which would not exceed Asset 2's $110 value immediately after the transaction. Accordingly, Asset 2 is not loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 3 would be $40, which would not exceed Asset 3's $40 value immediately after the transaction. Accordingly, Asset 3 is not loss duplication property.

(D) *Basis in loss duplication property*. DC's basis in Asset 1 is $50, computed as its $80 basis under section 362(a) reduced by FC1's $30 net built-in loss.

(E) *Basis in other property*. Under section 362(e)(1), DC's basis in Asset 2 is $110 and DC's basis in Asset 3 is $40. Under section 358(a), FC1 has an exchanged basis of $232 in the DC stock it receives in the transaction.

(ii) *Multiple transferors, no importation of loss*. (A) *Facts*. The facts are the same as paragraph (i)(A) of this *Example 11*, except that, in addition, FC2 transfers Asset 4 (basis $100, value $150) to DC as part of the same transaction. Asset 4 is importation property within the meaning of § 1.362–3(c)(2).

(B) *Application of section 362(e)(1)*. Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2, Asset 3, and Asset 4) would be $252 ($120 + $32 + $100). The aggregate value of the importation property immediately after the transfer is $300 ($110 + $40 + $150). Accordingly, the transaction is not a loss importation transaction within the meaning of § 1.362–3(c)(3) and DC's bases in the importation property is not determined under section 362(e)(1).

(C) *Application of section 362(e)(2) and this section*. Notwithstanding that the transfers by FC1 and FC2 are pursuant to a single plan forming one transaction, section 362(e)(2) and this section apply to each transferor separately.

(*1*) *Application of section to FC1*. (*i*) *Loss duplication transaction*. FC1's transfer of Asset 1, Asset 2, and Asset 3 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be $232 ($80 + $120 +$32), which would exceed the aggregate value of the assets $200 ($50 + $110 + $40) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of $32 ($232 – $200).

(*ii*) *Identifying loss duplication property*. But for section 362(e)(2) and this section, DC's basis in Asset 1 would be $80, which would exceed Asset 1's $50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be $120, which would exceed Asset 2's $110 value immediately after the transaction. Accordingly, Asset 2 is also loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 3 would be $32, which would not exceed Asset 3's $40 value immediately after the transaction. Accordingly, Asset 3 is not loss duplication property.

(*iii*) *Basis in loss duplication property*. DC's basis in Asset 1 is $56, computed as its $80 basis under section 362(a) reduced by $24, its allocable portion of FC1's $32 net built-in loss ($30/40 x $32). DC's basis in Asset 2 is $112, computed as its $120 basis under section 362(a) reduced by $8, its allocable portion of FC1's $40 net built-in loss ($10/$40 x $32).

(*iv*) *Basis in other property*. Under section 358(a), FC1 has an exchanged basis of $232 in the DC stock it receives in the transaction.

(*2*) *Application of section to FC2*. FC2's transfer of Asset 3 is not a loss duplication transaction because Asset 3's value exceeds its basis immediately after the transaction. Accordingly, under section 362(a), DC's basis in Asset 3 is $100.

* * * * *

(j) *Effective/applicability date*. * * * The introductory text and *Example 11* of paragraph (h) of this section apply with respect to transactions occurring on or after March 28, 2016, and also with respect to transactions occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such transaction is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter. In addition, taxpayers may apply such provisions to any transaction occurring after October 22, 2004.

Par. 12. Section 1.368–3 is amended by revising paragraphs (a)(3) and (b)(3) and adding a sentence to the end of paragraph (e) to read as follows:

§ 1.368–3 Records to be kept and information to be filed with returns.

(a) * * *

(3) The value and basis of the assets, stock or securities of the target corporation transferred in the transaction, determined immediately before the transfer and aggregated as follows—

(i) Importation property transferred in a loss importation transaction, as defined in § 1.362–3(c)(2) and (3), respectively;

(ii) Loss duplication property as defined in § 1.362–4(g)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (a)(3)(i) or (ii) of this section);

(iv) Property not described in paragraph (a)(3)(i), (ii), or (iii) of this section; and

* * * * *

(b) * * *

(3) The value and basis of all the stock or securities of the target corporation held by the significant holder that is transferred in the transaction and such holder's basis in that stock or securities, determined immediately before the transfer and aggregated as follows—

(i) Stock and securities with respect to which an election is made under section 362(e)(2)(C); and

(ii) Stock and securities not described in paragraph (b)(3)(i) of this section.

* * * * *

(e) *Effective/applicability date*. * * * Paragraphs (a)(3) and (b)(3) of this section apply with respect to reorganizations occurring on or after March 28, 2016, and also with respect to reorganizations occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such reorganization is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter.

Par. 13. Section 1.705–1 is amended by revising paragraph (a)(9) to read as follows:

§ 1.705–1 Determination of basis of partner's interest.

(a) * * *

(9) For basis adjustments necessary to coordinate sections 705 and 362(e)(2), see § 1.362–4(e)(1).

* * * * *

Par. 14. Section 1.755–1 is amended by adding a sentence after the second sentence of paragraph (b)(1)(i) to read as follows:

§ 1.755–1 Rules for allocation of basis.

* * * * *

(b) * * *

(1) * * *

(i) *Application*. * * * For transfers subject to section 334(b)(1)(B), see § 1.334–1(b)(3)(iii)(C)(*1*) (treating a determination of basis under § 1.334–1(b)(3) as a determination not by reference to the transferor's basis solely for purposes of applying section 755); for transfers subject to section 362(e)(1), see § 1.362–3(b)(4)(i) (treating a determination of basis under § 1.362–3 as a determination not by reference to the transferor's basis solely for purposes of applying section 755); for transfers subject to section 362(e)(2), see § 1.362–4(c)(3)(i) (treating a determination of basis under § 1.362–4 as a determination by reference to the transferor's basis for all purposes). * * *

* * * * *

Par. 15. Section 1.1367–1 is amended by revising the last sentence of paragraph (c)(2) to read as follows:

§ 1.1367–1 Adjustments to basis of shareholder's stock in an S corporation.

* * * * *

(c) * * *

(2) *Noncapital, nondeductible expenses.* * * * For basis adjustments necessary to coordinate sections 1367 and 362(e)(2), see § 1.362–4(e)(2).

* * * * *

John M Dalrymple,
Deputy Commissioner for
Services and Enforcement.

Approved: February 16, 2016.

Mark J. Mazur,
Assistant Secretary of the
Treasury (Tax Policy).

(Filed by the Office of the Federal Register on March 25, 2016, 8:45 a.m., and published in the issue of the Federal Register for March 28, 2016, 81 F.R. 17066)

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26 CFR 1.367(a)–3: Treatment of Transfers of Stock or Securities to Foreign Corporations

T.D. 9760

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Indirect Stock Transfers and the Coordination Rule Exceptions; Transfers of Stock or Securities in Outbound Asset Reorganizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under sections 367, 1248, and 6038B of the Internal Revenue Code (Code). These regulations finalize the elimination of one of two exceptions to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations. The regulations also finalize modifications to the exception to the coordination rule for section 351 exchanges so that it is consistent with the remaining asset reorganization exception. In addition, the regulations finalize modifications to the procedures for obtaining relief for failures to satisfy certain reporting requirements. Finally, the regulations finalize certain changes with respect to transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. These regulations primarily affect domestic corporations that transfer property to foreign corporations in certain outbound nonrecognition exchanges.

DATES: *Effective Date*: These regulations are effective on March 22, 2016.

Applicability Dates: For dates of applicability, see §§ 1.367(a)–3(g)(1)(vii), 1.367(a)–3(g)(1)(ix), 1.367(a)–6(e)(4), 1.1248(f)–3(b)(1), and 1.6038B–1(g)(5).

FOR FURTHER INFORMATION CONTACT: Joshua G. Rabon at (202) 317-6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On August 20, 2008, the Department of the Treasury (Treasury Department) and the IRS published proposed regulations (REG–209006–89) under sections 367, 1248, and 6038B of the Code (2008 proposed regulations) in the **Federal Register** (73 FR 49278) concerning transfers of property by a domestic corporation to a foreign corporation in an exchange described in section 361(a) or (b) and certain nonrecognition distributions of stock of a foreign corporation by a domestic corporation. The 2008 proposed regulations were substantially finalized on March 19, 2013, when the Treasury Department and the IRS published final regulations (TD 9614) in the **Federal Register** (78 FR 17024). However, the Treasury Department and the IRS simultaneously published the temporary regulations (TD 9615) in the **Federal Register** on March 19, 2013 (78 FR 17,053) (2013 temporary regulations) eliminating one of the two exceptions to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations, as well as modifying the one exception to the coordination rule for section 351 exchanges so that it is consistent with the remaining outbound asset reorganization exception. The 2013 temporary regulations also addressed the transfer of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange, as well as modified, in various contexts, procedures for obtaining relief for failures to satisfy certain reporting requirements. A notice of proposed rulemaking (REG–132702–10) cross-referencing the 2013 temporary regulations and incorporating the text of the 2013 temporary regulations was also published in the **Federal Register** on March 19, 2013 (78 FR 17066). A portion of the 2013 temporary regulations modifying the procedures for obtaining relief for failures to satisfy certain reporting requirements was amended and removed by final regulations (TD 9704) that were published in the **Federal Register** on November 19, 2014 (79 FR 68763). No requests for a public hearing were received regarding the 2013 temporary regulations, and accordingly no hearing was held. The text of these regulations is substantially identical to to the 2013 temporary regulations.

The Treasury Department and the IRS received one comment regarding the remaining exceptions to the coordination rule. In general, the coordination rule provides that if, in connection with an indirect stock transfer, a U.S. person (U.S. transferor) transfers assets to a foreign corporation (foreign acquiring corporation) in an exchange described in section 351 or 361, section 367 applies first to the asset transfer and then to the indirect stock transfer. Pursuant to the exceptions to the coordination rule, sections 367(a) and (d) will not apply to the outbound transfer of assets by the U.S. transferor to the foreign acquiring corporation to the extent those assets (re-transferred assets) are transferred by the foreign acquiring corporation to a domestic corporation in certain nonrecognition transactions, provided certain conditions are satisfied. Both of the remaining exceptions require that the transferee domestic corporation's adjusted basis in the re-transferred assets not be greater than the U.S. transferor's adjusted basis in those assets, disregarding any basis increase attributable to gain or income recognized by the U.S. transferor on the outbound asset transfer (basis comparison test).

The commenter first inquired whether the remaining coordination rule exceptions apply on a transaction-by-transaction basis such that the conditions of an exception, including the basis comparison test, must be satisfied with respect to all the re-transferred assets, or, alternatively, whether the exceptions apply on an asset-by-asset basis such that the conditions of an exception may be satisfied with respect to a portion of the re-transferred assets. The Treasury Department and the IRS have determined that the regulations clearly provide that the coordination rule exceptions apply to a transaction in its entirety and not on an asset-by-asset basis. See, for example, paragraph (d)(3) of Example 6C of the 2013 temporary regulations, illustrating the application of the coordination rule and the relevant exception using a transaction-based analysis. Thus, the 2013 temporary regulations are not clarified in response to this comment.

Given this transaction-based treatment, the commenter then requested a modification to the aspect of the basis comparison test that disregards an increase in basis in the re-transferred assets in the hands of the transferee domestic corporation that is attributable to gain or income recognized by the U.S. transferor on the outbound transfer of the re-transferred assets to the foreign acquiring corporation. The comment requested that the rule be extended to disregard a basis increase in the re-transferred assets that is attributable to gain or income recognized by the foreign acquiring corporation on the transfer of the re-transferred assets to the transferee domestic corporation when that gain or income is subject to U.S. tax (such as gain recognized by the foreign acquiring corporation with respect to U.S. real property that is subject to U.S. tax under section 897). These regulations do not provide for such an extension.

The coordination rule exceptions were first introduced in proposed regulations (INTL–54–91) published in the **Federal Register** on August 26, 1991 (56 FR 41993). The basis comparison test was introduced later, in final regulations (TD 8770) published in the **Federal Register** on June 19, 1998 (63 FR 33550). Proposed regulations (REG–125628–01) published in the **Federal Register** on January 5, 2005 (70 FR 746) proposed further revisions to the coordination rule exceptions in response to concerns "that asset reorganizations subject to this coordination rule may be used to facilitate corporate inversion transactions." Those 2005 proposed regulations were finalized on January 26, 2006, when the Treasury Department and the IRS published final regulations (TD 9243) in the **Federal Register** (71 FR 4276). Although the 2008 proposed regulations included a proposal to further refine one of the coordination rule exceptions in response to transactions utilizing that exception to inappropriately repatriate earnings and profits of foreign corporations, the proposed refinement was not included in the final regulations published on March 19, 2013. Instead, the 2013 temporary regulations eliminated this particular exception to the coordination rule and noted that the "Treasury Department and the IRS have, over time, clarified and modified the coordination rule exceptions to address various transactions that give rise to policy concerns."

The Treasury Department and the IRS remain concerned that the coordination rule exceptions may be utilized to inappropriately reduce U.S. tax, and therefore decline to liberalize the basis comparison test. The basis comparison test ensures preservation of the gain realized but not recognized by a U.S. transferor in re-transferred assets in the hands of a transferee domestic corporation by ensuring that the assets re-transferred into U.S. corporate solution retain identical tax attributes to the assets transferred to the foreign acquiring corporation. To the extent such assets do not have the same basis in the hands of the transferee domestic corporation and the basis adjustment is not attributable to gain recognized by the U.S. transferor, then the basis adjustment presumably results from transactions occurring in foreign corporate solution (including gain recognized under section 897). The Treasury Department and the IRS believe the coordination rule exceptions should not permit shifting of gain or income to a foreign corporation (even when the gain or income is subject to U.S. tax) as it may permit the U.S. transferor to inappropriately utilize the foreign corporation's favorable tax attributes available to offset the gain or income.

Accordingly, the text of the 2013 temporary regulations is adopted without substantive revision. The text is updated where appropriate for ministerial purposes. For example, the appropriate title for the LB&I officer responsible for determining whether a failure to comply with the reporting requirements was due to reasonable cause and not willful neglect is "Director of Field Operations, Cross Border Activities Practice Area of Large Business & International." It is expected that future guidance projects will update titles in other sections of the existing regulations as appropriate. The corresponding 2013 temporary regulations are removed.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. These regulations primarily will affect United States persons that are large corporations engaged in corporate transactions among their controlled corporations. Thus, the number of affected small entities—in any of the three categories defined in the Regulatory Flexibility Act (small businesses, small organizations, and small governmental jurisdictions)—will not be substantial. The Treasury Department and the IRS estimate that small organizations and small governmental jurisdictions are likely to be affected only insofar as they transfer the stock of a controlled corporation to a related corporation. While a certain number of small entities may engage in such transactions, the Treasury Department and the IRS do not anticipate the number to be substantial. Pursuant to section 7805(f) of the Code, the NPRM preceding this regulation 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 Joshua G. Rabon of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 * * *

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

* * * * *

Par. 2. Section 1.367(a)–3 is amended by:

1. Revising paragraph (d)(2)(vi)(B).
2. Revising paragraph (d)(3), *Examples 6B*, *6C*, and *9*.
3. Revising paragraph (e).
4. Revising paragraph (g)(1)(vii)(A).
5. Adding paragraph (g)(1)(ix).

The revisions and addition read as follows:

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

* * * * *

(d) * * *

(2) * * *

(vi) * * *

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

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

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

(*iii*) 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.

(*2*) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section if a U.S. person transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange, but only if the domestic transferee's adjusted basis in the assets is not greater than the adjusted basis that the U.S. person had in such assets. Any increase in adjusted basis in the assets that results because the U.S. person recognized gain or income with respect to such assets in the initial section 351 exchange is not taken into account for purposes of determining whether the domestic transferee's adjusted basis in the assets is not greater than the U.S. person's adjusted basis in such assets. This paragraph (d)(2)(vi)(B)(*2*) will not, however, apply to an exchange described in section 351 that is also an exchange described in section 361(a) or (b). An exchange described in section 351 that is also an exchange described in section 361(a) or (b) is only eligible for the exception in paragraph (d)(2)(vi)(B)(*1*) of this section.

* * * * *

(3) * * *

Example 6B. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts*. The facts are the same as in paragraph (d)(3), *Example 6A*, of this section, except that R is a domestic corporation.

(ii) *Result*. As in paragraph (d)(3), *Example 6A*, of this section, the outbound transfer of the Business A assets to F is not affected by the rules of § 1.367–3(d) and is subject to the general rules under section 367. Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). The Business B and C assets are part of an indirect stock transfer under § 1.367–3(d), but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, pursuant to paragraph (d)(2)(vi)(B)(*1*) of this section, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section are satisfied, and Z attaches a statement described in paragraphs (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. V also is deemed to make an indirect transfer of Z stock under the rules of paragraph (d) of this section to the extent the assets are transferred to R. To preserve non-recognition treatment, and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a gain recognition agreement in the amount of $50, which equals the aggregate gain in the Business B and C assets, because the transfer of those assets by Z was not taxable under section 367(a)(1) and constitute an indirect stock transfer.

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

(ii) *Result*. The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules of paragraph (d) of this section. However, gain must be recognized on the transfer of those assets under section 367(a)(1) because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5) and § 1.367(a)–7(b). The Business B and C assets are part of an indirect stock transfer under paragraph (d) of this section, but must first be tested with respect to Z under section 367(a) and (d), as provided in paragraph (d)(2)(vi) of this section. The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5) and § 1.367(a)–7(b). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, pursuant to paragraph (d)(2)(vi)(B) of this section, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to paragraph (d)(2)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (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 paragraph (c)(6) of this section, the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).

* * * * *

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) *Facts*. The facts are the same as in paragraph (d)(3), *Example 8*, of this section, except that R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in a controlled asset transfer. In addition, V's basis in its Z stock is $90.

(ii) *Result*. Pursuant to paragraph (d)(2)(vi)(B) of this section, sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R if M's basis in the Business A assets is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (ii), and (iv) and (c)(6) of this section are satisfied, and Z includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer. Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), Z's transfer of the Business B assets to R (which are not re-transferred to M) qualifies for the active trade or business exception under section 367(a)(3). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*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 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) of this section does not apply to the extent of the transfer of business A assets by R to M, a domestic corporation. As a result, to the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange subject to the rules of paragraphs (c) and (d) of this section. Thus, with respect to V's indirect transfer of stock of a domestic corporation to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of paragraph (c) of this section are satisfied, including the requirement that V enter into a gain recognition agreement (separate from the gain recognition agreement described above with respect to the deemed transfer of stock of a foreign corporation to F) and comply with the requirements of § 1.367(a)–8. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F and the transferred corporation is R (with respect to the transfer of stock of a foreign corporation) and M (with respect to the transfer of stock of a domestic corporation). Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R would trigger both gain recognition agreements. In addition, a disposition by R of the stock of M would trigger the gain recognition agreement filed with respect to the transfer of the stock of a domestic corporation. To determine whether there is a triggering event under § 1.367(a)–8(j)(2)(i) for the gain recognition agreement filed with respect to the transfer of stock of the domestic corporation, the Business A assets in M must be considered. To determine whether there is such a triggering event for the gain recognition agreement filed with respect to the transfer of stock of the foreign corporation, the Business B assets in R must be considered.

* * * * *

(e) *Transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *Overview*—(i) *Scope and definitions*. This paragraph (e) applies to a domestic corporation (U.S. transferor) that transfers stock or securities of a domestic or foreign corporation (transferred stock or securities) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. Except as otherwise provided in this paragraph (e), paragraphs (b) and (c) of this section do not apply to the U.S. transferor's transfer of the transferred stock or securities in the section 361 exchange. For purposes of this paragraph (e), the definitions of control group, control group member, and non-control group member in § 1.367(a)–7(f)(1), ownership interest percentage in § 1.367(a)–7(f)(7), section 361 exchange in § 1.367(a)–7(f)(8), and U.S. transferor shareholder in § 1.367(a)–7(f)(13), apply.

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

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

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

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

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

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

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

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

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

(4) *Application of certain rules at U.S. transferor-level*. For purposes of paragraphs (c)(5)(iii) and (e)(3)(ii) and (iii) of this section, ownership of the stock of the transferee foreign corporation is determined by reference to stock owned by the U.S. transferor immediately after the transfer of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c)(1) of the stock received.

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

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

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

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

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

(B) A deemed dividend included in the income of the U.S. transferor with respect to the transferred stock under § 1.367(b)–4(b)(1)(i) that is attributable to such U.S. transferor shareholder pursuant to § 1.367(a)–7(e)(4).

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

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

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

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

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

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

(vi) Except as otherwise provided in this paragraph (e)(6)(vi), if gain is subsequently recognized by the U.S. transferor shareholder under the terms of the gain recognition agreement pursuant to § 1.367(a)–8(c)(1)(i), the increase in stock basis provided under § 1.367(a)–8(c)(4)(i) with respect to the stock received by the U.S. transferor shareholder shall not exceed the amount of the stock basis adjustment made pursuant to § 1.367(a)–7(c)(3) with respect to the stock received by the U.S. transferor shareholder. This paragraph (e)(6)(vi) shall not apply if the U.S. transferor shareholder and the U.S. transferor are members of the same consolidated group at the time of the reorganization.

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

(7) *Gain subject to section 1248(a)*. If the U.S. transferor recognizes gain under

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

(8) *Examples*. The following examples illustrate the provisions of paragraph (e) of this section. Except as otherwise indicated: US1, US2, and UST are domestic corporations that are not members of a consolidated group; X is a United States citizen; US1, US2, and X are unrelated parties; CFC1, CFC2, and FA are foreign corporations; each corporation described herein has a single class of stock issued and outstanding and a tax year ending on December 31; the section 1248 amount (within the meaning of § 1.367(b)–2(c)) with respect to the stock of CFC1 and CFC2 is zero; Asset A is section 367(a) property that, but for the application of section 367(a)(5), would qualify for the active foreign trade or business exception under § 1.367(a)–2T; the requirements of § 1.367(a)–7(c)(2) through (5) are satisfied with respect to a section 361 exchange; the provisions of § 1.367(a)–6T (regarding branch loss recapture) are not applicable; and none of the foreign corporations in the examples is a surrogate foreign corporation (within the meaning of section 7874) as a result of the transactions described in the examples because one or more of the conditions of section 7874(a)(2)(B) is not satisfied.

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

(ii) *Result*—(A) UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of $100x on the transfer of the CFC1 stock (computed as the excess of the $100x fair market value over the $0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirements of paragraph (e)(3) of this section are satisfied. First, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of § 1.367(a)–7(c)(1) is satisfied, and a stated assumption is that the requirements of § 1.367(a)–7(c)(2) through (5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 85% of the stock of UST immediately before the reorganization. Second, the requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation and CFC1 is a foreign corporation. Third, paragraph (e)(3)(iii) of this section is not applicable because immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or the total value of the stock of FA. See paragraph (e)(4) of this section. Accordingly, UST does not recognize the $100x of gain realized in the CFC1 stock pursuant to this section.

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

(C) The requirement to recognize gain under § 1.367(a)–7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(B) of this *Example 1*, the inside gain is $50x. US1's attributable inside gain of $40x (equal to the product of $50x inside gain multiplied by US1's 80% ownership interest percentage, reduced by $0x, the sum of the amounts described in § 1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $160x (equal to the product of the section 367(a) percentage of 100% multiplied by $160x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of $2.50x (equal to the product of $50x inside gain multiplied by US2's 5% ownership interest percentage, reduced by $0x, the sum of the amounts described in § 1.367(a)–7(c)(2)(ii)(A)(*1*) through (*3*)) does not exceed $10x (equal to the product of the section 367(a) percentage of 100% multiplied by $10x fair market value of FA stock received by US2).

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

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

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

(B) Unlike paragraph (e), *Example 1*, of this section, however, UST owns 5% or more of the voting power or value of the stock of FA immediately after the transfer of the CFC1 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section US1 and X must enter into gain recognition agreements that satisfy the requirements of paragraph (e)(6) of this section and § 1.367(a)–8. See paragraph (ii)(G) of this *Example 2* for the computation of the amount of gain subject to each gain recognition agreement.

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

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

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

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

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

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

Example 3. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation; interaction with section 1248(f)—(i) *Facts*. US1, US2, and X own 50%, 30%, and 20%, respectively, of the stock of UST. The UST stock owned by US1 has a $180x basis and $200x fair market value; the UST stock owned by US2 has a $100x basis and $120x fair market value; and the UST stock owned by X has a $80x fair market value. UST owns Asset A, and all the stock of CFC1 and CFC2. UST has no liabilities. Asset A has a $10x basis and $200x fair market value. The CFC1 stock is a single block of stock (as defined in § 1.1248(f)–1(c)(2)) with a $20x basis, $40x fair market value, and $30x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount (as defined in § 1.1248(f)–1(c)(9)) is $20x). The CFC2 stock is also a single block of stock with a $30x basis, $160x fair market value, and $150x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount is $130x). On December 31, Year 3, in a reorganization described in section 368(a)(1)(D), UST transfers the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for 60 shares of FA stock with a $400x fair market value. UST's transfer of the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for the 60 shares of FA stock qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to section 361(c)(1). US1, US2, and X exchange their UST stock for 30, 18, and 12 shares, respectively, of FA stock pursuant to section 354. Immediately after the reorganization, FA has 100 shares of stock outstanding, and US1 and US2 are each a section 1248 shareholder with respect to FA.

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

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

(C) In order to meet the requirements of § 1.367(a)–7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain attributable to non-control group members (X), or $68x. The $68x of gain is computed as the product of the inside gain ($340x) multiplied by X's ownership interest percentage in UST (20%), reduced (but not below zero) by $0x, the sum of the amounts described in § 1.367(a)–7(c)(2)(i)(A) through (C). Pursuant to § 1.367(a)–7(f)(5), the $340x of inside gain is the amount by which the aggregate fair market value ($400x) of the section 367(a) property (Asset A, CFC1 stock, and CFC2 stock) exceeds the sum of the inside basis ($60x) and $0x (the product of the section 367(a) percentage (100%) multiplied by UST's deductible liabilities ($0x)). Pursuant to § 1.367(a)–7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange ($60x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 ($0x), but not including the $68x of gain recognized by UST under § 1.367(a)–7(c)(2)(i). Under § 1.367(a)–7(e)(1), the $68x gain recognized is treated as being with respect to the CFC1 stock, CFC2 stock, and Asset A in proportion to the amount of gain realized by UST on the transfer of the property. The amount treated as recognized with respect to the CFC1 stock is $4x ($68x gain multiplied by $20x/$340x). The amount treated as recognized with respect to the CFC2 stock is $26x ($68x gain multiplied by $130x/$340x). The amount treated as recognized with respect to Asset A is $38x ($68x gain multiplied by $190x/$340x). Under section 1248(a), UST must include in gross income as a dividend the $4x gain recognized with respect to the CFC1 stock and the $26x gain recognized with respect to CFC2 stock. Furthermore, FA's basis in the CFC1 stock, CFC2 stock, and Asset A, as determined under section 362, is increased by the amount of gain recognized by UST with respect to such property. See § 1.367(a)–1(b)(4)(i)(B). Thus, FA's basis in the CFC1 stock is $24x ($20x increased by $4x of gain), the CFC2 stock is $56x ($30x increased by $26x of gain), and Asset A is $48x ($10x increased by $38x of gain).

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

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

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

(G) If, however, UST along with US1 and US2 (each a section 1248 shareholder of FA immediately after the distribution) elect to apply the provisions of § 1.1248(f)–2(c) (as provided in § 1.1248(f)–2(c)(1)), the amount that UST is required to include in income as a dividend under § 1.1248(f)–1(b)(3) ($120x total section 1248(f) amount as computed in paragraph (ii)(F) of this *Example 3*) is reduced by the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that is attributable (under the rules of § 1.1248(f)–2(d)) to the FA stock distributed to US1 and US2. Assume that the election is made to apply § 1.1248(f)–2(c).

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

(*2*) If the shares of FA stock are divided into portions, § 1.1248(f)–2(d)(2) applies to attribute the attributable share amount to portions of shares of FA stock distributed to US1 and US2. Under § 1.1248(f)–2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the single block of stock of CFC1, one attributable to the single block of stock of CFC2, and one attributable to Asset A. Thus, the attributable share amount of $.33x with respect to the CFC1 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC1 stock. Similarly, the attributable share amount of $2.17x with respect to the CFC2 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC2 stock.

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

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

(*1*) With respect to US1's 30 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of $5.63x ($30x multiplied by $24x/$128x) and fair market value of $20x ($200x multiplied by $40x/$400x), resulting in aggregate gain in such portions of $14.38x (or $.48x gain in each such portion of the 30 shares). The portions attributable to the CFC2 stock have an aggregate basis of $13.13x ($30x multiplied by $56x/$128x) and fair market value of $80x ($200x multiplied by $160x/$400x), resulting in aggregate gain in such portions of $66.88x (or $2.23x in each such portion of the 30 shares). The portions attributable to Asset A have an aggregate basis of $11.25x ($30x multiplied by $48x/$128x) and fair market value of $100x ($200x multiplied by $200x/$400x), resulting in aggregate gain in such portions of $88.75x (or $2.96x in each such portion of the 30 shares). Thus, the aggregate gain in all the portions of the 30 shares is $170x ($14.38x plus $66.88x plus $88.75x).

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

(*3*) Under § 1.1248 – 8(b)(2)(iv), the earnings and profits of CFC1 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC1 stock is $15x (the product of US1's 50% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US1). The earnings and profits of CFC2 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC2 stock is $75x (the product of US1's 50% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US1). Similarly, the earnings and profits of CFC1 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC1 stock is $9x (the product of US2's 30% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US2). Finally, the earnings and profits of CFC2 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC2 stock is $45x (the product of US2's 30% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US2).

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

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

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

$45x earnings and profits attributable to the portions for purposes of section 1248).

(J) The amount of gain subject to the gain recognition agreement filed by each of US1 and US2 is determined pursuant to paragraph (e)(6)(i) of this section. The amount of gain subject to the gain recognition agreement filed by US1 with respect to the stock of CFC1 and CFC2 is $10x and $65x, respectively. The $10x and $65x are computed as the product of US1's ownership interest percentage (50%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US1 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). The amount of gain subject to the gain recognition agreement filed by US2 with respect to the stock of CFC1 and CFC2 is $6x and $39x, respectively. The $6x and $39x are computed as the product of US2's ownership interest percentage (30%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US2 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is $0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock, computed as X's ownership percentage (20%) multiplied by the gain realized in the stock of CFC1 ($20x multiplied by 20%, or $4x) and CFC2 ($130x multiplied by 20%, or $26x), reduced by the amount of gain recognized by UST with respect to the stock of CFC1 and CFC2 that is attributable to X pursuant to § 1.367(a)–7(c)(2) ($4x and $26x, respectively, as determined in paragraph (ii)(C) of this *Example 3*). Pursuant to paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in § 1.367(a)–8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and US2 must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of § 1.367(a)–8.

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

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(vii) * * *

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

* * * * *

(ix) Paragraphs (d)(2)(vi)(B)(*1*)(*i*) and (*iii*), (d)(2)(vi)(B)(*2*), and (d)(3), *Examples 6B*, *6C*, and *9* of this section apply to transfers that occur on or after March 18, 2013. See paragraphs (d)(2)(vi)(B)(*1*)(*i*) and (*iii*), (d)(2)(vi)(B)(*2*), and (d)(3), *Examples 6B*, *6C*, and *9* of this section, as contained in 26 CFR part 1 revised as of April 1, 2012, for transfers that occur on or after January 23, 2006, and before March 18, 2013. Paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section applies to statements that are required to be filed on or after November 19, 2014. See paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section, as contained in 26 CFR part 1 revised as of April 1, 2014, for statements required to be filed on or after March 18, 2013, and before November 19, 2014.

* * * * *

§ 1.367(a)–3T [Removed]

Par. 3. § 1.367(a)–3T is removed.

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

§ 1.367(a)–6 Transfer of foreign branch with previously deducted losses.

(a) through (e)(3) [Reserved]. For further guidance, see § 1.367(a)–6T(a) through (e)(3).

(4) *Gain recognized under section 367(a)*. The previously deducted branch losses shall be reduced by any gain recognized pursuant to section 367(a)(1) (other than by reason of the provisions of this section) upon the transfer of the assets of the foreign branch to the foreign corporation. For transactions occurring on or after April 17, 2013, notwithstanding the prior sentence, this paragraph (e)(4) shall apply before the rules of § 1.367(a)–7(c).

(e)(5) through (i) [Reserved]. For further guidance, see § 1.367(a)–6T(e)(5) through (i).

§ 1.367(a)–6T [Amended]

Par. 5. Section 1.367(a)–6T is amended by removing and reserving paragraph (e)(4) and removing paragraph (j).

Par. 6. Section 1.1248(f)–3 is revised by adding paragraph (a) and adding a sentence at the end of paragraph (b)(1) to read as follows:

§ 1.1248(f)–3 Reasonable cause and effective/applicability dates.

(a) *Reasonable cause for failure to comply*—(1) *Request for relief*. If an 80-percent distributee, a distributee that is a section 1248 shareholder, or the domestic distributing corporation (reporting person) fails to timely comply with any requirement under § 1.1248(f)–2, the failure shall be deemed not to have occurred if the reporting person is able to demonstrate that the failure was due to reasonable cause and not willful neglect using the procedure set forth in paragraph (a)(2) of this section. Whether the failure to timely comply was due to reasonable cause and not willful neglect will be determined by the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (Director) based on all the facts and circumstances.

(2) *Procedures for establishing that a failure to timely comply was due to reasonable cause and not willful neglect*—(i) *Time of submission*. A reporting person's statement that the failure to timely comply was due to reasonable cause and not willful neglect will be considered only if, promptly after the reporting person becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to timely comply.

(ii) *Notice requirement*. In addition to the requirements of paragraph (a)(2)(i) of this section, the reporting person must comply with the notice requirements of this paragraph (a)(2)(ii). If any taxable year of the reporting person is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the reporting person is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(b) * * *

(1) * * * The provisions of § 1.1248(f)–3(a) apply to distributions occurring on or after April 17, 2013.

* * * * *

§ 1.1248(f)–3T [Removed]

Par. 7. § 1.1248(f)–3T is removed.

Par. 8. Section 1.6038B–1 is amended by:

1. Removing "or § 1.367(a)–3T" from paragraph (c)(4)(ii); and

2. Revising paragraph (f)(3).

The revision reads as follows:

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

* * * * *

(f) * * *

(3) *Reasonable cause for failure to comply*—(i) *Request for relief*. If the U.S. transferor fails to comply with any requirement of section 6038B and this section, the failure shall be deemed not to have occurred if the U.S. transferor is able to demonstrate that the failure was due to reasonable cause and not willful neglect using the procedure set forth in paragraph (f)(3)(ii) of this section. Whether the failure to timely comply was due to reasonable cause and not willful neglect will be determined by the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (Director) based on all the facts and circumstances.

(ii) *Procedures for establishing that a failure to timely comply was due to reasonable cause and not willful neglect*—(A) *Time of submission*. A U.S. transferor's statement that the failure to timely comply was due to reasonable cause and not willful neglect will be considered only if, promptly after the U.S. transferor becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to timely comply.

(B) *Notice requirement*. In addition to the requirements of paragraph (f)(3)(ii)(A) of this section, the U.S. transferor must comply with the notice requirements of this paragraph (f)(3)(ii)(B). If any taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

* * * * *

§ 1.6038B–1T [Amended]

Par. 9. Section 1.6038B–1T is amended by removing and reserving paragraphs (c)(4)(ii)(B) and (f)(3).

§§ 1.367(a)–2T, 1.367(a)–3, 1.367(a)–4T, 1.367(a)–7, 1.367(a)–8, 1.367(b)–4, 1.367(e)–1, 1.1248(f)–1, 1.1248(f)–2, 1.6038B–1, 1.6038B–1T [Amended]

Par. 10. For each section listed in the table, remove the language in the "Remove" column and add in its place the language in the "Add" column as set forth below:

Section	*Remove*	*Add*
§ 1.367(a)–2T(a)(2), fourth sentence	§ 1.367(a)–3T	§ 1.367(a)–3
§ 1.367(a)–3(d)(3), *Example 12*(ii), third sentence	§ 1.367(a)–3T(e)(3)	§ 1.367(a)–3(e)(3)
§ 1.367(a)–4T(d), first sentence	§ 1.367(a)–3T	§ 1.367(a)–3
§ 1.367(a)–7(c) introductory text, second sentence	§ 1.367(a)–3T	§ 1.367(a)–3
§ 1.367(a)–7(c)(2)(i)(A), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(c)(2)(ii)(A)(*1*), first sentence	§ 1.367(a)–3T(e)(3)(iii)(C)	§ 1.367(a)–3(e)(3)(iii)(C)
§ 1.367(a)–7(c)(3)(v), first sentence	§ 1.367(a)–3T(e)(8)	§ 1.367(a)–3(e)(8)
§ 1.367(a)–7(c)(4)(ii), first sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.367(a)–7(e)(1), third sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.367(a)–7(e)(1), fourth sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(4)(i), paragraph heading	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(4)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(4)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(4)(i), last sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(4)(ii), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(4)(ii), last sentence	§ 1.367(a)–3T(e)(7)	§ 1.367(a)–3(e)(7)

Section	*Remove*	*Add*
§ 1.367(a)–7(e)(4)(ii), last sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(5)(i), paragraph heading	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(5)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(5)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(5)(i), last sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(e)(5)(ii), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(e)(5)(ii), first sentence	§ 1.367(a)–3T(e)(7)	§ 1.367(a)–3(e)(7)
§ 1.367(a)–7(f)(4), last sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(f)(4)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(B)	§ 1.367(a)–3(e)(3)(iii)(B)
§ 1.367(a)–7(f)(4)(ii), first sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(f)(4)(iii), first sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.367(a)–7(g) introductory text, second sentence	§ 1.367(a)–3T(e)(8)	§ 1.367(a)–3(e)(8)
§ 1.367(a)–7(h), second sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.367(a)–8(c)(6), first sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.367(a)–8(j)(9), first sentence	§ 1.367(a)–3T(e)(6)(iv)	§ 1.367(a)–3(e)(6)(iv)
§ 1.367(b)–4(b)(1)(iii) *Example 4*(i), ninth sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.367(b)–4(b)(1)(iii), *Example 4*(i), tenth sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.367(b)–4(b)(1)(iii), *Example 5*(i), penultimate sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.367(b)–4(b)(1)(iii) *Example 5*(i), last sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.367(e)–1(e), first sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.1248(f)–1(c)(4)(i), first sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.1248(f)–2(e) introductory text, second sentence	§ 1.367(a)–3T(e)(8), *Example 3*	§ 1.367(a)–3(e)(8), *Example 3*
§ 1.1248(f)–2(e), *Example 2*(i), last sentence	§ 1.367(a)–3T(e)(3)(iii)(A)	§ 1.367(a)–3(e)(3)(iii)(A)
§ 1.1248(f)–2(e), *Example 2*(i), last sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), first sentence	§ 1.367(a)–3T(e)(2)	§ 1.367(a)–3(e)(2)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), first sentence	§ 1.367(a)–3T(e)(3)(i)	§ 1.367(a)–3(e)(3)(i)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), second sentence	§ 1.367(a)–3T(e)(3)(i)	§ 1.367(a)–3(e)(3)(i)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), third sentence	§ 1.367(a)–3T(e)(3)(ii)	§ 1.367(a)–3(e)(3)(ii)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), fourth sentence	§ 1.367(a)–3T(e)(3)(iii)	§ 1.367(a)–3(e)(3)(iii)
§ 1.1248(f)–2(e), *Example 2*(ii)(A), fourth sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.1248(f)–2(e), *Example 3*(i), penultimate sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), first sentence	§ 1.367(a)–3T(e)(2)	§ 1.367(a)–3(e)(2)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), first sentence	§ 1.367(a)–3T(e)(3)(i)	§ 1.367(a)–3(e)(3)(i)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), second sentence	§ 1.367(a)–3T(e)(3)(i)	§ 1.367(a)–3(e)(3)(i)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), third sentence	§ 1.367(a)–3T(e)(3)(ii)	§ 1.367(a)–3(e)(3)(ii)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), fourth sentence	§ 1.367(a)–3T(e)(3)(iii)	§ 1.367(a)–3(e)(3)(iii)
§ 1.1248(f)–2(e), *Example 3*(ii)(A), fourth sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.1248(f)–2(e), *Example 3*(ii)(G), first sentence	§ 1.367(a)–3T(e)(6)	§ 1.367(a)–3(e)(6)
§ 1.1248(f)–2(e), *Example 3*(ii)(G), first sentence	§ 1.367(a)–3T(e)(6)(i)(A)	§ 1.367(a)–3(e)(6)(i)(A)
§ 1.1248(f)–2(f), third sentence	§ 1.367(a)–3T(e)	§ 1.367(a)–3(e)
§ 1.6038B–1T(c)(4)(ii)(A), second sentence	§ 1.367(a)–3T(d)(2)	§ 1.367(a)–3(d)(2)

John Dalrymple,
Deputy Commissioner for Services
and Enforcement.

Approved: March 11, 2016.

Mark J. Mazur,
Assistant Secretary of the Treasury
(Tax Policy).

(Filed by the Office of the Federal Register on March 18, 2016, 4:15 p.m., and published in the issue of the Federal Register for March 22, 2016, 81 F.R. 15159)

Part III. Administrative, Procedural, and Miscellaneous

Date for Compliance with Consistent Basis Reporting Between Estate and Person Acquiring Property from Decedent

Notice 2016–27

SECTION 1: PURPOSE

On July 31, 2015, the President of the United States signed into law the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015*, Public Law 114–41, 129 Stat. 443 (Act). Section 2004 of the Act added new sections 1014(f) and 6035. On August 21, 2015, the Treasury Department and the IRS issued Notice 2015–57, 2015–36 IRB 294. That notice delayed until February 29, 2016, the due date for any statements required under section 6035(a)(3)(A) to be provided before February 29, 2016. On February 11, 2016, the IRS issued Notice 2016–19, 2016–09 IRB 362, to provide that executors and other persons required to file or furnish a statement under section 6035(a)(1) or (a)(2) before March 31, 2016, need not do so until March 31, 2016. On March 4, 2016, the Treasury Department and the IRS published temporary and proposed regulations under sections 1014(f) and 6035. TD 9757, 81 FR 11431; REG–127923–15, 81 FR 11486. This notice provides that executors and other persons required to file or furnish a statement under section 6035(a)(1) or (a)(2) before June 30, 2016, need not do so until June 30, 2016.

SECTION 2: BACKGROUND

Section 1014(f) provides rules requiring that the basis of certain property acquired from a decedent, as determined under section 1014, may not exceed the value of that property as finally determined for federal estate tax purposes, or if not finally determined, the value of that property as reported on a statement made under section 6035.

Section 6035 imposes new reporting requirements with regard to the value of property included in a decedent's gross estate for federal estate tax purposes.

Section 6035(a)(1) provides that the executor of any estate required to file a return under section 6018(a) must furnish, both to the Secretary and to the person acquiring any interest in property included in the decedent's gross estate for federal estate tax purposes, a statement identifying the value of each interest in such property as reported on such return and such other information with respect to such interest as the Secretary may prescribe.

Section 6035(a)(2) provides that each person required to file a return under section 6018(b) must furnish, both to the Secretary and to each other person who holds a legal or beneficial interest in the property to which such return relates, a statement identifying the information described in section 6035(a)(1).

Section 6035(a)(3)(A) provides that each statement required to be furnished under section 6035(a)(1) or (a)(2) is to be furnished at such time as the Secretary may prescribe, but in no case at a time later than the earlier of (i) the date which is 30 days after the date on which the return under section 6018 was required to be filed (including extensions, if any) or (ii) the date which is 30 days after the date such return is filed.

Section 6035(b) authorizes the Secretary to prescribe such regulations as necessary to carry out section 6035. Section 7805(a) provides generally that the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue. Section 7805(b)(2) provides that regulations may apply retroactively if they are issued within 18 months of the date of the enactment of the statutory provision to which they relate.

SECTION 3: GUIDANCE

The Treasury Department and the IRS have received numerous comments that executors and other persons have not had sufficient time to adopt the systemic changes that would enable the filing of an accurate and complete Form 8971 and Schedule A. Accordingly, statements required under sections 6035(a)(1) and (a)(2) to be filed with the IRS or furnished to a beneficiary before June 30, 2016, need not be filed with the IRS and furnished to a beneficiary until June 30, 2016.

SECTION 4: EFFECTIVE DATE

This notice is effective on March 23, 2016. This notice applies to executors of the estates of decedents and to other persons who are required under section 6018(a) or (b) to file a return if that return is filed after July 31, 2015.

DRAFTING INFORMATION

The principal author of this notice is Eliezer Mishory of the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, please contact Theresa Melchiorre at (202) 317-6859 (not a toll-free number).

Empowerment Zone Designation Extension

Notice 2016–28

I. PURPOSE

This notice provides the manner in which a State or local government may amend an empowerment zone nomination to provide for a new termination date of December 31, 2016. This notice is issued pursuant to § 1391 of the Internal Revenue Code, as amended by § 171(a) of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), enacted as part of the Consolidated Appropriations Act, 2016, Division Q, Pub. L. 114–113, ______ Stat. ______ (December 18, 2015).

II. BACKGROUND

Section 1391 was enacted in 1993 to allow a State or local government ("entity") to nominate an area or areas in its jurisdiction for designation as an empowerment zone. The Secretary of Housing and Urban Development, in the case of any nominated area that is located in an urban area, and the Secretary of Agriculture, in the case of any nominated area that is located in a rural area, have since designated which of the nominated areas are empowerment zones. Unless an earlier termination date was provided by the nominating entity, a designation was originally effective for the period beginning on the date of designation and ending on the close of the 10^{th} taxable year beginning on or after the date of designation. Section 112 of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554, 114 Stat. 2763A–587 (December 21, 2000) (CRTRA), amended § 1391(d)(1) to extend the designation period for all empowerment zones through December 31, 2009, regardless of the original termination date. Subsequent amendments to § 1391(d)(1)(A) further extended the designation period through December 31, 2014. *See* § 753(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111–312, 124 Stat. 3296 (December 17, 2010) (TRUIRJCA), § 327(a) of the American Taxpayer Relief Act of 2012, Pub. L. 112–240, 126 Stat. 2313 (January 2, 2013) (ATRA), and § 139(a) of the Tax Increase Prevention Act of 2014, Pub. L. 113–295, 128 Stat. 4010 (December 19, 2014) (TIPA).

In 2013, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2013–38, 2013–25 I.R.B. 1251, pursuant to § 753(c) of TRUIRJCA and § 327(c) of ATRA. Notice 2013–38 provided that any nomination for an empowerment zone that was in effect on December 31, 2009, is deemed to be amended to provide for a new termination date of December 31, 2013, unless the nominating entity declined the extension in a written notification to the IRS. In 2015, the Treasury Department and the IRS issued Notice 2015–26, 2015–13 I.R.B. 814, pursuant to § 139(b) of TIPA. Notice 2015–26 provided that any nomination for an empowerment zone that was in effect on December 31, 2013, is deemed to be amended to provide for a new termination date of December 31, 2014, unless the nominating entity declined the extension in a written notification to the IRS. No written requests were received under either Notice 2013–28 or Notice 2015–26. Accordingly, the designations of all empowerment zones currently have a termination date of December 31, 2014.

In 2015, Congress further amended § 1391(d)(1) to extend the period for which an empowerment zone designation is in effect by an additional two years. As amended by § 171(a)(1) of the PATH Act, § 1391(d)(1) provides that any designation of an empowerment zone ends on the earliest of (A) December 31, 2016, (B) the termination date designated by the State and local governments as provided for in their nomination, or (C) the date the appropriate Secretary revokes the designation. Section 171(a)(2) of the PATH Act provides that where a nomination of an empowerment zone included a termination date of December 31, 2014, § 1391(d)(1)(B) shall not apply with respect to such designation if, after the date of the enactment of the PATH Act, the entity that made such nomination amends the nomination, in such manner as the Secretary of the Treasury may provide, to provide for a new termination date. The amendments made by § 171(a) of the PATH Act apply to taxable years beginning after December 31, 2014.

Thus, pursuant to the PATH Act, an entity must amend its nomination to provide for a new termination date of December 31, 2016, in order to retain an empowerment zone designation that is effective through that date. Section III of this notice provides the procedures that an entity must follow to amend its termination date.

III. AMENDMENT OF A NOMINATION TO EXTEND EMPOWERMENT ZONE DESIGNATION THROUGH DECEMBER 31, 2016

Any nomination for an empowerment zone with a current termination date (as amended by CRTRA, Notice 2013–38, and Notice 2015–26) of December 31, 2014, is deemed to be amended to provide for a new termination date of December 31, 2016, unless the nominating entity sends written notification to the IRS by May 24, 2016. The written notification must affirmatively decline extension of the empowerment zone nomination through December 31, 2016. If the United States mail is used, the notification should be sent to the following address:

Internal Revenue Service
Attn: Charles Magee, CC:ITA:7,
Room 4136
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

If a private delivery service is used, the notification should be sent to the following address:

Internal Revenue Service
Attn: Charles Magee, CC:ITA:7,
Room 4136
1111 Constitution Ave., NW
Washington, DC 20224

If the entity that nominated an empowerment zone does not send written notification, the nomination of that empowerment zone will be deemed extended from December 31, 2014, through December 31, 2016. Accordingly, § 1391(d)(1)(B) does not apply and, pursuant to § 1391(d)(1)(A)(i), the designation of that empowerment zone ends on December 31, 2016.

IV. DRAFTING INFORMATION

The principal author of this notice is Charles Magee of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact Mr. Magee at (202) 317-7005 (not a toll-free number).

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26 CFR 601.106: Appeals Functions

Rev. Proc. 2016–22

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 87–24, 1987–1 C.B. 720, to clarify and describe the practices for the administrative appeals process in cases docketed in the United States Tax Court (Tax Court). The purpose of this revenue procedure is to facilitate effective utilization of administrative appeals and achieve earlier development and disposition of Tax Court cases.

SECTION 2. BACKGROUND

.01 The Office of Chief Counsel (Counsel) is charged with the responsibility of representing the Commissioner of

Internal Revenue in cases docketed in the Tax Court. I.R.C. §§ 7452, 7803(b)(2)(D).

.02 The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206, § 1001(4), 112 Stat. 685, 689, requires the Internal Revenue Service (IRS) to "ensure an independent appeals function" within the IRS.

.03 Under Rev. Proc. 2012–18, 2012–1 C.B. 455, for cases docketed in the Tax Court, the rules prohibiting ex parte communications continue to apply to communications between the Office of Appeals (Appeals) and the originating function, but do not apply to communications between Counsel and Appeals. However, Counsel and Appeals share a responsibility to interact – in all circumstances – in a manner that preserves and promotes Appeals' independence. *See* Rev. Proc. 2012–18, § 2.02(2), (3), 2012–1 C.B. 455, 457.

.04 On October 15, 2015, the Department of Treasury and the Service published Notice 2015–72, 2015–44 I.R.B. 613, which released a proposed revenue procedure that would update Rev. Proc. 87–24, 1987–1 C.B. 720. Notice 2015–72 invited public comment regarding the proposed revenue procedure. The IRS received a total of four comments, one of which contained a general objection to the proposed revenue procedure. The three substantive comments ranged from seeking clarification on some of the terms used in the proposed revenue procedure to seeking expansion of the scope of the proposed revenue procedure to cover other areas. Treasury and the Service considered all comments received and adopted several of the suggestions by making clarifying modifications. A number of the suggestions that were not adopted in the revenue procedure may be addressed in the Internal Revenue Manual, the Chief Counsel Directives Manual, or in training.

SECTION 3. PROCEDURES

Cases docketed in the Tax Court will be processed under the following procedures:

.01 Except as set forth in section 3.03 and section 4 of this Revenue Procedure, Counsel will refer docketed cases to Appeals for settlement consideration unless 1) Appeals issued the notice of deficiency or made the determination that is the basis of the Tax Court's jurisdiction or 2) the taxpayer notifies Counsel that the taxpayer wants to forego settlement consideration by Appeals.

.02 If Appeals issues a notice of deficiency, or makes a determination, without having fully considered one or more issues because of an impending expiration of the statute of limitations on assessment, Appeals may include a request in the administrative case file for Counsel to return the case to Appeals for full consideration of the issue or issues once the case is docketed in the Tax Court. If Appeals includes such a request in the administrative case file, the case will be treated as if Appeals did not issue the notice of deficiency or make the determination.

.03 Counsel will not refer to Appeals any docketed case or issue that has been designated for litigation by Counsel. In limited circumstances, a docketed case or issue that has not been designated for litigation will not be referred to Appeals if Division Counsel or a higher level Counsel official determines that referral is not in the interest of sound tax administration. For example, Counsel may decide not to refer a docketed case to Appeals in cases involving a significant issue common to other cases in litigation for which it is important that the IRS maintain a consistent position or in cases related to a case over which the Department of Justice has jurisdiction. If Counsel determines that a docketed case or issue will not be referred to Appeals, Counsel will notify the taxpayer that the case will not be referred to Appeals.

.04 For cases not covered by the exceptions in section 3 or the exclusions in section 4, Counsel will refer a docketed case to Appeals within 30 calendar days of the case becoming "at issue in the Tax Court" (as defined by Tax Ct. R. 38). Counsel may, with manager approval, delay forwarding a docketed case to Appeals if Counsel identifies a need for additional time. A delay of more than 90 calendar days (120 calendar days from when the case is at issue) requires approval of a Counsel executive. If a delay of more than 90 calendar days is approved, Counsel will discuss with Appeals the need for the delay and when Counsel expects to forward the case to Appeals for settlement consideration. Examples of when Counsel may delay forwarding a docketed case to Appeals include, but are not limited to, cases in which Counsel determines a need to retain the administrative file for early trial preparation or when new facts, issues, or items are raised in the pleadings. Counsel may also delay forwarding a docketed case to Appeals when Counsel anticipates filing a dispositive motion, in which case Counsel will retain the case until the Tax Court rules on the motion. If a delay of more than 90 calendar days is approved by a Counsel executive, Counsel will promptly notify the taxpayer that referral of the case to Appeals will be delayed.

.05 When a docketed case is forwarded to Appeals for consideration, Appeals has the sole authority to resolve a docketed case through settlement until the case is returned to Counsel.

.06 To the extent feasible, Counsel will alert Appeals about limits on the amount of time that Appeals may have the case for settlement consideration. In such cases, Counsel and Appeals shall then agree upon the time when the case will be returned to Counsel.

.07 A docketed case proceeding as a small tax case under the provisions of section 7463, or as a regular case in which the amount at issue for each year is $50,000 or less, that has been forwarded to Appeals for consideration may be recalled by Counsel after six months. If not recalled, Appeals will return the case so that it is received by Counsel no later than 30 calendar days prior to the date of the calendar call. In all other docketed cases, Appeals will return the case to Counsel when Appeals concludes that the case is not susceptible to settlement or within 10 calendar days after the case appears on a trial calendar, whichever is sooner. In all cases, Counsel and Appeals may agree to extend the time for Appeals to consider a case if settlement appears reasonably likely.

.08 If Counsel determines that the case is needed for trial preparation, Counsel may request that Appeals return the case (including settlement authority) to Counsel before Appeals has completed its consideration of the case.

.09 Notwithstanding any other provision in this revenue procedure, any docketed case may be transferred from Counsel to Appeals or from Appeals to Counsel by agreement between Appeals and Counsel. This authority will be used when such transfer may promote a more efficient disposition of the case.

.10 Upon request, Appeals will make the administrative case file, or a copy, readily available to Counsel when needed for trial preparation. A request for the administrative case file by Counsel will not transfer settlement authority back to Counsel. Counsel will promptly return the administrative file to Appeals on request, or when it is no longer needed by Counsel for trial preparation.

.11 When transferring a docketed case to Appeals, Counsel may request to be included in a settlement conference with the taxpayer. Appeals may, with manager approval, decline to include Counsel in the settlement conference if, after considering the views of both Counsel and the taxpayer, Appeals determines that Counsel's participation in the settlement conference will not further settlement of the case. Whether or not Counsel participates in the settlement conference, Counsel will continue with trial preparation, which may include, but is not limited to, asking the taxpayer to participate in informal discovery conferences with Counsel only.

.12 Appeals will provide Counsel with access to any documents received by Appeals in a settlement conference with respect to the docketed case.

.13 If a taxpayer or the taxpayer's representative raises an issue for the first time while the docketed case is with Appeals for settlement consideration, Appeals will advise Counsel as soon as the new issue is identified. Appeals or Counsel will coordinate with the examination function as appropriate to obtain the IRS's views on the new issue, and in docketed cases containing an issue that was not previously examined, Appeals or Counsel will coordinate with the examination function of the relevant operating division, as needed, to develop the material facts relating to the new issue prior to Appeals' consideration of the issue.

.14 In evaluating the merits of a docketed case that has been referred to Appeals for settlement consideration, Appeals may obtain advice from Counsel and consider it in conjunction with other factors to reach a basis for settlement.

.15 If Appeals reaches a settlement with the taxpayer in the docketed case, a stipulated decision document reflecting the proposed resolution will be prepared and forwarded to the taxpayer. When Appeals prepares the decision document, Counsel may assist with drafting, as needed. By signing the proposed stipulated decision document and returning the document to the IRS, the taxpayer makes an offer to settle the case. Counsel will review the decision document for accuracy and completeness, sign the decision document on behalf of the Commissioner, and file the document with the Tax Court.

SECTION 4. EXCLUSIONS

.01 Section 3 does not apply to cases docketed under section 6015(e)(1)(A)(i)(II), section 6110, sections 6320 and 6330, section 6404, section 7428, section 7476, section 7477, section 7478, section 7479, and section 7623 of the Internal Revenue Code. For cases docketed under section 6213(a), section 3 does not apply to section 6015 relief raised for the first time in the petition.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 87–24, 1987–1 C.B. 720, is superseded.

SECTION 6. EFFECTIVE DATE

This revenue procedure is applicable to all docketed Tax Court cases pending on or after March 23, 2016.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Jenni Black of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure contact Jenni Black on (202) 317-6834 (not a toll free number).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with modified, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with amplified and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, modified and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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