least every six feet, not less than one foot from the edge.

(c) *Periodic tests and quality control inspections.* (1) Five samples of carpet and carpet with attached cushion shall be tested annually by the administrator or by an administrator-approved laboratory. Three samples of each certified quality shall be taken from the plant annually. Of these, two shall be interim samples (taken every six months) and one an annual sample. In addition, two samples of each certified quality shall be taken annually from sources other than the manufacturer, *i.e.*, brought in the market place from distributors or stores, not from the factory. The administrator shall select samples for testing, and testing shall be conducted, in accordance with the applicable standards in a laboratory accredited by the National Voluntary Laboratory Accreditation Program (NVLAP) of the National Bureau of Standards, U.S. Department of Commerce.

(2) The administrator shall visit the manufacturer's facility at least once every six months to assure that the initially accepted quality control procedures continue to be followed.

Dated: April 24, 1986.

**Silvio J. DeBartolomeis,**

*Acting General Deputy Assistant Secretary for Housing, Deputy Federal Housing Commissioner.*

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## DEPARTMENT OF THE TREASURY

## Internal Revenue Service

## 26 CFR Part 1

[T.D. 8088]

## Income Taxes; Temporary Regulations Under Section 338, Stock Acquisitions, Statements of Elections and Due Dates

**AGENCY:** Internal Revenue Service, Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document contains temporary regulations primarily relating to section 338(g) of the Internal Revenue Code of 1954 ("Code") as added by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). The temporary regulations provide additional guidance to taxpayers concerning the filing of certain statements of election on or after December 9, 1985, and on or before July 15, 1986. An amendment to temporary regulation § 1.338-4T clarifies the application of the mitigation of limitations provisions.

The temporary regulations also extend the time for taking certain actions under section 338. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the proposed rules section of this issue of the **Federal Register.**

**DATES:** The temporary regulations under section 338(g) and the amendments to the temporary regulations generally are effective with respect to stock acquisitions made after August 31, 1982. New paragraph (m) of § 1.338-1T is effective only with respect to elections under section 338 filed on or after December 9, 1985, and on or before July 15, 1986.

**FOR FURTHER INFORMATION CONTACT:** Thomas J. Kane of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224 (Attention: CC:LR:T) or telephone 202-566-3458 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### Background

This document amends temporary regulations §§ 1.338-1T, 1.338-2T, 1.338-4T, 1.338-5T, and 1.338(h)(10)-1T in Part 1 of Title 26 of the Code of Federal Regulations ("CFR"). Section 1.338-1T was published as T.D. 7942 in the **Federal Register** on February 8, 1984 (49 FR 4722), and was amended and redesignated (as § 1.338-1T) by temporary regulations published as T.D. 7975 in the **Federal Register** on September 6, 1984 (49 FR 35086). Section 1.338-1T also was amended by temporary regulations published as T.D. 8021 in the **Federal Register** on April 25, 1985 (50 FR 16402). The temporary regulations published on April 25, 1985, also added § 1.338-4T. Sections 1.338-1T and 1.338-4T were amended by temporary regulations published as T.D. 8068 in the **Federal Register** on January 8, 1986, and by temporary regulations published as T.D. 8072 in the **Federal Register** on January 29, 1986. The temporary regulations published on January 8, 1986, also added § 1.338(h)(10)-1T. All these temporary regulations were further amended by temporary regulations published as T.D. 8074 published in the **Federal Register** on February 12, 1986, which also added § 1.338-5T. The temporary regulations amended by this document will remain in effect until superseded by later temporary or final regulations relating to these matters.

The amendments made by this document are primarily under section 338(g). That provision was originally added by section 224 of TEFRA (Pub. L. No. 97-248; 96 Stat. 485) and was amended by section 712(k) of the Tax Reform Act of 1984 (Pub. L. 98-369; 98 Stat. 946). Other amendments are briefly discussed at the end of this preamble.

### Operation of Section 338

*In General*

Section 338 generally provides that, if a corporation ("target") is acquired by another corporation ("purchasing corporation") in a qualified stock purchase, the purchasing corporation may elect (or may be deemed to elect under certain consistency rules) to have the target treated as if it: (1) Sold all of its assets (as "old target") at fair market value at the close of the day on which the qualified stock purchase occurred ("acquisition date") and (2) purchased those assets as a new corporation ("new target") at the beginning of the following day for an amount generally equal to the price paid by the purchasing corporation for target stock plus liabilities of target and other relevant items. Section 338 (a) and (b). The deemed sale of assets by old target generally is governed by the nonrecognition rule of section 337. In general, the tax attributes of old target are not available to new target. The net effect of a section 338 election is that the purchasing corporation obtains a basis in target assets that generally reflects the price it paid for target stock.

*Effect of Section 338 Election on Taxable Year*

Once a valid section 338 election has been made, old target's taxable year ends as of the close of business on the acquisition date. If the selling and purchasing groups each file separate returns (as opposed to consolidated returns) and the acquisition date occurs on a day other than the last day of target's regular taxable year, then the Federal income tax return (filed prior to making the section 338 election) for the relevant taxable year which includes the acquisition date should be amended and two separate amended returns should be filed as a result of the section 338 election. The first amended return would cover the portion of that relevant taxable year through the close of business on the acquisition date, which would include any additional Federal tax due because of target's deemed sale of assets under section 338. The second amended return would cover the balance of target's taxable year (relating

to target's operations) subsequent to the acquisition date.

The impact of a section 338 election on target's taxable year will be different if old target was a subsidiary in an affiliated group that filed a consolidated return for the period that included the acquisition date and an election under section 338(h)(10) is not made. In such case, the deemed sale will be the only transaction reported on old target's final return (called a "deemed sale return"). The Federal income tax consequences of target's operations through the close of business on the acquisition date shall continue to be reported on the selling group's consolidated return for the taxable period which included the acquisition date. Likewise, the Federal income tax consequences of target's operations for the remainder of target's regular taxable year shall continue to be reported either on the purchasing group's consolidated return or on a separate return for target if the purchaser was not included on a consolidated return.

**Explanation of Provisions**

These temporary regulations provide procedures in new paragraph (m) of § 1.338–1T for filing and for perfecting certain statements of election under section 338(g) for statements of election filed on or after December 9, 1985, and on or before July 15, 1986. The time for making such an election is extended by these regulations to the later of the 15th day of the ninth month beginning after the month in which the acquisition date occurs or July 15, 1986. See News Release IR–86–18, dated February 27, 1986.

For elections which do not require the filing of a deemed sale return, the procedures in new paragraph (m) condition the election on either filing consents which postpone the expiration of the statute of limitations or filing closing agreements which waive the expiration of the statute of limitations and extend the period for assessment. These new procedures are applicable for each relevant taxable year for which the statute of limitation of assessment has expired or will expire on or before November 15, 1986. A relevant taxable year is one for which a Federal income tax return was filed prior to filing the statement of section 338 election, but only if there would be an increase or decrease in Federal income tax as a result of the election. Additionally, new paragraph (m) conditions an effective section 338 election upon the filing of a closing agreement in situations where a deemed sale return must be filed as a result of the section 338 election. Standard language for these agreements is prescribed in this document for the convenience of both taxpayers and the Internal Revenue Service.

The procedures described in these regulations are required whether the tax for the period affected would be increased or decreased. Increased tax may arise, for example, by reasons of income or tax credit recapture caused by the deemed sale by old target and by tax attributes of old target not carrying over to new target. An example that results in a decrease in tax is higher depreciation or a similar deduction for new target that arises by reason of the deemed purchase under section 338 (a)(2) by new target of assets that had a tax basis in the hands of old target lower than new target's tax basis.

*Statute of Limitations*

As previously described, the section 338 election may create two taxable periods within a relevant taxable year which otherwise would be properly accounted for as a single taxable year before the statement of election was filed. If new target chooses the same taxable year that old target used, and if target had filed a tax return for the relevant taxable year which includes the acquisition date, the statute of limitations for any short period which may arise (as a consequence of the section 338 election) starts to run under new § 1.339–1T(m)(10) on the date on which target is considered to have filed under section 6501(b) its tax return for that relevant taxable year. For example, if target is a calendar year taxpayer and a qualified stock purchase of its stock is made on December 1, 1982, the statute of limitations for target's year ending December 1, 1982 (a short period which results from the section 338 election) would begin to run on the date target is considered to have filed its return for its taxable year ending December 31, 1982.

A deemed sale return cannot be filed prior to the filing of a section 338 election. Accordingly, the statute of limitations will not begin to run until the deemed sale return is filed. See section 6501(a) and section 6501(b)(1). The closing agreements required by new paragraph (m) of § 1.338–1T in these situations reflect this rule of law.

*Consents To Extend Statute of Limitations*

Section 1.338–1T (m) provides for procedures in circumstances when the statement of section 338 election is filed and the statute of limitations for a relevant taxable year of target, affected target, or corporate transferee expires after August 15, 1986, and on or before November 15, 1986. As a condition for making a section 338 election, the target, affected target, or corporate transferee is required to extend under section 6501(c)(4) the period for making an assessment for each such relevant taxable year until May 15, 1987. Unless such requirement is satisfied, the statement of section 338 election is ineffective unless such condition is waived by the District Director.

The extensions required by these regulations are necessary to ensure that taxpayers do not avoid the burdens of a section 338 election while retaining its benefits. The extensions will also have the effect of extending the period to file claim for refund. The extension date of May 15, 1987, was chosen to avoid requiring taxpayers to extend the period within which an assessment can be made for a period of less than 6 months and, for administrative convenience in order to provide a uniform date to which extensions would be made. The consent procedures in § 1.338–1T (m) apply only if the statute of limitations on assessment will not otherwise expire on or before August 15, 1986.

*Closing Agreements—No Deemed Sale Returns*

If for a relevant taxable year the statute of limitations has already expired or will expire on or before August 15, 1986, new paragraph (m) of § 1.338–1T also provides that an express election filed on or after December 9, 1985, and on or before July 15, 1986, is conditioned upon filing a closing agreement executed by target, affected target or corporate transferee wherein they: (1) Agree to waive the statute of limitations which has expired or is about to expire, (2) agree to file on or before November 3, 1986, amended returns which reflect the consequences of the deemed sale of assets under section 338(a) (1) and (3) agree to extend the statute of limitations for assessment of any additional tax due as a result of the deemed sale of assets until June 15, 1988. The election will be ineffective unless this condition is satisfied or is waived by the District Director.

It should be noted that even if each of the conditions for an effective election pursuant to this regulation are satisfied, certain adverse consequences may result in the event that an amended return reflecting the deemed sale is filed after July 15, 1986, and on or before November 3, 1986. Section 1.338–1T (h) of the existing temporary regulations generally permits waivers of certain additions to tax and time to act only if any required amended return is filed and certain other corrective action is taken on or before the last day for making an election under section 338.

Also, section 1.338–1T (f)(7) permits a new target to adopt on its first return a taxable year other than the one target used before making the section 338 election, but only if that first return is filed on or before the last day for making an express election under section 338.

Except in the event a section 338(h)(10) election is made, the statement of section 338 election will also be ineffective if the amended return described in any closing agreement is not filed on or before the time required by the agreement unless the District Director waives this additional requirement. If a selling group participates in a section 338(h)(10) election, the selling group must agree to file an amended consolidated return which reports the deemed sale gain. However, the section 338 election and the section 338(h)(10) election are not ineffective if the amended consolidated return is not filed. This rule protects target and its purchaser from an act of omission which is beyond their control.

Section 6401(a) provides that any amount of a payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto is an overpayment. By entering into a closing agreement which waives and extends the applicable statute of limitations, and tax reported, paid, and collected as a result of the deemed sale of assets is not an overpayment within the meaning of section 6401(a).

In general, the reasons for these closing agreement procedures are similar to the reasons previously explained in this document for the requirements for consents to extend the statute of limitations. The August 15, 1986, cut-off date for the expiration of the statute of limitations for closing agreements in those cases where a deemed sale return is not required was selected in order to allow the Internal Revenue Service a reasonable amount of time to process the required documents and affix the appropriate signatures and for purposes of taxpayer convenience.

**Closing Agreements—Deemed Sale Returns or Combined Deemed Sale Returns**

A closing agreement is also required if a deemed sale return must be filed as a result of a section 338 election. The closing agreement procedures require that a deemed sale return or a combined deemed sale return must be filed on or before November 3, 1986, and that the statute of limitations with respect to a deemed sale return or a combined deemed sale return will not terminate prior to the expiration of three years from the date a deemed sale return or combined deemed sale return is considered filed.

*Effective Date*

After December 6, 1985, the public was on notice that the Internal Revenue Service was going to consider the publication of rules dealing with "elections made in circumstances when the statute of limitations has expired or is about to expire for certain taxable years (such as might be the case for target's taxable year that includes the acquisition date)." See IRS News Release IR–85–115, December 9, 1985, was selected as the effective date for the procedures in new paragraph (m) because it was the first business day following the release of News Release IR–85–115.

*Elections for Which Perfection Is Required*

If a statement of section 338 election filed on or after December 9, 1985, and on or before July 15, 1986, does not meet the requirements in new paragraph (m)(2) of § 1.338–1T, which includes the filing of consents to extend the statute of limitations or certain closing agreements, then the election may be perfected by refiling in accordance with those requirements on or before July 15, 1986.

*District Director Discretion*

For a statement of section 338 election filed on or before July 15, 1986, the District Director (or his delegate) has discretion to waive any requirement in new paragraph (m)(2) of § 1.338–1T, including the requirement of filing any amended return as prescribed by closing agreement. This discretion is to be exercised in connection with the examination of any Federal income tax return which would be affected by a section 338 election and is to be exercised on the basis of all the relevant facts and circumstances.

*Mitigation*

In the absence of a section 338(h)(10) election, any tax due in any closed taxable year as the result of a section 338 election made after the close of such year may be collected through the operation of the mitigation provisions (sections 1311–1314). Section 1.338–4T (l)(5), added by this document, points out that old target and new target are the same "taxpayer" for purposes of the mitigation provisions. Although section 338(a)(2) treats target as a "new corporation" for the purpose of having "purchased all the assets" of old target "as of the beginning of the day after the acquisition date", the legislative history makes it clear that new target and old target may be regarded as the same taxpayer for purposes of carrying out the intent of the statute, *e.g.*, nonrecognition treatment for minority shareholders who retain their stock interest in target and the requirement that new target must report as income on its return any additional recapture income arising from an adjustment of the deemed sale price to old target due to an event or events occurring after old target files its final return. See H. Rep. No. 97–760 (Conf. Rep.), 97th Cong., 2d Sess. 537. The treatment of old target and new target as the same taxpayer is appropriate in view of the legislative history.

*Postponement of Due Date*

The temporary regulations extend the time for taking certain actions under section 338. Thus, in temporary regulations §§ 1.338–1T, 1.338–2T, 1.338–4T, 1.338–5T, and 1.338(h)(10)–1T, all references to "March 15, 1986" with respect to the time for making elections or taking certain other actions under section 338 will be changed to "July 15, 1986." However, references to "March 15, 1986" will not be amended where the applicability of certain rules depends on whether the acquisition date occurs after March 15, 1986.

**Regulatory Flexibility Act; Executive Order 12291; and Paperwork Reduction Act of 1980**

A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, these temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required. The collection of information contained in the regulations refer to requirements that have been submitted to the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1980, and have been approved by OMB (Control Number 1545–070).

**Drafting Information**

The principal author of these temporary regulations is Thomas J. Kane of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing

the regulations, both on matters of substance and style.

**List of Subjects in 26 CFR Part 1**

Income taxes, Corporations, Corporate distributions, Corporate adjustments, Reorganizations.

*Adoption of Amendments to the Regulations*

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—[AMENDED]**

**Paragraph 1.** The authority for Part 1 continues to read in part:

**Authority:** 26 U.S.C. 7805. * * * Sections 1.338–1T, 1.338–2T, 1.338–4T, 1.338–5T, and 1.338(h)(10)–1T also issued under 26 U.S.C. 338.

**Par. 2.** Section 1.338–1T is amended as follows:

1. Paragraph (c) is amended by—

a. Removing from the first sentence the word "March" and by adding in its place the word "July".

b. Adding a new sentence at the end of paragraph (c) to read as set forth below.

2. Paragraph (e) is amended by:

a. Removing, from each place it appears in paragraph (e)(1)(ii) (A) and (B), the word "March" and by adding in its place the word "July".

b. Removing, from paragraph (e)(2)(ii)(A), the word "March" and by adding in its place the word "July".

3. Paragraph (f)(7)(ii) is amended by removing the word "March" and by adding in its place the word "July".

4. Paragraph (h) is amended by:

a. Removing, from each place it appears in paragraph (h) (1) and (2), the word "March" and by adding in its place the word "July".

b. Removing, from each place it appears in *Example (1)* of paragraph (h)(4), the word "March" and by adding in its place the word "July".

c. Removing, from the third sentence of paragraph (h)(4) *Example (2),* the word "March" and by adding in its place the word"July".

5. Subparagraphs (2) and (4) of paragraph (j) are amended by removing, from each place it appears, the word "March" and by adding in its place the word "July".

6. Paragraph (k) is amended by—

a. Adding a new sentence at the end of paragraph (k)(1) to read as set forth below

b. Removing from each place it appears in subdivisions (iv) and (v) of paragraph (k)(7) the word "March" and by adding in its place the word "July".

7. Adding at the end thereof new paragraph (m) to read as set forth below.

**§ 1.338–1T Elections under section 338(g) of the Internal Revenue Code of 1954 (temporary).**

* * * * *

(c) *Time and manner of making election.* * * * For special rules applicable to certain statements of section 338 election filed on or after December 9, 1985, and on or before July 15, 1986, see paragraph (m) of this section.

* * * * *

(K) *Special rules for foreign corporations or DISCs*—(1) *Election by certain foreign purchasing corporations.* * * * However, the items required under paragraph (m) of this section to be filed by such a foreign purchasing corporation with the District Director shall be filed with the District Director of the Foreign Operations District (Attention: Chief of Examination), 1325 K Street N.W., Washington, D.C. 20225.

* * * * *

(m) *Statements of section 338 election filed on or after December 9, 1985, and on or before July 15, 1986*—(1) *General rule.* A statement of section 338 election filed on or after July 15, 1986, is not effective unless—

(i) It meets the applicable requirements prescribed in paragraph (m)(2) of this section when it is filed,

(ii) It is perfected by refiling in accordance with paragraph (m)(4)(ii) of this section, or

(iii) The District Director or his delegate waives, under paragraph (m)(13) of this section, the applicable requirements contained in paragraph (m)(2) of this section.

(2) *Applicable requirements.* The requirements of this subparagraph (2) are that—

(i) The statement of section 338 election meets the filing, documentation, and Form 872 requirements of paragraph (m)(4), (5), and (6) of this section for each relevant taxable year (within the meaning of paragraph (m)(3) of this section) for which the statute of limitations on making an assessment is considered under paragraph (m)(10) of this section to expire after August 15, 1986, and on or before November 15, 1986,

(ii) The statement of section 338 election meets the filing, documentation, and closing agreement requirements of paragraph (m)(4), (5), and (7) of this section for each relevant taxable year (within the meaning of paragraph (m)(3) of this section) for which the statute of limitations on making assessment is considered under paragraph (m)(10) of this section to expire on or before August 15, 1986, and

(iii) The statement of section 338 election meets the filing and closing agreement requirements of paragraph (m)(4) and (7)(v) of this section if a deemed sale return is required to be filed and the acquisition date occurred on or before November 15, 1983.

(3) *Relevant taxable year.* For purposes of this paragraph (m), a taxable year is relevant if it is one for which a Federal income tax return was filed prior to filing the statement of section 338 election, but only if it is also—

(i) A taxable year of target (or an affected target) which includes its acquisition date, or

(ii) Any subsequent taxable year of target (or an affected target) or an affected taxable year of an affected corporation (within the meaning of paragraph (m)(12) of this section).

(4) *Filing procedures*—(i) *In general.* The statement of section 338 election and any documents, Forms 872, and closing agreements to which paragraph (m)(2) of this section applies shall all be filed in one envelope with the District Director (Attention: Chief of Examination) for the internal revenue district where original target had its principal place of business or where it principal office or agency was located on the acquisition date.

(ii) *Perfection rule.* A statement of section 338 election filed on or after December 9, 1985, and on or before July 15, 1986, that does not comply with the applicable procedures prescribed in paragraph (m)(2) of this section is perfected by refiling in accordance with those procedures the statement of election on or before July 15, 1986, along with a copy of the previously filed statement of election.

(5) *Documents required under paragraph (m)(2) of this section.* The documents required by this subparagraph (5) for each relevant taxable year are—

(i) A photocopy of the face page of the income tax return (and of any amended return or returns) filed for the taxable year, and

(ii) A photocopy of any extension, consent, or other document previously entered into or filed which extended the statute of limitations on assessment for the year.

(6) *Contents of Form 872*—(i) *In general.* For purposes of paragraph (m)(2)(i) of this section, for each relevant taxable year a Form 872 must be properly completed and executed in duplicate on behalf of each target or any affected corporation and must agree to

extend until May 15, 1987, the period for making an assessment with respect to any tax due as a result of the deemed sale under section 338(a)(1) by the target. A photocopy of Form 872 (including one on white paper) may be used instead of a copy supplied by the Internal Revenue Service.

(ii) *Restrictive language*—(A) *General language.* The following restrictive language shall be inserted as numbered paragraph (4) on the face page of any Form 872 to which this subparagraph (6) applies: "THIS CONSENT AND AGREEMENT IS LIMITED TO ANY FEDERAL TAX DUE FROM TAXPAYER (INCLUDING ACCRUED INTEREST THEREON) AS A RESULT OF THE DEEMED SALE OF ASSETS UNDER SECTION 338(a)(1) OF THE INTERNAL REVENUE CODE BY TAXPAYER" [if taxpayer is not the target, substitute name of target instead of last word].

(B) *Year which includes the acquisition date.* If the relevant taxable year of target includes the acquisition date, the Form 872 for that relevant taxable year shall contain the following language inserted as numbered paragraph (5): "THIS CONSENT AND AGREEMENT COVERS THE ENTIRE PERIOD ENDING ON THE DATE SET FORTH IN PARAGRAPH (1) OF THIS AGREEMENT, AS WELL AS ALL SHORT PERIODS WHICH RESULT AS A CONSEQUENCE OF THE SECTION 338 ELECTION AND WHICH END WITH OR WITHIN THAT ENTIRE PERIOD".

(7) *Closing agreement*—(i) *In general.* For purposes of paragraph (m)(2) (ii) and (iii) of this section, a separate closing agreement under section 7121 shall be submitted on Form 906 and must be properly completed and executed on behalf of each target or any affected corporation. For guidelines on preparation of closing agreements, see Rev. Proc. 68–16, 1968–1 C.B. 770. A photocopy of Form 906 (including one on white paper) may be used instead of a copy supplied by the Internal Revenue Service. In addition, a separate closing agreement under the provisions of paragraph (m)(2)(ii) of this section must be executed in triplicate for each relevant taxable year and contain the applicable language prescribed in paragraph (m)(7) (ii), (iii), and (iv) of this section. For special rules for applying the provisions of paragraph (m)(2)(iii) of this section with respect to a deemed sale return or a combined deemed sale return, see paragraph (m)(7)(v) of this section.

(ii) *Waiver of statute of limitations*—(A) *In general.* Each closing agreement required by paragraph (m)(2)(ii) of this section must contain an express waiver of the statute of limitations on assessment (under section 6501(a)) and credit (under section 6402(a)) with respect to any Federal tax (including accrued interest thereon) required to be reported on any return or claim for refund for the relevant taxable year of the taxpayer, using the following language: "TAXPAYER AND COMMISSIONER AGREE TO WAIVE THE STATUTE OF LIMITATIONS FOR ASSESSMENT AND CREDIT WHICH (HAS EXPIRED or WILL EXPIRE) ON [insert expiration date] FOR ANY FEDERAL TAX DUE OR REFUNDABLE (INCLUDING ACCRUED INTEREST THEREON) AS A RESULT OF THE DEEMED SALE OF ASSETS UNDER SECTION 338(a)(1) OF THE INTERNAL REVENUE CODE BY TAXPAYER" [if taxpayer is not the target, substitute name of target instead of last word].

(B) *Year which includes the acquisition date.* If the relevant taxable year is a taxable year of target which includes the acquisition date, the closing agreement for that relevant taxable year shall contain the following language in addition to the language contained in subdivision (m)(7)(ii)(A) of this section: "TAXPAYER ACKNOWLEDGES THAT THIS CLOSING AGREEMENT COVERS THE ENTIRE PERIOD DESCRIBED IN THE PRECEDING SENTENCE, AS WELL AS ALL SHORT PERIODS WHICH RESULT AS A CONSEQUENCE OF THE SECTION 338 ELECTION AND WHICH END WITH OR WITHIN THAT ENTIRE PERIOD".

(iii) *Amended returns*—(A) *In general.* Each closing agreement must contain an express agreement on behalf of the taxpayer to file an amended Federal income tax return or returns on or before November 3, 1986, for each relevant taxable year, and an acknowledgement that the statement of section 338 election will not be effective in the event of a failure to timely file any such amended return, unless the requirement of filing an amended return is waived by the District Director or his delegate.

(B) *Relevant taxable year which includes acquisition date.* For the relevant taxable year which includes the acquisition date, the following language shall be inserted in the closing agreement: "FOR THE RELEVANT TAXABLE YEAR COVERED BY THIS CLOSING AGREEMENT, TAXPAYER AGREES TO FILE ON OR BEFORE NOVEMBER 3, 1986 (IF NOT ALREADY FILED), THE FOLLOWING FEDERAL INCOME TAX RETURNS[S]:(*1*) AN AMENDED RETURN AS OLD TARGET'S FINAL RETURN, AND (*2*) AN AMENDED RETURN FOR NEW TARGET'S FIRST TAXABLE YEAR ENDING ON [insert date]. TAXPAYER ACKNOWLEDGES THAT A STATEMENT OF ELECTION UNDER SECTION 338 WILL NOT BE EFFECTIVE IF THE FEDERAL INCOME TAX RETURN(S) COVERED BY THIS CLOSING AGREEMENT (IS) (ARE) NOT FILED ON A TIMELY BASIS, UNLESS SUCH REQUIREMENT IS WAIVED IN WRITING BY THE DISTRICT DIRECTOR OR HIS DELEGATE." If the acquisition date occurs on the last day of target's relevant taxable year or if new target does not have a taxable year that terminates within the relevant taxable year, then the language in (*2*) of this subdivision (B) shall be omitted. If new target has more than one taxable year ending within the relevant taxable year covered by a closing agreement governed by this subdivision (B), then appropriate language referring to the amended returns for those years shall be added to the closing agreement, using the format set forth in this subdivision (B).

(C) *Other relevant taxable years.* For a relevant taxable year which does not include the acquisition date, the following language shall be inserted in the closing agreement. "TAXPAYER AGREES TO FILE AN AMENDED FEDERAL INCOME TAX RETURN ON OR BEFORE NOVEMBER 3, 1986, FOR THE RELEVANT TAXABLE YEAR COVERED BY THIS CLOSING AGREEMENT. TAXPAYER ACKNOWLEDGES THAT A STATEMENT OF ELECTION UNDER SECTION 338 WILL NOT BE EFFECTIVE IF ANY FEDERAL INCOME TAX RETURN COVERED BY THIS CLOSING AGREEMENT IS NOT FILED ON OR BEFORE NOVEMBER 3, 1986, UNLESS SUCH REQUIREMENT IS WAIVED IN WRITING BY THE DISTRICT DIRECTOR OR HIS DELEGATE."

(D) *Section 338(h)(10) election.* The second quoted sentence in subdivision (iii) (B) and (C) of this paragraph (m)(7) shall be omitted from any closing agreement for a relevant taxable year of a selling group referred to in paragraph (m)(11)(ii)(A) of this section (relating to section 338(h)(10) election).

(E) *Waiver of certain additions to tax and time to act.* See § 1.338–1T(h) for rules applicable to the waiver of certain additons to tax and time to act.

(iv) *Consent to extend expiration date.* Each closing agreement must contain an express consent to extend until June 15, 1988, the period for further assessment (under section 6501(a)) or credit (under section 6402(a)) of any tax due or refundable (including accrued interest

thereon) for any relevant taxable year resulting from the deemed sale under section 338(a)(1), using the following language: "TAXPAYER AND COMMISSIONER AGREE TO EXTEND UNTIL JUNE 15, 1988, THE PERIOD FOR MAKING ANY FURTHER ASSESSMENT OR CLAIMING ANY CREDIT OF ANY FEDERAL TAX DUE OR REFUNDABLE (INCLUDING ACCURED INTEREST THEREON) AS A RESULT OF THE DEEMED SALE OF ASSETS UNDER SECTION 338(a)(1) BY TAXPAYER" [If taxpayer is not the target, substitute name of target instead of last word].

(v) *Special rule for deemed sale return or combined deemed sale return*—(A) *In general.* For purposes of paragraph (m)(2)(iii) of this section, if a target is required to file a deemed sale return (as defined in paragraph (f)(3)(i) of this section), then a separate closing agreement with respect to that deemed sale return must be filed in triplicate in order to make an effective election under section 338. The closing agreement shall contain the following language: "TAXPAYER AGREES TO FILE ON OR BEFORE NOVEMBER 3, 1986 (IF NOT ALREADY FILED), A DEEMED SALE RETURN REFLECTING THE CONSEQUENCES OF THE DEEMED SALE OF ASSETS BY TAXPAYER [if taxpayer is not the target, substitute the name of target instead of last word] UNDER SECTION 338. TAXPAYER ACKNOWLEDGES THAT A STATEMENT OF ELECTION UNDER SECTION 338 WILL NOT BE EFFECTIVE IF THE DEEMED SALE RETURN IS NOT FILED ON A TIMELY BASIS, UNLESS SUCH REQUIREMENT IS WAIVED IN WRITING BY THE DISTRICT DIRECTOR OR HIS DELEGATE. TAXPAYER FURTHER AGREES THAT THE STATUTE OF LIMITATIONS ON ASSESSMENT FOR ANY FEDERAL TAX DUE AS A RESULT OF THE DEEMED SALE OF ASSETS BY TAXPAYER [if taxpayer is not the target, substitute the name of target instead of last word] UNDER SECTION 338 WILL NOT TERMINATE PRIOR TO THE EXPIRATION OF THREE YEARS FROM THE DATE THE DEEMED SALE RETURN IS ACTUALLY FILED."

(B) *Combined deemed sale return.* All targets which are eligible to file a combined deemed sale return (as defined in section 338(h)(15) and § 1.338–4T(k)(6)) may join together in a combined deemed sale closing agreement, instead of filing a separate closing agreement for each target under paragraph (m)(7)(v)(A) of this section. If a combined deemed sale closing agreement is filed, then a combined deemed sale return must be filed. The combined deemed sale closing agreement shall contain the language prescribed in paragraph (m)(7)(v)(A) of this section, except that the words "COMBINED DEEMED SALE RETURN" shall be substituted for "DEEMED SALE RETURN," the word "TAXPAYER" shall be expressed in the singular or plural (as the case may be), and each target's name shall be inserted in place of "TAXPAYER", if appropriate. A list containing the name, address, and employer identification number of each target which is joining in the combined deemed sale closing agreement shall be included in the text of the combined deemed sale closing agreement. If the targets included in the combined deemed sale closing agreement constitute a single affiliated group within the meaning of section 1504(a), the combined deemed sale closing agreement shall be signed by an officer of the common parent of that group. Otherwise, the combined deemed sale closing agreement must be signed by an officer of each target included in the combined deemed sale closing agreement.

(8) *Execution of Form 872 or Form 906*—(i) *On behalf of Commissioner.* Any Form 872 or Form 906 properly submitted pursuant to the requirements in this paragraph (m) will be executed on behalf of the Commissioner of Internal Revenue and an executed copy of each Form 872 and each Form 906 will be returned to the originating party.

(ii) *On behalf of target.* If target was included on a consolidated return filed by the purchasing group for a relevant taxable year, the common parent of the purchasing group shall be the proper party to execute any Form 872 or Form 906 required by this paragraph (m) for that year. See § 1.1502–77(a).

(9) *Exceptions.* This paragraph (m) shall not apply—

(i) If the statement of section 338 election has been filed before December 9, 1985, or after July 15, 1986,

(ii) If there is no relevant taxable year of a target, affected target, or affected corporation for which the statute of limitations expires on or before November 15, 1986,

(iii) With respect to the taxable year of a selling group that files a consolidated return for the period that includes the acquisition date, if the binding contract rule in paragraph (l) of this section applies, or

(iv) With respect to the taxable year of a person that includes the acquisition date of a target, if (A) the target is a DISC, a controlled foreign corporation, or a domestic corporation described in section 1248 (e) and (B) the person actually transfers the target stock (as distinguished from being treated under section 338(a)(1) as having sold it).

(10) *Statute of limitations on assessment*—(i) *General rule.* For purposes of applying this paragraph (m), the statute of limitations on assessment is considered to begin to run for a relevant taxable year, and any short period of target which may result as a consequence of a section 338 election that ends with or within that relevant taxable year, on the date target is considered under section 6501(b) to have filed its return for that relevant taxable year.

(ii) *Deemed sale return.* If old target's final return is a deemed sale return (within the meaning of paragraph (f)(3)(i) of this section) or a combined deemed sale return (within the meaning of section 338(h)(15)), then the period for assessment under section 6501 does not begin to run until such deemed sale return or combined deemed sale return is filed.

(11) *Section 338(h)(10)*—(i) *Scope.* This subparagraph (11) provides rules for applying this paragraph (m) as a condition for electing to report the consequences of old target's deemed sale of its assets under section 338(a)(1) on the selling group's consolidated return under section 338(h)(10).

(ii) *Application.* If this subparagraph (11) applies, then—

(A) A relevant taxable year under paragraph (m)(3) of this section is considered to include the period for which a consolidated return of the selling group is filed that includes the acquisition date.

(B) Any document executed or item submitted by the common parent of the selling group on behalf of that entire group with respect to that relevant taxable year is considered to be on behalf of old target (see § 1.1502–77(a)).

(12) *Affected taxable years of affected corporations.* For purposes of this paragraph (m)—

(i) *Affected taxable year.* A taxable year is affected by the section 338 election if Federal tax for that year is increased or decreased as a result of the section 338 election. For example, an affected taxable year may arise if target originally filed a return for a period which ended on or after the acquisition date and the deemed sale of assets results in additional Federal tax due from target for that period, or if consideration for stock included in a qualified stock purchase is contingent and receipt of that consideration subsequent to the acquisition date is

reported on new target's return under § 1.338 (b)–3T(h).

(ii) *Affected corporation.* An affected corporation is a corporation that has a basis in an asset transferred to it by a new target or another affected corporation that is determined in whole or in part by reference to the asset's basis in the hands of the transferor.

(13) *Discretion of the District Director*—(i) *General standard.* In exercising discretion to waive any of the requirements prescribed under this paragraph (m) for any statement of section 338 election or amended returns, the District Director or his delegate shall consider all of the relevant facts and circumstances.

(ii) *Time when discretion is exercised.* The discretion of the District Director or his delegate under this paragraph (m) can be exercised at any time in connection with the examination of any Federal income tax return which would be affected by a section 338 election.

(14) *Applicability of the mitigation provisions.* For application of the mitigation provisions contained in sections 1311–1314, see § 1.338–4T (l)(5).

(15) *Examples.* The provisions of this paragraph (m) may be illustrated by the following examples.

*Example (1).* (i) T is an unaffiliated corporation filing income tax returns on the basis of a fiscal year ending February 28. At the close of January 20, 1983, P acquires all of T's stock in a qualified stock purchase. P does not file consolidated returns. On May 15, 1983, T timely files an income tax return (without extensions) for its taxable year beginning on March 1, 1982, and ending February 28, 1983. On May 14, 1986, P files a statement of election under section 338 which (if effective) would cause T's taxable year ending on February 28, 1983, to be divided into two periods. The first period for "old T" ends on the close of the acquisition date (January 20, 1983), and the second period for "new T" begins the next day. For T's taxable year ending February 28, 1983, the statute of limitations expires on May 15, 1986. In order for the section 338 election to be effective, the statement of election must be filed in accordance with the requirements of paragraph (m)(2)(ii) of this section. Thus, for example, there must be filed with the election, in the form prescribed in paragraph (m)(7) of this section, a closing agreement for T's taxable year ending on February 28, 1983, for which T's return was filed on May 15, 1983, extending the time within which assessments can be made until June 15, 1988. This closing agreement will cover the two periods into which that taxable year has now been divided. Additionally, the closing agreement must provide that on or before November 3, 1986, T must file old target's final return for the taxable year ending on January 20, 1983, and an amended return for the taxable year ending on February 28, 1983. The section 338 election will be ineffective unless the closing agreement procedures are followed and T files on or before November 3, 1986, the required returns, unless the District Director, in his discretion, waives any failure by P or T to comply with these requirements. However, in order for the waiver provisions contained in paragraph (h) of this section to apply, the amended returns must be filed on or before the last day for making an election under section 338, *i.e.*, July 15, 1986.

(ii) T also timely filed an income tax return (without extensions) on May 15, 1984, for its taxable year beginning on March 1, 1983, and ending on February 29, 1984. Since the statute of limitations on assessment for the income tax return filed on May 15, 1984, expires on May 15, 1987, which is after November 15, 1986, the provisions contained in paragraph (m) of this section are not applicable with respect to that taxable year.

*Example (2).* Assume the same facts as in *Example (1)* except that P files the statement of election on April 1, 1986, and that filing does not comply with the requirements of paragraph (m)(2)(ii) of this section. On July 6, 1986, under paragraph (m)(1)(ii) of this section, P perfects the election by refiling the election in accordance with the requirements of paragraph (m) (2)(ii) and (4)(ii) of this section. As long as T timely files on or before November 3, 1986, the returns which relate to the periods covered by the closing agreement (*i.e.*, T's taxable years ending on January 20, 1983, and February 28, 1983), the section 338 election will be valid.

*Example (3).* Assume the same facts as in *Example (2)* except that P does not perfect the election. Under paragraph (m) (1)(iii) and (13) of this section, the election is ineffective unless the District Director waives the requirements of paragraph (m)(2) of this section.

*Example (4).* Assume the same facts as in *Example (2)* except that T does not timely file the returns covered by the closing agreement. The section 338 election is ineffective under paragraph (m)(13) of this section unless the District Director waives the timely filing requirement for the amended returns.

*Example (5).* Assume the same facts as in *Example (1)* Assume further that T owns all the stock of T1 and that T1 uses the same taxable year as T. For the election to be effective, P must also file a closing agreement for T1 and T1 must file on or before November 3, 1986, the returns for the periods covered by T1's closing agreement unless those requirements are waived by District Director.

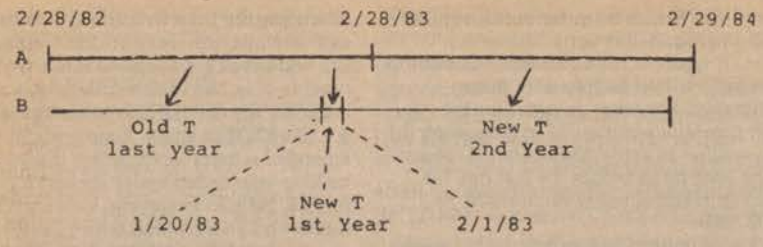
*Example (6).* Assume the same facts as in *Example (2)* except that T reports its income on the basis of a taxable year ending June 30. Assume further that on September 15, 1983, T timely filed an income tax return (without extensions) for its taxable year ending June 30, 1983, and that the statute of limitations for that year expires on September 15, 1986. In order for the section 338 election to be effective, the statement of election must be filed in accordance with the requirements of paragraph (m)(2)(i) of this section. Thus, for example, there must be filed with the election, in the form prescribed in paragraph (m)(6) of this section, a Form 872 for T's taxable year ending June 30, 1983, for which T's return was filed on September 15, 1983, extending the time within which assessments can be made until May 15, 1987. This Form 872 will cover both periods into which the taxable year has been divided. However, in order for the waiver provisions contained in § 1.338–1T(h) to apply, T must file the amended returns on or before the last day for making an election under section 338, *i.e.*, July 15, 1986. In any event, old target's final return and an amended return for the taxable year ending June 30, 1983, should be filed on or before May 15, 1987.

*Example (7).* Assume the same facts as in *Example (1)* except that T files its income tax returns on the basis of the calendar year and actually filed its returns for calendar year 1983 on March 3, 1984. No Form 872 or closing agreement is required for T's 1983 calendar year if the statute of limitations for that year expires after November 15, 1986. See paragraph (m)(1) and (9)(ii) of this section. The statute of limitations for new T's first taxable year and old T's period ending on the close of the acquisition date (January 20, 1983) did not start to run until the due date for T's 1983 return (March 15, 1984), and therefore cannot expire prior to March 15, 1987. See section 6501(b)(1) and paragraph (m)(10) of this section.

*Example (8).* (i) Assume the same facts as in *Example (1)* except that T, on its first tax return as new T filed on or before July 15, 1986, adopts a taxable year ending on January 31. The closing agreement referred to in *Example (1)* for the taxable year ending on February 28, 1983, will also operate to waive and extend the statute of limitations on assessment for new T's first taxable year which begins January 21, 1983, and ends on January 31, 1983. If T filed its first tax return as new T after July 15, 1986, it would not be permitted to adopt a taxable year different from the year T used before making the section 338 election. See paragraph (f)(7)(ii) of this section.

(ii) The tax consequences of new T's operations for the period that begins on February 1, 1983, and ends on February 28, 1983, will now have to be reported on an amended return which should be filed by new T for its second taxable year which begins on February 1, 1983, and ends on January 31, 1984. The statute of limitations on assessment for new T's second taxable year is controlled by the due date of the return T originally filed (without regard to the section 338 election) on May 15, 1984, for its taxable year ending February 29, 1984, which includes the last day of new T's second taxable year (*i.e.*, January 31, 1984). Because the statute of limitations on assessment for the taxable year ending on February 29, 1984, does not expire until May 15, 1987, the provisions of paragraph (m) does not apply to new T's second taxable year.

(iii) The results of this example may be summarized with time lines. Line A represents taxable years of T for which returns were filed prior to the time that a section 338 statement of election was filed. Line B represents taxable years of old T and new T reflecting such election. Arrows show dates on Line A when T's tax returns were filed, which started the statute of limitations running for the taxable periods shown on Line B.




*Example (9).* Assume the same facts as in *Example (1)* except that T, on its first tax return as new T filed on or before July 15, 1986, adopts a taxable year ending on April 30. The closing agreement referred to in *Example (1)* for the taxable year ending on February 28, 1983, will waive and extend the statute of limitations on assessment only for old T's taxable year ending on January 20, 1983. The tax consequences of new T's operations for new T's taxable year which begins on January 20, 1983, and ends on April 30, 1983, will have to be reported on an amended return filed for that period. The statute of limitations on assessment for new T's first taxable year is controlled by the due date of the return T originally filed (without regard to the section 338 election) on May 15, 1984, for its taxable year ending February 29, 1984, which includes the last day of new T's first taxable year, (*i.e.*, April 30, 1983). Because the statute of limitations on assessment for the taxable year ending on February 29, 1984, does not expire until May 15, 1987, the provisions of paragraph (m) do not apply to new T's first taxable year.

*Example (10).* All of T's stock is owned by S, which is included in a consolidated return that is filed for the S group on the basis of a fiscal year ending January 31. At the close November 15, 1982, P acquired all of T's stock in a qualified stock purchase. P is the common parent of an affiliated group that files consolidated returns on the basis of a calendar year. On July 1, 1986, P files a statement of election under section 338 for T. As a result of the acquisition, the results of T's operations through the close of business on November 15, 1982, was originally reported on the consolidated return for the S group which was timely filed on April 15, 1983. The results of T's operations from November 16, 1982, through December 31, 1982, were originally reported on the consolidated return for the P group, which was timely filed on March 15, 1983. Because T must file a deemed sale return (within the meaning of paragraph (f)(3)(i) of this section) and the acquisition date occurred on or before November 15, 1983, in order for the section 338 election to be effective, the closing agreement and other procedures required by paragraph (m)(2)(iii) and (7)(v) of this section must be followed and the deemed sale return must be filed on or before November 3, 1983, unless those requirements are waived by the District Director.

**Par. 3.** Section 1.338–2T is amended by removing, from each place they appear in *Example (1)* and *Example (2)* of paragraph (j), the words "August 23, 1985" and by adding in their place the words "July 15, 1986".

**Par. 4.** Section 1.338–4T is amended as follows:

1. Paragraph (a)(3) is amended by adding immediately after item (l)(4) a new item (l)(5) to read as follows: "(5) Application of mitigation provisions."

2. Paragraph (a)(4) is amended by adding in the second table immediately after the line "1248 (e) . . . (b)(6)" the following new line: "1311 . . . (l)(5)".

3. Paragraph (l) is amended by adding at the end thereof new subparagraph (5) to read as set forth below.

4. Paragraph (f)(6) (iv) Answer (i)(C)(l) is amended by removing the word "March" and by adding in its place the word "July".

5. Paragraph (j)(2) Answer 5(i) is amended by removing from the third sentence the word "March" and by adding in its place the word "July".

**§ 1.338–4T Questions and answers relating to miscellaneous issues under section 338 (temporary).**

* * * * *

(l) *Miscellaneous matters affecting new T.* * * *

* * * * *

(5) *Application of mitigation provisions.*

*Question:* For purposes of applying sections 1311–1314 (relating to the mitigation of the effect of limitations), in the absence of a section 338(h)(10) election, are old T and new T to be treated as being the same taxpayer?

*Answer:* Yes.

**Par. 5.** Section 1.338–5T is amended as follows:

1. Paragraph (a)(2) is amended by removing from the outline of topics at both (j)(8) (ii) and (iii) the word "March" and by adding in both places the word "July".

2. Paragraph (c)(2)(v)(C) is amended by removing, from each place it appears, the word "March" and by adding in its place the word "July".

3. Subdivisions (ii) and (iii) of paragraph (j)(8) are each amended by removing from the heading and from the text the word "March" and by adding in both places in each such subdivision the word "July".

**Par. 6.** Section 1.338(h)(10)–1T(d) is amended by—

1. Removing, from each place it appears in subparagraph (7) (i) and (ii), the word "March" and by adding in its place the word "July".

2. Adding at the end thereof new subparagraph (9) to read as follows:

**§ 1.338(h)(10)–1T Elective recognition by selling consolidated group of deemed sale gain or loss on target's assets (temporary).**

* * * * *

(d) *Time and manner of making section 338(h)(10) election.* * * *

(9) *Special rules.* See § 1.338–1T(m)(11) for special rules applicable to certain statements of section 338 election filed on or after December 9, 1985, and on or before July 15, 1986.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

**Roscoe L. Egger, Jr.,**

*Commissioner of Internal Revenue.*

Approved: May 6, 1986.

**J. Roger Mentz,**

*Assistant Secretary of the Treasury.*

[FR Doc. 86–10998 Filed 5–15–86; 8:45 am]

BILLING CODE 4830–01–M

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**26 CFR Parts 1, 7, and 602**

**[T.D. 8087]**

## Income Taxes; Transfers of Property by U.S. Persons to Foreign Corporations

**AGENCY:** Internal Revenue Service, Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document provides temporary Income Tax Regulations relating to transfers of property by U.S. persons to foreign corporations. These regulations affect U.S. persons that transfer property to foreign corporations pursuant to the corporate organization, reorganization, or liquidation provisions of the Internal Revenue Code. They provide the public with guidance necessary to comply with the Tax Reform Act of 1984. In addition, the text of the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in

the proposed rules section of today's Federal Register.

**DATES:** These temporary regulations are generally applicable for transfers made after December 31, 1984, and are effective June 16, 1986.

**FOR FURTHER INFORMATION CONTACT:** Charles W. Culmer, of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C. 20224, Attention: CC:LR:T (202–566–4336, not a toll-free call).

**SUPPLEMENTARY INFORMATION:**

## Background

This document contains temporary Income Tax Regulations (26 CFR Part 1) under section 367 of the Internal Revenue Code of 1954, as amended by section 131 of the Tax Reform Act of 1984 (98 Stat. 662). The temporary regulations are issued under the authority contained in sections 367 (26 U.S.C. 367) and 7805 (26 U.S.C. 7805) of the Internal Revenue Code of 1954.

## Discussion

### *Statutory Provisions*

The Tax Reform Act of 1984 substantially revised the rules that apply under section 367 to transfers of property by U.S. persons to foreign corporations. Section 367(a) now provides generally that a foreign corporation will not be considered to be a corporation, for purposes of applying the corporate organization, reorganization, and liquidation rules to a U.S. person's transfer of property to the foreign corporation. Thus, transfers of property to foreign corporations will generally be treated as taxable exchanges. However, an exception is provided for transfers of property that will be used in the active conduct of a trade or business outside of the United States. Such transfers may be made tax-free. On the other hand, certain types of property are specified that may not be transferred free of tax, even if they are to be used in the active conduct of a trade or business. In addition, a special rule requires the recapture of previously deducted losses of a foreign branch, when the branch is transferred to a foreign corporation. New section 367(d) applies a special rule to certain transfers of intangible property to foreign corporations, requiring the U.S. transferor to recognize a U.S.-source deemed payment for the transferred property annually over the useful life of the property. Finally, new section 367(e) provides that liquidating distributions by domestic corporations under section 336 will be taxable under rules similar to those of section 367(a).

### *Need for Temporary Regulations*

The effective date of the amendments to section 367 is January 1, 1985. The proper application of the section is dependent upon the Service's detailed specification by regulations of the manner in which the general requirements of the statute will be administered. Without this specification, taxpayers will be unable to make transfers to related foreign corporations with certainty as to the U.S. income tax consequences of the transfer. Because of the need for immediate guidance in this regard, for both the public and employees of the Internal Revenue Service, the Service has found it to be impracticable to issue these temporary regulations either with notice and public procedure under section 553(b) of Title 5 of the United States Code.

### *Description of Temporary Regulations*

Section 1.367(a)-1T provides general rules describing the transfers of property that are subject to section 367(a), and explaining the effect of the section upon those transfers. A gain-limitation rule is provided in § 1.367(a)-1T(b)(3), ensuring that the gain recognized under section 367(a) upon a transfer of appreciated property is not greater than the gain that would be recognized on a normal taxable exchange. Detailed rules are provided in § 1.367(a)-1T(c) concerning various transactions that are considered to include a transfer subject to section 367(a). Relevant definitions are provided in § 1.367(a)-1T(d). Section 1.367(a)-1T(e) contains effective date provisions.

Section 1.367(a)-2T provides rules concerning the exception from section 367(a) for transfers of property that will be used in the active conduct of a trade or business outside of the United States. Paragraph (b) of the section separately defines the concepts of "trade or business," "active conduct," and "outside of the United States." Each standard must be met for a transfer to qualify for the exception.

Section 1.367(a)-3T provides rules concerning transfers of stock or securities to a foreign corporation in an exchange described in section 367(a). Paragraph (b) specifies certain transfers of stock that are not subject to section 367(a). Paragraph (c) provides rules concerning transfers of stock of domestic corporations. Such transfers are generally taxable, but several exceptions are provided. Paragraph (d) provides rules concerning transfers of stock of foreign corporations. Again, such transfers are generally taxable, but several exceptions are provided. Paragraphs (e), (f), and (g) provide rules concerning the exceptions that are applicable under paragraphs (c) and (d). Under paragraph (e), a transfer of stock is not subject to section 367(a) if the transfer is for use in the active conduct of a trade or business, as defined in that paragraph. Paragraph (f) provides that a transfer is not subject to section 367(a) if the U.S. transferors of the stock obtain a limited interest in the transferee foreign corporation. Under paragraph (g), a transfer of stock is not subject to section 367(a) if the U.S. transferor agrees to recognize gain upon any subsequent disposition of the stock by the transferee foreign corporation. Finally, paragraph (h) sets forth two anti-abuse rules.

Section 1.367(a)-4T contains a series of special rules concerning the treatment of certain specified transfers of property. Paragraph (b) addresses transfers of depreciated property previously used in the United States, while paragraph (c) concerns property that will be leased by the transferee. Paragraph (d) concerns property to be sold by the transferee. Paragraph (e) specifies the circumstances in which oil and gas working interests will be considered to have been transferred for use in the active conduct of a trade or business. Paragraphs (f) and (g) provide exceptions from section 367(a) for transfers that are required by foreign governments and for transfers to FSCs.

Section 1.367(a)–5T provides rules concerning transfers of property that are subject to taxation by reason of section 367(a) regardless of whether the property will be used in the active conduct of a trade or business. These rules apply to transfers of inventory, installment obligations, foreign currency, intangible property, and leased property.

Section 1.367(a)–6T provides special rules relating to the incorporation of a foreign branch with previously deducted losses. Paragraph (b) provides generally that such losses must be recaptured by recognizing the gain realized on the transfer of the branch's assets. Paragraph (c) specifies the character of, and limitations on, the gain required to be recognized, while paragraphs (d) and (e) provide for adjustments to the amount of losses subject to recapture. Paragraph (f) provides an example. Finally, paragraph (g) defines the term "foreign branch."

Section 1.367(d)–1T provides rules under section 367(d) concerning transfers of intangible property by U.S. persons to foreign corporations. Paragraph (b) specifies the transfers that are subject to section 367(d), while

paragraph (c) provides rules concerning the consequences of such a transfer. In general, the U.S. transferor will be treated as receiving payments contingent on productivity or use of the transferred property, over the useful life of the property (regardless of whether such payments are in fact made by the transferee). Under a special transitional rule contained in § 1.367(a)–1T (d)(3)(iv), certain foreign marketing intangibles developed by a foreign branch and transferred prior to May 16, 1986, will not be subject to the rules of section 367(d). Transfers of such marketing intangibles made on or after that date are subject to the section 367(d) rules. Paragraphs (d), (e), and (f) provide rules for cases in which there is a later direct or indirect disposition of the intangible property transferred. In general, deemed license payments will continue if a transfer is made to a related person, while gain must be recognized immediately if the transfer is to an unrelated person. Paragraph (g) provides several special rules, including a rule allowing appropriate adjustments where deemed payments under section 367(d) are not in fact received by the U.S. transferor of the intangible property, and a rule providing for a limited election to treat certain transfers of intangible property as sales at fair market value (in lieu of applying the general useful life-contingent payment rule). In addition, paragraph (g) provides rules coordinating the application of section 367(d) with other relevant Code sections. Finally, paragraph (h) defines the term "related person" for purposes of section 367(d).

Section 1.6038B–1T provides rules concerning the information that is required to be reported under section 6038B with respect to transfers of property to foreign corporations. Paragraph (b) of the section explains when and how to report under section 6038B. Paragraphs (c) and (d) specify the information that is required to be reported with respect to transfers of property described in section 367 (a) and (d), respectively. Paragraph (e) is reserved to specify the information required to be reported with respect to transfers subject to section 367(e). Finally, paragraph (f) sets forth the consequences of a failure to comply with the requirements of section 6038B.

The temporary regulations do not provide rules concerning new section 367(e). When such regulations are issued, they will apply only on a prospective basis. The temporary regulations do, however, describe the situations in which section 367(a) will apply to corporate liquidations under section 332.

**Nonapplicability of Executive Order 12291**

The Treasury Department has determined that these temporary regulations are not subject to Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

**Regulatory Flexibility Act**

A general notice of proposed rulemaking is not required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply and no Regulatory Flexibility Analysis is required for this rule.

**Paperwork Reduction Act**

These regulations were submitted to The Office of Management and Budget for review under the Paperwork Reduction Act and approved under OMB number 1545–0026.

**Drafting Information**

The principal authors of these regulations are Charles W. Culmer of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, and Robert E. Culbertson, Jr., of the Office of the Associate Chief Counsel (International), Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations.

**List of Subjects**

*26 CFR 1.301–1–1.385–6*

Income taxes, Corporations, Corporate distributions, Corporate adjustments, Reorganizations.

*26 CFR 1.6001–1 Through 1.6109–2*

Income taxes, Administrative practice and procedure, Filing requirements.

*26 CFR Part 7*

Income taxes, Tax Reform Act of 1976.

*26 CFR Part 602*

Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

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

**Income Tax Regulations**

**Paragraph 1.** The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Sections 1.367(a)–1T through 1.367(a)–7T also issued under 26 U.S.C 367(a). Section 1.367(d)–1T also issued under 26 U.S.C 367(d). Section 1.6038B–1T also issued under 26 U.S.C 6038B.

**§ 1.367(a)–1 [Removed]**

Par. 2. Section 1.367(a)–1 is removed.

**§ 1.367(a)–4T [Redesignated as § 1.367(a)–7T]**

Par. 3. Section 1.367(a)–4T is redesignated as § 1.367(a)–7T.

Par. 4. Sections 1.367(a)–1T through 1.367(a)–6T are added immediately after § 1.362–2, to read as follows:

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

(a) *Purpose and scope of regulations.* These regulations set forth rules relating to the provisions of section 367(a) concerning certain transfers of property to foreign corportions. This § 1.367(a)–1T provides general rules explaining the effect of section 367(a)(1) and describing the transfers of property that are subject to the rule of that section. Section 1.367(a)–2T provides rules concerning the exception from the rule of section 367(a)(1) for transfers of property to be used in the active conduct of a trade or business outside of the United States. Rules concerning the application of section 367(a)(1) to transfers of stock or securities are provided in § 1.367(a)–3T, while § 1.367(a)–4T provides special rules regarding other specified transfers of property. Section 1.367(a)–5T describes types of property that are subject to the rule of section 367(a)(1) regardless of whether they are transferred for use in a trade or business. Section 1.367(a)–6T provides rules concerning the application of section 367(a) to the transfer of a branch with previously deducted losses. Finally, § 1.367(a)–7T contains transitional rules concerning transfers of intangible property to foreign corporations made after June 6, 1984 and before January 1, 1985. Rules explaining the operation of section 367(d), concerning transfers of intangible property pursuant to an exchange described in section 351 or 361, are provided in § 1.367(d)–1T. Rules concerning the reporting requirements of section 6038B are provided in § 1.6038B–1T.

(b) *General rules*—(1) *Foreign corporation not considered a corporation for purposes of certain transfers.* If a U.S. person transfers property to a foreign corporation in connection with an exchange described in section 332, 351, 354, 355, 356, or 361, then pursuant to section 367(a)(1) the foreign corporation shall not be considered to be a corporation for purposes of determining the extent to

which gain shall be recognized on the transfer. Section 367(a)(1) denies nonrecognition treatment only to transfers of items of property on which gain is realized. Thus, the amount of gain recognized because of section 367(a)(1) is unaffected by the transfer of items of property on which loss is realized (but not recognized). The transfers of property that are subject to section 367(a)(1) are further described in paragraph (c) of this section, and relevant definitions are provided in paragraph (d) of this section.

(2) *Cases in which foreign corporate status is not disregarded.* Section 367(a)(1) shall not apply, and a foreign corporate transferee shall, thus, be considered to be a corporation, in the case of any of the following:

(i) The transfer of stock or securities of a foreign corporation which is a party to the exchange or reorganization (as defined in section 368 (b));

(ii) The transfer of property for use in the active conduct of a trade or business outside of the United States in accordance with the rules of §§ 1.367(a)-2T through 1.367(a)-6T; or

(iii) Certain other transfers of property described in §§ 1.367(a)-2T through 1.367(a)-6T.

For the treatment of a transfer of stock or securities of a foreign corporation which is a party to the exchange or reorganization, see §§ 1.367(a)-3T(b)(1), 7.367(b)-4, and 7.367(b)-7.

(3) *Limitation of gain required to be recognized*—(i) *In general.* If a U.S. person transfers property to a foreign corporation in a transaction on which gain is required to be recognized under section 367(a) and regulations thereunder, then the gain required to be recognized by the U.S. person shall in no event exceed the gain that would have been recognized on a taxable sale of those items of property if sold individually and without offsetting individual losses against individual gains.

(ii) *Losses.* No loss may be recognized by reason of the operation of section 367.

(iii) *Ordinary income and capital gain.* If section 367(a) and regulations thereunder require the recognition of ordinary income and capital gain in excess of the limitation described in paragraph (b)(3)(i) of this section, then the limitation shall be imposed by making proportionate reductions in the amounts or ordinary income and capital gain, regardless of the character of the gain that would have been recognized on a taxable sale of the property.

(4) *Character, source, and adjustments*—(i) *In general.* If a U.S. person is required to recognize gain under section 367 upon a transfer of property to a foreign corporation, then—

(A) The character and source of such gain shall be determined as if the property had been disposed of in a taxable exchange with the transferee foreign corporation (unless otherwise provided by regulation); and

(B) Appropriate adjustments to earnings and profits, basis, and other affected items shall be made according to otherwise applicable rules, taking into account the gain recognized because of section 367(a)(1). Any increase in the basis of the property received by the foreign corporation resulting from the application of section 367(a) and section 362 (a) or (b) shall be allocated over the transferred property with respect to which gain is recognized in proportion to the amount realized by the U.S. person on the transfer of each item of that property. See paragraph (c)(3) of this section for special rules applicable to transfers of partnership interests.

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

*Example.* Domestic corporation DC transfers inventory with a fair market value of $1 million and adjusted basis of $800,000 to foreign corporation FC in an exchange for stock of FC that is described in section 351 (a). Title passes within the U.S. Pursuant to section 367(a), DC is required to recognize gain of $200,000 upon the transfer. Under the rule of this paragraph (b)(4), such gain shall be treated as ordinary income (sections 1201 and 1221) from sources within the U.S. (section 861) arising from a taxable exchange with FC. Appropriate adjustments to earnings and profits, basis, etc., shall be made as if the transfer were subject to section 351. Thus, for example, DC's basis in the FC stock received, and FC's basis in the transferred inventory, will each be increased by the $200,000 gain recognized by DC, pursuant to sections 358(a)(1) and 362(a), respectively.

(c) *Transfers described in section 367(a)(1)*—(1) *In general.* A transfer described in section 367(a)(1) is any transfer of property by a U.S. person to a foreign corporation pursuant to an exchange described in section 332, 351, 354, 355, 356, or 361. Section 367(a)(1) applies to such a transfer whether it is made directly, indirectly, or constructively. Indirect or constructive transfers that are described in section 367(a)(1) include the transfers described in subparagraphs (2) through (7) of this paragraph (c). See § 1.367(a)-3T(b)(1) for rules relating to the transfer of stock or securities of a foreign corporation that is a party to the exchange or the reorganization.

(2) *Indirect transfers in certain reorganizations*—(i) *Mergers described in section 368(a)(1)(A)*—(A) *In general.* A transfer in connection with a reorganization described in section 368(a)(1)(A) to which either section 368(a)(2) (D) or (E) applies may be an indirect transfer described in section 367(a)(1) if the reorganization involves the merger of two domestic corporations and if stock of a foreign corporation which controls one of such domestic corporations is exchanged in the reorganization. The transfers in connection with such a reorganization that are described in section 367(a)(1) are specified in subdivisions (B) and (C) of this paragraph (c)(2)(i). If a transfer in connection with such a reorganization is described in section 367(a)(1), then the rules of § 1.367(a)-3T shall apply to determine whether the U.S. transferor is required to recognize gain with respect to the transfer.

(B) *Mergers to which section 368(a)(2)(D) applies.* A U.S. shareholder of a domestic corporation shall be considered to make a transfer of stock that is described in section 367(a)(1) if—

(*1*) The domestic corporation transfers substantially all of its properties to another domestic corporation in connection with a reorganization described in section 368(a)(1)(A) to which section 368(a)(2)(D) applies; and

(*2*) The controlling corporation (within the meaning of section 368(a)(2)(D)) is a foreign corporation.

The indirect transfer of stock by the shareholder shall be subject to the provisions of § 1.367(a)-3T.

*Example.* F, a foreign corporation, owns all the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(A) to which section 368(a)(2)(D) applies, S acquires substantially all the properties of W, a domestic corporation, in a merger of W into S. The stock of F is used as consideration. The reorganization is considered to constitute a transfer of stock described in section 367(a)(1) by the shareholders of W that are U.S. persons.

(C) *Mergers described in section 368(a)(1)(A) to which section 368(a)(2)(E) applies.* A shareholder of a domestic corporation that is a U.S. person shall be considered to make a transfer of stock that is described in section 367(a)(1) if—

(*1*) The domestic corporation acquires substantially all of the properties of another domestic corporation in connection with a reorganization described in section 368(a)(1)(A) to which section 368(a)(2)(E) applies; and

(*2*) The controlling corporation (within the meaning of section 368(a)(2)(E)) is a foreign corporation.

The indirect transfer of stock by the shareholder shall be subject to the provisions of § 1.367(a)-3T.

(ii) *Reorganizations described in section 368(a)(1)(B).* If, in connection with a reorganization described in section 368(a)(1)(B), a U.S. person exchanges stock of a domestic corporation for voting stock of a foreign corporation that is in control (as defined in section 368(c)) of the domestic acquiring corporation, then that U.S. person is considered to make a transfer of stock that is subject to section 367(a)(1). The rule of this paragraph (c)(2)(ii) is illustrated by the following example.

*Example.* F, a foreign corporation, owns all the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(B), S acquires all the stock of domestic corporation Y, and the shareholders of Y receive voting stock of F. The reorganization includes an indirect stock transfer described in section 367(a)(1) by those shareholders of Y who are U.S. persons.

(iii) *Reorganization described in section 368(a)(1)(C).* A U.S. shareholder of a domestic corporation shall be considered to make a transfer of stock that is subject to section 367(a)(1) if—

(A) The domestic corporation transfers substantially all of its properties to another domestic corporation in connection with a reorganization described in section 368(a)(1)(C); and

(B) The domestic corporation receives voting stock in a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation (and distributes the stock to its shareholders in accordance with section 368(a)(2)(G)).

The rule of this paragraph (c)(2)(iii) is illustrated by the following example.

*Example.* F, a foreign corporation, owns all of the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(C), S acquires substantially all of the properties of Z, a domestic corporation, and Z receives voting stock of F (and distributes the stock to its shareholders). The reorganization is considered to include an indirect transfer of stock described in section 367(a)(1) by the shareholders of Z that are U.S. persons.

(3) *Indirect transfers involving partnerships and interests therein*—(i) *Transfer by partnership treated as transfer by partners*—(A) *In general.* If a partnership (whether foreign or domestic) transfers property to a foreign corporation in an exchange described in section 367(a)(1), then a U.S. person that is a partner in the partnership shall be treated as having transferred a proportionate share of the property in an exchange described in section 367(a)(1). A U.S. person's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder. The rule of this paragraph (c)(3)(i)(A) is illustrated by the following example.

*Example.* P is a partnership having five equal general partners, two of whom are United States persons. P transfers property to F, a foreign corporation, in connection with an exchange described in section 351. The exchange includes an indirect transfer of property by the partners to F. The transfers of property attributable to those partners who are United States persons, that is, 40 percent of each asset transferred to F, are transfers described in section 367(a)(1). The gain (if any) recognized on the transfer of 40 percent of each asset to F is attributable to the two partners who are United States persons.

(B) *Special adjustments to basis.* If a U.S. person is treated under the rule of this paragraph (c)(3)(i) as having transferred a proportionate share of the property of a partnership in an exchange described in section 367(a), and is therefore required to recognize gain upon the transfer, then—

(*1*) The U.S. person's basis in the partnership shall be increased by the amount of gain recognized by him;

(*2*) Solely for purposes of determining the basis of the partnership in the stock of the transferee foreign corporation, the U.S. person shall be treated as having newly acquired an interest in the partnership (for an amount equal to the gain recognized), permitting the partnership to make an optional adjustment to basis pursuant to sections 743 and 754; and

(*3*) The transferee foreign corporation's basis in the property acquired from the partnership shall be increased by the amount of gain recognized by U.S. persons under this paragraph (c)(3)(i).

(ii) *Transfer of partnership interest treated as transfer of proportionate share of assets*—(A) *In general.* If a U.S. person transfers an interest as a partner in a partnership (whether foreign or domestic) in an exchange described in section 367(a)(1), then that person shall be treated as having transferred a proportionate share of the property of the partnership in an exchange described in section 367(a)(1). Accordingly, the applicability of the exception to section 367(a)(1) provided in § 1.367(a)–2T shall be determined with reference to the property of the partnership rather than the partnership interest itself. A U.S. person's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

(B) *Special adjustments to basis.* If a U.S. person is treated under the rule of paragraph (c)(3)(ii)(A) of this section as having transferred a proportionate share of the property of a partnership in an exchange described in section 367(a), and is therefore required to recognize gain upon the transfer, then—

(*1*) The U.S. person's basis in the stock of the transferee foreign corporation shall be increased by the amount of gain so recognized by that person;

(*2*) The transferee foreign corporation's basis in the transferred partnership interest shall be increased by the amount of gain recognized by the U.S. person; and

(*3*) Solely for purposes of determining the partnership's basis in the property held by it, the U.S. person shall be treated as having newly acquired an interest in the partnership (for an amount equal to the gain recognized), permitting the partnership to make an optional adjustment to basis pursuant to sections 743 and 754.

(C) *Limited partnership interest.* The transfer by a U.S. person of an interest in a partnership shall not be subject to the rules of paragraph (c)(3)(ii) (A) and (B) if—

(*1*) The interest transferred is a limited partnership interest; and

(*2*) Such interest is regularly traded on an established securities market.

Instead, the transfer of such an interest shall be treated in the same manner as a transfer of stock or securities. Thus, the consequences of such a transfer shall be determined under the rules of § 1.367(a)–3T. For purposes of this section, a limited partnership interest is an interest as a limited partner in a partnership that is organized under the laws of any State of the United States or the District of Columbia. Whether such an interest is regularly traded on an established securities market shall be determined under the provisions of paragraph (c)(3)(ii)(D) of this section.

(D) *Regularly traded on an established securities market*—(*1*) *Established securities market.* For purposes of this paragraph (c)(3)(ii), an established securities market is—

(*i*) A national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 USC 78f);

(*ii*) A foreign national securities exchange which is officially recognized, sanctioned, or supervised by governmental authority; and

(*iii*) An over-the-counter market. An over-the-counter market is any market reflected by the existence of an inter-dealer quotation system. An inter-dealer quotation system is any system of general circulation to brokers and dealers which regularly disseminates

quotations of stock and securities by identified brokers or dealers, other than by quotation sheets which are prepared and distributed by a broker or dealer in the regular course of business and which contain only quotations of such broker or dealer.

(2) *Regularly traded.* A class of interests that is traded on an established securities market is considered to be regularly traded if it is regularly quoted by brokers or dealers making a market in such interests. A class of interests shall be presumed to be regularly traded if the entity has a total of 500 or more interest-holders.

(4) *Transfers by trusts and estates*—(i) *In general.* For purposes of section 367(a), a transfer of property by an estate or trust shall be treated as a transfer by the entity itself and not as an indirect transfer by its beneficiaries. Thus, a transfer of property by a foreign trust or estate (as defined in section 7701(a)(31)) is not described in section 367(a)(1), regardless of whether the beneficiaries of the trust or estate are U.S. persons. Similarly, a transfer of property by a domestic trust or estate may be described in section 367(a)(1), regardless of whether the beneficiaries of the trust or estate are foreign persons.

(ii) *Grantor trusts.* A transfer of a portion or all of the assets of a foreign or domestic trust to a foreign corporation in an exchange described in section 367(a)(1) is considered a transfer by any U.S. person who is treated as the owner of any such portion or all of the assets of the trust under sections 671 through 679.

(5) *Termination of election under section 1504(d).* Section 367(A) applies to the constructive reorganization and transfer of property from a domestic corporation to a foreign corporation that occurs upon the termination of an election under section 1504(d), which permits the treatment of certain contiguous country corporations as domestic corporations. The rule of this paragraph (c)(5) is illustrated by the following example.

*Example.* Domestic corporation Y previously made a valid election under section 1504(d) to have its wholly owned Canadian subsidiary, C, treated as a domestic corporation. On July, 1, 1986, C fails to continue to qualify for the election under section 1504 (d). A constructive reorganization described in section 368(a)(1)(D) occurs. The resulting constructive transfer of assests by "domestic" corporation C to Canadian corporation C upon the termination of the election is a transfer of property described in section 367(a)(1).

(6) *Changes in classification of an entity.* If a foreign entity is classified as an entity other than an association taxable as a corporation for United States tax purposes, and subsequently a change is made in the governing documents, articles, or agreements of the entity so that the entity is thereafter classified as an association taxable as a corporation, the change in classification is considered a transfer of property to a foreign corporation in connection with an exchange described in section 351. For purposes of section 367(a)(1), the transfer of property is considered as made by the persons determined under the rules set forth in paragraph (c)(3) of this section with respect to partnerships, and paragraph (c)(4) (i) or (ii), with respect to trusts and estates, and the rules of such paragraphs apply determining whether a transfer described in section 367(a)(1) has been made.

(7) *Contributions to capital.* For rules with respect tothe treatment of a contribution to the capital of a foreign corporation as a transfer described in section 367(a)(1), see section 367(c)(2) and the regulations thereunder.

(d) *Definitions.* The following definitions apply for purposes of this section and § 1.367(d)–1T.

(1) *United States person.* The term "United States person" includes those persons described in section 7701(a)(30). The term includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust other than a foreign estate or trust. (For definitions of these terms, see section 7701 and regulations thereunder.) For purposes of this section, an individual with respect to whom an election has been made under section 6013 (g) or (h) is considered to be a resident of the United States while such election is in effect. A nonresident alien or a foreign corporation will not be considered a United States person because of its actual or deemed conduct of a trade or business within the United States during a taxable year.

(2) *Foreign corporation.* The term "foreign corporation" has the meaning set forth in section 7701(a) (3) and (5) and § 301.7701–5.

(3) *Transfer.* For purposes of section 367 and regulations thereunder, the term "transfer" means any transaction that constitutes a transfer for purposes of sections 332, 351, 354, 355, 356, or 361, as applicable. A person's entering into a bona fide cost-sharing arrangement under § 1.482–2(d)(4) or acquiring rights to intangible property under such an arrangement shall not be considered a transfer of property described in section 367(a)(1). See § 1.6038B–1T(b)(3) for the date on which the transfer is considered to be made.

(4) *Property.* For purposes of section 367 and regulations thereunder, the term "property" means any item that constitutes property for purposes of sections 332, 351, 354, 355, 356, or 361, as applicable.

(5) *Intangible property*—(i) *In general.* For purposes of section 367 and regulations thereunder, the term "intangible property" means knowledge, rights, documents, and any other intangible item within the meaning of section 936(h)(3)(B) that constitutes property for purposes of sections 332, 351, 354, 355, 356, or 361, as applicable. Such property shall be treated as intangible property for purposes of section 367 (a) and (d) and the regulations thereunder without regard to whether it is used or developed in the United States or in a foreign country and without regard to whether it is used in manufacturing activities or in marketing activities. A working interest in oil and gas properties shall not be considered to be intangible property for purposes of section 367 and the regulations thereunder.

(ii) *Operating intangibles.* An operating intangible is any intangible property of a type not ordinarily licensed or otherwise transferred in transactions between unrelated parties for consideration contingent upon the licensee's or transferee's use of the property. Examples of operating intangibles may include long-term purchase or supply contracts, surveys, studies, and customer lists.

(iii) *Foreign goodwill or going concern value.* Foreign goodwill or going concern value is the residual value of a business operation conducted outside of the United States after all other tangible and intangible assets have been identified and valued. For purposes of section 367 and regulations thereunder the value of the right to use a corporate name in a foreign country shall be treated as foreign goodwill or going concern value.

(iv) *Transitional rule for certain marketing intangibles.* For transfers occurring after December 31, 1984, and before May 16, 1986, for foreign trademarks, tradenames, brandnames, and similar marketing intangibles developed by a foreign branch shall be treated as foreign goodwill or going concern value.

(e) *Effective date of certain section*—(1) *In general.* Except as specifically provided to the contrary elsewhere in these sections, §§ 1.367(a)–1T through 1.367(a)–6T apply to transfers occurring after December 31, 1984.

(2) *Private rulings.* The taxpayer may rely on a private ruling under section 367(a) received by him before June 16, 1986.

(3) *Certain indirect transfers.* Sections 1.367(a)–1T(c)(2) (i) and (iii) and 1.367(a)–1T(c)(3) apply to transfers made after June 16, 1986. For transfers made before that date, see 26 CFR § 1.367(a)–1(b) (revised as of April 1, 1986).

**§ 1.367(a)–2T Exception for transfers of property for use in the active conduct of a trade or business (temporary).**

(a) *In general.* Section 367(a)(1) shall not apply to property transferred to a foreign corporation if—

(1) Such property is transferred for use by that corporation in the active conduct of a trade or business outside of the United States; and

(2) The U.S. person that transfers the property complies with the reporting requirements of section 6038B and regulations thereunder.

Where these conditions are satisifed, the foreign corporate transferee of the property shall be considered to be a corporation for purposes of determining the extent to which gain or loss is required to be recognized upon the transfer pursuant to section 332, 351, 354 [reserved as to section 355 or so much of section 356 as relates to section 355], 356, or 361. Paragraph (b) of this section provides rules concerning the requirement that property be transferred for use in the active conduct of a trade or business outside of the United States, while paragraph (c) concerns the application of the requirement where the transferee itself re-transfers the property. In addition, § 1.367(a)–3T provides rules concerning the treatment of stock or securities transferred to a foreign corporation in an exchange described in section 367(a)(1), and § 1.367(a)–4T provides special rules concerning the treatment of other specified types of property. Finally, §§ 1.367(a)–5T and 1.367(a)–6T provide rules concerning certain transfers of property that are subject to section 367(a)(1) regardless of whether the property is used in the active conduct of a trade or business.

(b) *Active conduct of a trade or business outside the United States*—(1) *In general.* Property qualifies for the exception provided by this section if it is transferred to a foreign corporation for use in the active conduct of a trade or business outside of the United States. Therefore, to determine whether property is subject to the exception provided by this section, four factual determinations must be made:

(i) What is the trade or business of the transferee;

(ii) Do the activities of the transferee constitute the active conduct of that trade or business;

(iii) Is the trade or business conducted outside of the United States; and

(iv) Is the transferred property used or held for use in the trade or business?

Rules concerning these four determinations are provided in paragraphs (b) (2), (3), (4), and (5) of this section.

(2) *Trade or business.* Whether the activities of a foreign corporation constitute a trade or business must be determined under all the facts and circumstances. In general, a trade or business is a specific unified group of activities that constitute (or could constitute) an independent economic enterprise carried on for profit. For example, the activities of a foreign selling subsidiary could constitute a trade or business if they could be independently carried on for profit, even though the subsidiary acts exclusively on behalf of, and has operations fully integrated with, its parent corporation. To constitute a trade or business, a group of activities must ordinarily include every operation which forms a part of, or a step in, a process by which an enterprise may earn income or profit. In this regard, one or more of such activities may be carried on by independent contractors under the direct control of the foreign corporation. (However, see paragraph (b)(3) of this section.) The group of activities must ordinarily include the collection of income and the payment of expenses. If the activities of a foreign corporation do not constitute a trade or business, then the exception provided by this section does not apply, regardless of the level of activities carried on by the corporation. The following activities are not considered to constitute by themselves a trade or business for purposes of this section:

(i) Any activity giving rise to expenses that would be deductible only under section 212 if the activities were carried on by an individual; or

(ii) The holding for one's own account of investments in stock, securities, land, or other property, including casual sales thereof.

(3) *Active conduct.* Whether a trade or business is actively conducted must be determined under all the facts and circumstances. In general, a corporation actively conducts a trade or business only if the officers and employees of the corporation carry out substantial managerial and operational activities. A corporation may be engaged in the active conduct of a trade or business even though incidental activities of the trade or business are carried out on behalf of the corporation by independent contractors. In determining whether the officers and employees of the corporation carry out substantial managerial and operational activities, however, the activities of independent contractors shall be disregarded. On the other hand, the officers and employees of the corporation are considered to include the officers and employees of related entities who are made available to and supervised on a day-to-day basis by, and whose salaries are paid by (or reimbursed to the lending related entity by), the transferee foreign corporation. Whether a trade or business that produces rents or royalties is actively conducted shall be determined under the principles of § 1.954–2(d)(1) (but without regard to whether the rents or royalties are received from an unrelated person). The rule of this paragraph (b)(3) is illustrated by the following example.

*Example.* X, a domestic corporation, and Y, a foreign corporation not related to X, transfer property to Z, a newly formed foreign corporation organized for the purpose of combining the research activities of X and Y. Z contracts all of its operational and research activities to Y for an arm's-length fee. Z's activities do not constitute the active conduct of a trade or business.

(4) *Outside of the United States.* Whether a foreign corporation conducts a trade or business outside of the United States must be determined under all the facts and circumstances. Generally, the primary managerial and operational activities of the trade or business must be conducted outside the United States and immediately after the transfer the transferred assets must be located outside the United States. Thus, the exception provided by this section would not apply to the transfer of the assets of a domestic business to a foreign corporation if the domestic business continued to operate in the United States after the transfer. In such a case, the primary operational activities of the business would continue to be conducted in the United States. Moreover, the transferred assets would be located in the United States. However, it is not necessary that every item of property transferred be used outside of the United States. As long as the primary managerial and operational activities of the trade or business are conducted outside of the United States and substantially all of the transferred assets are located outside the United States, incidental items of transferred property located in the United States may be considered to have been transferred for use in the active conduct of a trade or business outside of the United States.

(5) *Use in the trade or business.* Whether property is used or held for use

in a trade or business must be determined under all the facts and circumstances. In general, property is used or held for use in a foreign corporation's trade or business if it is—

(i) Held for the principal purpose of promoting the present conduct of the trade or business;

(ii) Acquired and held in the ordinary course of the trade or business; or

(iii) Otherwise held in a direct relationship to the trade or business.

Property is considered held in a direct relationship to a trade or business if it is held to meet the present needs of that trade or business and not its anticipated future needs.

Thus, property will not be considered to be held in a direct relationship to a trade or business if it is held for the purpose of providing for future diversification into a new trade or business, future expansion of trade or business activities, future plant replacement, or future business contingencies.

(c) *Property transferred by transferee corporation*—(1) *General rule.* If a foreign corporation receives property in an exchange described in section 367(a)(1) and as part of the same transaction transfers the property to another person, then the exception provided by this section shall not apply to the initial transfer. For purposes of the preceding sentence, a subsequent transfer within six months of the initial transfer shall be considered to be part of the same transaction, and a subsequent transfer more than six months after the initial transfer may be considered to be part of the same transaction upon the application of step-transaction principles.

(2) *Exception.* Notwithstanding paragraph (c)(1) of this section, the active conduct exception provided by this section shall apply to the initial transfer if—

(i) The initial transfer is followed by one or more subsequent transfers described in section 351 or 721; and

(ii) Each subsequent transferee is either a partnership in which the preceding transferor is a general partner or a corporation in which the preceding transferor owns common stock; and

(iii) The ultimate transferee uses the property in the active conduct of a trade or business outside the United States.

(d) *Transitional rule.* Notwithstanding any other provision of this section, property shall be considered to have been transferred for use in the active conduct of a trade or business outside of the United States, if—

(1) The property was transferred after December 31, 1984, and before June 16, 1986;

(2) The property was, or would have been, considered to be transferred for use by the transferee foreign corporation in the active conduct, in any foreign country, or a trade or business, under the principles of section 3.02(1) of Revenue Procedure 68–23, 1968–1 C.B. 821; and

(3) Based on all of the facts and circumstances, it was, or would have been, determined under section 2.02 of Revenue Procedure 68–23 that tax avoidance was not one of the principal purposes of the transaction.

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

(a) *In general.* This section provides rules concerning the transfer of stock or securities to a foreign corporation in an exchange described in section 367(a)(1). In general, a transfer of stock or securities by a U.S. person to a foreign corporation in connection with any exchange described in section 332, 351, 354 [reserved as to section 355 and so much of section 356 as relates to section 355], 356, or 361, is subject to section 367(a)(1) (and, therefore, treated as a taxable exchange) unless one of the exceptions set forth in this section applies to the transfer. Paragraph (b) of this section specifies certain transactions that are not subject to section 367(a)(1), while paragraph (c) provides rules concerning the treatment of transfers of stock or securities of domestic corporations pursuant to any exchange described in section 367(a)(1). Paragraph (d) of this section provides rules concerning the transfer of stock of a foreign corporation to another foreign corporation pursuant to section 332 or 351 [reserved as to section 355 and so much of section 356 as relates to section 355]. Finally, paragraphs (e), (f), and (g) provide detailed rules applicable to certain transfers decribed above and paragraph (h) sets forth anti-abuse rules.

(b) *Transfers to which section 367(a)(1) does not apply*—(1) *Transfers in certain reorganizations of stock or securities of foreign corporations.* If, pursuant to an exchange described in section 354, 361, or so much of section 356 as relates to section 354, a U.S. person transfers to a foreign corporation stock or securities of a foreign corporation that is a party to the reorganization, then section 367(a) shall not apply to the transfer, by reason of the operation of section 367(a)(2) and 1.367(a)–1T(b)(2)(i). Thus, section 367(a)(1) shall not apply to a transfer of stock of a foreign corporation by a U.S. person to another foreign corporation pursuant to a reorganization described in section 368(a)(1)(B) because the foreign corporation whose stock is transferred is a party to the reorganization. This result follows even though that foreign corporation may not be a party to other types of reorganizations or exchanges for which the transaction also qualifies. For rules concerning the treatment of certain transfers that are described in section 351 as well as one of the above-cited sections, see §§ 7.367(b)–4 and 7.367(b)–7.

(2) *Compulsory transfers.* For rules regarding a transfer of property (including stock or securities) that is compelled by foreign government action, see § 1.367(a)–4T(f).

(c) *Transfer of stock or securities of domestic corporation*—(1) *In general.* The transfer of stock or securities of a domestic corporation to a foreign corporation (in an exchange described in section 367(a)(1)) shall be subject to section 367(a)(1) and shall therefore be treated as a taxable exchange, except in the circumstances set forth in paragraphs (c) (2), (3), (4), (5), and (6) of this section.

(2) *Active conduct of a trade or business.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a domestic corporation if—

(i) The transfer is described in paragraph (e)(2) of this section; and

(ii) The transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

In general, paragraph (e)(2) of this section describes certain transfers of stock or securities for use by the transferee in the active conduct of a trade or business outside of the United States.

(3) *U.S. transferors obtain limited interest in transferee.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a domestic corporation if the transfer is described in paragraph (f) of this section. In general, paragraph (f) of this section describes transfers in which the U.S. transferors of stock or securities obtain only a limited interest in the transferee foreign corporation.

(4) *Transferor files agreement to recognize gain upon later disposition.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a domestic corporation if—

(i) Immediately after the transfer all U.S. transferors own in the aggregate less than fifty percent of both the total voting power and the total value of the stock of the transferee foreign corporation; and

(ii) The subject transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

(5) *Certain transfers in connection with performance of services.* Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of § 1.83–6(d)(1).

(6) *Transfers pursuant to section 355 or so much of section 356 as related to section 355.* [Reserved.]

(d) *Transfer of stock or securities of foreign corporation pursuant to section 332 or 351 [reserved as to section 355 and so much of section 356 as relates to section 355]*—(1) *In general.* If a U.S. person transfers stock or securities of a foreign corporation to another foreign corporation in an exchange described in section 332 or 351 [reserved as to section 355 or so much of section 356 as relates to section 355] then section 367(a)(1) shall apply to the transfer (which is therefore treated as a taxable exchange), except in the circumstances set forth in paragraphs (d) (2), (3), (4), (5), and (6) of this section. Transfers described in section 351 that are also described in section 368(a)(1)(B) shall be subject to the rules set forth in §§ 7.367(b)–4 and 7.367(b)–7 and shall not be subject to the rules of this paragraph (d).

(2) *Active conduct of a trade or business.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a foreign corporation if—

(i) The transfer is described in paragraph (e) (2) or (3) of this section; and

(ii) The transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

In general, paragraph (e) describes transfers of stock or securities for use by the transferee corporation in the active conduct of a trade or business outside of the United States.

(3) *Transfer of stock or securities of foreign corporation to another corporation organized in same country.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a foreign corporation if—

(i) The transferred corporation and the transferee corporation are created or organized under the laws of the same foreign country;

(ii) At least 50 percent of the assets used in the trade or business of the transferred corporation are located in that same foreign country;

(iii) Prior to the transfer, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of the transferred corporation was held by U.S. persons;

(iv) After the transfer, the transferee corporation holds more than 50 percent of the total combined voting power of all classes of stock entitled to vote of the transferred corporation;

(v) After the transfer, the U.S. persons that controlled the transferred corporation before the transfer hold at least 50 percent of the total combined voting power of all classes of stock entitled to vote of the transferee corporation;

(vi) After the transfer, the transferee corporation is a controlled foreign corporation within the meaning of section 957(a); and

(vii) The transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

The provisions of this paragraph (d)(3) shall apply to transfers occurring after June 16, 1986. For other transfers, see section 3.02(1)(a)(iii)(B) of Revenue Procedure 68–23.

(4) *U.S. transferors obtain limited interest in transferee.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a foreign corporation if the transfer is described in paragraph (f) of this section. In general, paragraph (f) of this section describes transfers in which the U.S. transferors of stock or securities obtain only a limited interest in the transferee foreign corporation.

(5) *Transferor files agreement to recognize gain upon later disposition.* Section 367(a)(1) shall not apply to a transfer of stock or securities of a foreign corporation if—

(i) Immediately after the transfer all U.S. transferors own in the aggregate less than fifty percent of both the total voting power and the total value of the stock of the transferee foreign corporation; and

(ii) The subject transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

(6) *Transfer pursuant to section 355 or so much of section 356 as relates to section 355.* [Reserved.]

(e) *Transfer for use in the active conduct of a trade or business outside of the United States*—

(1) *In general.* Section 367(a) shall not apply to a transfer of stock or securities of a corporation if—

(i) The transfer is described in paragraph (e) (2) or (3) of this section; and

(ii) The transferor files an agreement to recognize gain upon the transferee's later disposition of the transferred interest in accordance with the provisions of paragraph (g) of this section.

(2) *Stock constituting operating asset.* A transfer of stock or securities of a foreign or domestic corporation to a foreign corporation shall be considered to be for use in the active conduct of a trade or business outside of the United States if the stock or securities are essentially operating assets in the hands of the transferor because ownership of the stock or securities grants material rights to acquire for use in the transferor's trade or business outside the United States products produced by the transferred corporation outside the United States. See *Kaiser Aluminum Chemical Corp. V. Comm'r*, 76 T.C. 325 (1981).

(3) *Consolidation of integrated business*—(i) *In general.* A transfer of stock or securities of a foreign corporation to a foreign corporation shall be considered to be for use in the active conduct of a trade or business outside of the United States if—

(A) Immediately after the transfer, the transferee foreign corporation holds more than 50 percent of the total voting power and more than 50 percent of the total value of stock of the transferred corporation; and

(B) Both immediately before and immediately after the transfer, the transferred corporation and the transferee foreign corporation constitute an integrated business in accordance with the provisions of paragraph (e)(2)(ii) of this section.

(ii) *Integrated business.* For purposes of this paragraph (e)(2), the transferred and transferee corporations shall be considered to constitute an integrated business only if—

(A) Each corporation is engaged, directly or indirectly, in substantial business operations beyond the mere provision of general managerial, financial, or similar services to the other corporation; and

(B) Either the business operations of one corporation are substantially identical to all or the principal part of the operations of the other, or the operations of the two corporations

constitute in principal part complementary and mutually interdependent steps in the production and sale or lease of a product or products or in the provision of a service. Substantial identity of business operations requires that the two corporations engage in substantially the same production (or service) and marketing processes or activities for generally the same or similar products (or services).

(f) *U.S. transferors obtain limited interest in transferee*—(1) *In general.* A transfer of stock or securities of a foreign or domestic corporation by a U.S. person to a foreign corporation shall not be subject to section 367(a)(1) if immediately after the transfer—

(i) All U.S. transferors own in the aggregate less than twenty percent of both the total voting power and the total value of the stock of the transferee foreign corporation; or

(ii)(A) All U.S. transferors own in the aggregate twenty percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation, but less than fifty percent of that total voting power and that total value; and

(B) The subject U.S. transferor owns less than five percent of both the total voting power and the total value of the stock of the transferee foreign corporation.

(2) *Attribution.* Section 958 shall apply in determining the ownership of stock for purposes of this paragraph (f).

(3) *Rule not applicable to stock of holding companies.* The rule of paragraph (f)(1) of this section shall not apply if the assets of the transferred corporation consist principally of stock or securities held as portfolio investments. Stock of securities of a given entity held by the transferred corporation shall be presumed not to constitute a portfolio investment if the transferred corporation holds ten percent or more by value of the outstanding stock and securities of that entity. This presumption may be rebutted by evidence that the stock was held by the transferred corporation as a passive, portfolio investment.

(g) *Transferor's agreement to recognize gain upon later disposition by transferee*—(1) *In general.* A transfer of stock or securities shall not be subject to section 367(a)(1) if—

(i) The transferor complies with the reporting requirements of section 6038B and any regulations thereunder;

(ii) The transferor files a binding agreement to recognize gain upon the transferee corporation's later disposition of the transferred stock or securities, in accordance with the rules of this section; and

(iii) The transfer is described in paragraph (d)(3) or (e) of this section or, immediately after the transfer, all U.S. transferors own in the aggregate less than 50 percent of both the total voting power and the total value of the stock of the transferee foreign corporation.

(2) *Agreement to recognize gain: in general.* A transferor's agreement to recognize gain must be attached to, and filed by the due date of, the information return required under section 6038B.

In general, the return must be filed with the transferor's tax return for the taxable year that includes the date of the transfer. However, pursuant to § 1.6038B–1T(b)(1), returns with respect to transfers that took place prior to June 16, 1986, are not required to be filed until September 16, 1986. Therefore, an agreement to recognize gain under the rules of this section with respect to any such transfer may be timely filed until that date. The agreement must be signed under penalties of perjury by a trustee, executor, or equivalent fiduciary in the case of a trust or estate, by a responsible officer in the case of a corporation, by a debtor in possession or trustee in a bankruptcy case under Title 11, United States Code, and in the case of an individual, including a partner who is treated as a transferor by virtue of § 1.367–1T(c)(3), by the individual himself. An agreement may also be signed by an agent authorized to do so under a general or specific power of attorney. The agreement must set forth the following materials, preferably in paragraphs labeled to correspond with the subparagraphs set forth below:

(i) A statement that the document submitted constitutes the transferor's agreement to recognize gain, in accordance with the requirements of § 1.367(a)–3T(g);

(ii) A description of the stock or securities transferred, an estimate of fair market value as of the date of the transfer, and a statement of cost or other basis and any adjustments thereto;

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

(iv) A waiver of the period of limitations, as described in subparagraph (4) of this paragraph (g); and

(v) An agreement to file with the transferor's tax returns for the 5 years following the year of the transfer a certification and waiver as described in subparagraph (5) of this paragraph (g).

(3) *Terms of agreement*—(i) *Recognition of gain.* The transferor must agree that if, prior to the close of the fifth taxable year following the taxable year of the transfer, the transferee foreign corporation disposes of the transferred stock in any manner (other than in a liquidation of the transferred corporation), then by the 90th day thereafter the transferor will file an amended return for the year of the transfer and recognize thereon the gain realized but not recognized upon the initial transfer. Such gain shall be computed as if there had been a sale of the stock or securities at fair market value at the time of the initial transfer. Net operating losses or credits against tax that were available in the year of the initial transfer and that have expired unused may be applied (respectively) against any gain recognized or tax owed by reason of this provision, but no other adjustments shall be made with respect to any other items of income or deduction in the year of the transfer or other years. If additional tax is required to be paid, then interest must be paid on that amount at the rates determined under section 6621, with respect to the period between the date that was prescribed for filing the transferor's income tax return for the year of the transfer and the date on which the additional tax for that year is paid. For special rules applicable to nonrecognition transfers, see subparagraph (7) of this paragraph (g). For special rules applicable when a U.S. transferor that enters into an agreement under this paragraph (g) ceases to exist, see subparagraph (9) of this paragraph (g).

(ii) *Partial disposition.* If the transferee foreign corporation disposes of only a portion of the stock or securities of the transferred corporation, then the U.S. transferor shall be required to recognize a proportionate amount of the gain realized but not recognized upon the initial transfer. The proportion required to be recognized shall be determined by reference to the fair market value of the stock or securities disposed of an the fair market value of those retained. The rule of this paragraph (g)(3)(ii) is illustrated by the following example.

*Example.* A is a U.S. citizen who owns 100 percent of the outstanding stock of foreign corporation X. In a transaction described in section 351, A exchanges his stock in X for 25 percent of the outstanding stock of foreign corporation Y. A submits an agreement under the rules of this section to recognize gain upon a later disposition. In the following year, Y disposes of 50 percent of the fair market value of the stock of X. Therefore, A is required to recognize 50 percent of the gain he realized but did not recognize upon the initial transfer of the shares of X.

(iii) *Disposition of assets by transferred corporation.* For purposes of paragraph (g)(3) (i) and (ii) of this section, a disposition not in the ordinary course of business by the transferred corporation of all or a substantial portion of its assets (other than a distribution, including a liquidating distribution, to the transferee foreign corporation) shall be treated as a disposition by the transferee foreign corporation of a proportionate amount of stock of the transferred corporation.

(iv) *Disposition of assets after distribution by transferred corporation.* For purposes of paragraph (g)(3) (i) and (ii) of this section, a disposition not in the ordinary course of business by the transferee foreign corporation of all or a substantial portion of the assets received by it in a distribution, including a liquidating distribution, from the transferred corporation shall be treated as a disposition by the transferee foreign corporation of a proportionate amount of stock of the transferred corporation.

(4) *Waiver of period of limitation.* The transferor must file a waiver of the period of limitation on assessment of tax upon the gain realized on the transfer. The waiver shall be executed on such forms as are prescribed therefor by the Commissioner and shall extend the period for assessment of such tax to a date not earlier than the close of the eighth taxable year following the taxable year of the transfer. Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to ensure the assessment and collection of the correct tax liability for each year for which the waiver is required. The waiver must be signed by a person authorized to sign the agreement pursuant to the provisions of paragraph (g)(2) of this section.

(5) *Annual certification and waiver*—(i) *Certification.* The transferor must agree to file with its income tax return for each of the five taxable years following the taxable year of the transfer a certification that the stock or securities transferred have not been disposed by the transferee in a transaction that is considered to be a disposition for purposes of this paragraph. If either a disposition qualifying under paragraph (g)(1) of this section or a nonrecognition transfer subject to paragraph (g)(7) of this section has occurred, the transferor's certification must provide the information required under the rules of the subject paragraph. The annual certification pursuant to this paragraph (g)(5) must be signed under penalties of perjury by a person authorized to sign the agreement pursuant to the provisions of paragraph (g)(2) of this section. The certification must identify the transfer with respect to which it is given by setting forth the date of the transfer and a description of the stock or securities transferred. If a taxpayer has made more than one transfer subject to the rules of this paragraph (g), the certifications for those transfers may be combined in a single document, but each transfer must be separately identified.

(ii) *Waiver.* The transferor must agree to file with its income tax return for each of the eight taxable years following the taxable year of the transfer a waiver of the period of limitations on assessment as described in paragraph (g)(4) of this section. For the rule extending the period of limitations upon a failure to comply with the reporting requirements of section 6038B and regulations thereunder, see § 1.6038B–1T(f)(1)(iii).

(6) *Warranty of information regarding disposition.* The transferor must warrant that arrangements have been made in connection with the transfer of stock or securities to ensure that the transferor will be informed of any subsequent disposition of stock, securities, or assets that would require the recognition of gain under the agreement.

(7) *Treatment of nonrecognition transfers.* If, during the period the agreement is in force, the transferee foreign corporation disposes of the stock or securities of the transferred corporation in a transaction on which gain or loss would not be required to be recognized under U.S. income tax principles, then the U.S. transferor shall not be required to recognize gain under paragraph (g)(3)(i) of this section, provided that the U.S. transferor complies with the requirements of subdivisions (i), (ii), and (iii) of this paragraph (g)(7).

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

(A) A description of the transfer;

(B) The applicable nonrecognition provision; and

(C) The name, address, and identifying number (if any) of the new transferee of the stock or securities of the transferred corporation.

(ii) The U.S. transferor must provide a new agreement to recognize gain (in accordance with the rules of paragraph (g) (2) and (3)(i) of this section) if, prior to the close of the fifth taxable year following the taxable year of the initial transfer, either—

(A) The initial transferee foreign corporation disposes of the interest which it received in exchange for the stock or securities of the transferred corporation (other than in a disposition which itself qualifies under the rules of this paragraph (g)(7)); or

(B) The person that obtained the stock or securities of the transferred corporation disposes of that stock or those securities (other than in a disposition which itself qualifies under the rules of this paragraph (g)(7)).

If a disposition that triggers the recognition of gain under the rules of this paragraph is only a partial disposition of the property, then the U.S. transferor shall be required to recognize a proportionate amount of the gain realized but not recognized upon the initial transfer. The proportion required to be recognized shall be determined by reference to the fair market value of the stock or securities disposed of and the fair market value of those retained as of the date of the disposition.

(iii) The U.S. transferor must warrant that arrangements have been made, in connection with the nonrecognition transfer, ensuring that the U.S. transferor will be informed of any subsequent disposition with respect to which recognition of gain would be required under the agreement.

(8) *Special rules for indirect transfers*—(i) *Transfers covered.* If a U.S. person that holds an interest in an entity is considered to make an indirect transfer of stock or securities described in section 367(a) under the provisions of § 1.367(a)–1T(c), then the rules of this paragraph (g)(8) shall apply to the transfer.

(ii) *Applicable rules.* For purposes of this paragraph (g), the foreign corporation that issued the stock or securities received by the U.S. transferor shall be considered to be the transferee foreign corporation. Any agreement entered into under this paragraph (g) with respect to such a transfer shall require the recognition of gain by the transferor if—

(A) That transferee foreign corporation disposes of the corporation that it controls (regardless of whether that corporation is the transferred corporation itself or another corporation that obtained the stock, securities, or assets of the transferred corporation); or

(B) The corporation that holds the assets of the transferred corporation disposes of all or a substantial portion of those assets other than in the ordinary course of business.

The rules of paragraph (g)(7) of this section shall apply if gain or loss would

not be required to be recognized under U.S. income tax principles with respect to such a transfer.

(9) *U.S. transferor goes out of existence.* If a U.S. corporation, trust, or estate that has entered into an agreement under this paragraph (g) goes out of existence, and that corporation, trust, or estate is not required to recognize gain under section 367 upon its liquidating transfer of the stock of the transferee foreign corporation, or if an individual transferor that has entered into an agreement under this paragraph (g) dies, then either—

(i) The person winding up the affairs of the transferor must retain assets to meet any possible liability of the transferor under the agreement;

(ii) The person winding up the affairs of the transferor must provide security under subparagraph (10) of this paragraph (g) for any possible liability of the transferor under the agreement; or

(iii) Each person that obtains the stock of the transferee foreign corporation from the transferor must enter into an agreement under this paragraph (g) having the same terms as the agreement entered into by the transferor (but only with respect to that person's proportionate share of the gain realized but not recognized upon the transferor's initial transfer of stock to the transferee foreign corporation).

(10) *Use of security.* The transferor may be required to furnish a bond or other security that satisfies the requirements of § 301.7101–1 if the district director determines that such security is necessary to ensure the payment of any tax upon the gain realized upon the transfer. Such bond or security will generally be required only if the stock or securities transferred are the principal asset of the tranferor and the director has reason to believe that a disposition of the stock or securities may be contemplated. In addition, if a tranferor corporation, trust, or estate ceases to exist, or if an individual transferor dies, then the person winding up the affairs of the transferor (such as a trustee in bankruptcy or an executor) may choose to supply security pursuant to paragraph (g)(9) of this section for the performance of the transferor's obligations under an agreement entered into under this paragraph (g).

(11) *Failure to comply.* If a person that has entered into an agreement under this paragraph (g) fails at any time to comply in any material respect with the requirements of this section or with the terms of any agreement submitted pursuant thereto, then the rule of paragraph (g)(1) of this section shall not apply. Thus, the initial transfer of the stock or securities will become subject to section 367(a)(1) (unless otherwise excepted under the rules of this section) and will be treated as a taxable exchange in the year of the initial transfer. Such a material failure to comply shall extend the period for assessment of tax until three years after the date on which the Internal Revenue Service receives actual notice of the failure to comply.

(12) *Availability of forms.* Any agreement, certification, waiver, or other document required to be filed pursuant to the provisions of this paragraph (g) shall use such forms as may be prescribed therefore by the Commissioner (or a similar statement providing the same information). Until such time as forms are published, all necessary filings may be accomplished by providing the required information to the Service in accordance with the rules of this paragraph.

(13) *Basis adjustments*—(i) If a U.S. transferor is required to recognize gain under this paragraph (g), then in determining for U.S. income tax purposes any gain or loss recognized by the transferee foreign corporation upon its subsequent dispositon of the transferred stock or securities, its basis in such interests shall be increased by the amount of gain required to be recognized (but not by any tax or interest required to be paid on such amount).

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

(h) *Anti-abuse rules*—(1) *Coordination with Subpart F.* Notwithstanding the provisions of paragraph (d) (2) or (3) of this section, section 367(a)(1) shall apply to a transfer of stock or securities of a foreign corporation if either:

(i) The transferred corporation was a controlled foreign corporation within the meaning of section 957(a), and the transferee corporation is not a controlled foreign corporation; or

(ii) Both the transferred and the transferee corporations are controlled foreign corporations within the meaning of section 957(a) but the transferor was a U.S. shareholder of the transferred corporation within the meaning of section 951(b) and is not a U.S. shareholder of the transferee corporation, within the meaning of section 951(b).

However, section 367(a)(1) shall not apply to such a transfer if the transferor enters into an agreement to recognize gain under paragraph (g) of this section.

(2) *Incorporation of property to avoid section 367(a)(1).* Notwithstanding any other provision of this section, section 367(a)(1) shall apply to a transfer of stock or securities of a domestic corporation if:

(i) The domestic corporation holds property that would be subject to section 367(a)(1) if it were transferred directly to a foreign corporation;

(ii) A U.S. person transferred that property to the domestic corporation in a transaction on which gain or loss was not required to be recognized, and

(iii) One of the principal purposes of the incorporation and transfer was avoidance of the provisions of section 367(a).

A transfer of property shall be presumed to have been made to avoid the provisions of section 367(a) if the transfer to the domestic corporation occurred less than two years before the transfer of the stock of the domestic corporation to the foreign corporation, or if it otherwise appears that the transfer of stock to the foreign corporation was planned or contemplated at the time of the transfer of the property to the domestic corporation. The presumption created by the previous sentence may be rebutted by evidence establishing that avoidance of the provisions of section 367(a) was not one of the principal purposes of the incorporation and subsequent transfer.

**§ 1.367 (a)–4T Special rules applicable to specified transfers of property (temporary).**

(a) *In general.* This section provides special rules for determining the applicability of section 367(a)(1) to specified transfers of property. Paragraph (b) of this section provides a special rule requiring the recapture of depreciation upon the transfer abroad of property previously used in the United States. Paragraphs (c) through (f) of this section provide rules for determining whether certain types of property are transferred for use in the active conduct of a trade or business outside of the United States. Paragraph (g) excepts certain transfers to FSCs from the operation of section 367(a)(1). The treatment of any transfer of property described in this section shall be determined exclusively under the rules of this section.

(b) *Depreciated property used in the U.S.*—(1) *In general.* If a U.S. person transfers U.S. depreciated property (as defined in paragraph (b)(2) of this section) to a foreign corporation in an exchange described in section 367(a)(1),

then that person shall include in its gross income for the taxable year in which the transfer occurs ordinary income equal to the gain realized that would have been includible in the transferor's gross income as ordinary income under section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a), whichever is applicable, if at the time of the transfer the transferor had sold the property at its fair market value. Recapture of depreciation under this paragraph (b) shall be required regardless of whether any exception to section 367(a)(1) (such as the exception for property transferred for use in the active conduct of a foreign trade or business) would otherwise apply to the transfer. However, any applicable exception shall apply with respect to realized gain that is not included in ordinary income pursuant to this paragraph (b).

(2) *U.S. depreciated property.* U.S. depreciated property subject to the rules of this paragraph (b) is any property that—

(i) Is either mining property (as defined in section 617(f)(2)), section 1245 property (as defined in section 1245(a)(3)), section 1250 property (as defined in section 1250(c)), farm land (as defined in section 1252(a)(2)), or oil, gas, or geothermal property (as defined in section 1254(a)(3)); and

(ii) Has been used in the United States or has qualified as section 38 property by virtue of section 48(a)(2)(B) prior to its transfer.

(3) *Property used within and without the U.S.* If U.S. depreciated property has been used partly within and partly without the United States, then the amount required to be included in ordinary income pursuant to this paragraph (b) shall be reduced to an amount determined in accordance with the following formula:

$$\text{Full recapture amount} \times \frac{\text{U.S. use}}{\text{Total use}}$$

For purposes of the above fraction, the "full recapture amount" is the amount that would otherwise be included in the transferor's income under paragraph (b)(1) of this section. "U.S. use" is the number of months that the property either was used within the United States or qualified as section 38 property by virtue of section 48(a)(2)(B), and was subject to depreciation by the transferor or a related person. "Total use" is the total number of months that the property was used (or available for use), and subject to depreciation, by the transferor or a related person. For purposes of this paragraph (b)(3), property shall not be considered to have been in use outside of the United States during any period in which such property was, for purposes of section 48 or 168, treated as property not used predominantly outside the United States pursuant to the provisions of section 48(a)(2)(B). For purposes of this paragraph (b)(3) the term "related person" shall have the meaning set forth in § 1.367(d)–1T(h).

(4) *Transfer followed by section 338 election.* For purposes of paragraph (b)(1) of this section, property that is transferred by a U.S. corporation to a foreign corporation in a transfer described in the section 367(a)(1) shall be treated as U.S. depreciated property at the time of the transfer if—

(i) The transferee foreign corporation was a member of the U.S. transferor's affiliated group (determined without regard to the exceptions contained in section 1504(b)) at the time of the transfer; and

(ii) Within three years after the transfer, a purchasing corporation files an express election under section 338(g) for any member of the U.S. corporation's affiliated group (determined without regard to the exceptions contained in section 1504(b)) and files a regular exclusion election under § 1.338–5T(c)(2)(v) by virtue of which the transferee foreign corporation is excluded from the status of target affiliate.

(5) *Effective date.* This paragraph (b) applies to transfers occurring on or after June 16, 1986.

(c) *Property to be leased*—(1) *Leasing business of transferee.* Tangible property transferred to a foreign corporation that will be leased to other persons by the foreign corporation shall be considered to be transferred for use in the active conduct of a trade or business outside of the United States only if—

(i) The transferee's leasing of the property constitutes the active conduct of a leasing business;

(ii) The lessee of the property is not expected to, and does not, use the property in the United States; and

(iii) The transferee has need for substantial investment in assets of the type transferred.

The active conduct of a leasing business requires that the employees of the foreign corporation perform substantial marketing, customer service, repair and maintenance, and other substantial operational activities with respect to the transferred property outside of the United States. Tangible property subject to the rules of this paragraph (c) includes real property located outside of the United States. The rules of § 1.367(a)–5T(b) shall apply to transfers of property described in that section regardless of satisfaction of the rules of this paragraph (c).

(2) *De minimis leasing by transferee.* Tangible property transferred to a foreign corporation that will be leased to other persons by the foreign corporation and that does not satisfy the conditions of paragraph (b)(1) of this section shall, nevertheless, be considered to be transferred for use in the active conduct of a trade or business if either—

(i) The property transferred will be used by the transferee foreign corporation in the active conduct of a trade or business but will be leased during occasional brief periods when the property would otherwise be idle, such as an airplane leased during periods of excess capacity; or

(ii) The property transferred is real property located outside the United States and—

(A) The property will be used primarily in the active conduct of a trade or business of the transferee foreign corporation; and

(B) Not more than ten percent of the square footage of the property will be leased to others.

(d) *Property to be sold.* Property shall not be considered to be transferred for use in the active conduct of a trade or business and a transfer of stock or securities shall not be excepted from section 367(a)(1) under the rules of § 1.367(a)–3T if, at the time of the transfer, it is reasonable to believe that, in the reasonably foreseeable future, the transferee will sell or otherwise dispose of any material portion of the transferred stock, securities, or other property other than in the ordinary course of business.

(e) *Oil and gas working interests*—(1) *In general.* A working interest in oil and gas properties shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The transfer satisfies the conditions of paragraph (e)(2) of this section;

(ii) At the time of the transfer, the transferee has no intention to farmout or otherwise transfer any part of the transferred working interest; and

(iii) During the first three years after the transfer there are no farmouts or other transfers of any part of the transferred working interest as a result of which the transferee retains less than a 50 percent share of the transferred working interest.

(2) *Active use of working interest.* Working interests in oil and gas properties shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The transferor is regularly and substantially engaged in exploration for and extraction of minerals, either directly or through working interests in joint ventures, other than by reason of the property that is transferred;

(ii) The terms of the working interest transferred were actively negotiated among the joint venturers;

(iii) The working interest transferred constitutes at least a five percent working interest;

(iv) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively engaged in—

(A) Operating the working interest, or

(B) Analyzing technical data relating to the activities of the venture;

(v) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively involved in decisionmaking with respect to the operations of the venture, including decisions relating to exploration, development, production, and marketing; and

(vi) After the transfer, the transferee foreign corporation will for the foreseeable future satisfy the requirements of subdivisions (iv) and (v) of this paragraph (d)(2).

(3) *Start-up operations.* Working interests in oil and gas properties that do not satisfy the requirements of paragraph (e)(2) of this section shall, nevertheless, be considered to be transferred for use in the active conduct of a trade or business if—

(i) The working interest was acquired by the transferor immediately prior to the transfer and for the specific purpose of transferring it to the transferee foreign corporation;

(ii) The requirements of paragraph (e)(2) (ii) and (iii) of this section are satisfied; and

(iii) The transferee foreign corporation will for the foreseeable future satisfy the requirements of paragraph (e)(2) (iv) and (v) of this section.

(4) *Other applicable rules.* Oil and gas interests not described in this paragraph (e) may nonetheless qualify for the exception to section 367(a)(1) contained in § 1.367(a)–2T, relating to transfers of property for use in the active conduct of a trade or business outside of the United States. However, a mere royalty interest in oil and gas properties will not be treated as transferred for use in the active conduct of a trade or business outside the United States. Moreover, a royalty or similar interest that constitutes intangible property will be subject to the rules of § 1.367(d)–1T, relating to transfers of intangible property.

(f) *Compulsory transfers.* Property shall be presumed to be transferred for use in the active conduct of a trade or business outside of the United States, if—

(1) The property was previously in use in the country in which the transferee foreign corporation is organized; and

(2) The transfer is either:

(i) Legally required by the foreign government as a necessary condition of doing business in that country; or

(ii) Compelled by a genuine threat of immediate expropriation by the foreign government.

(g) *Relationship to other sections.* The rules of §§ 1.367(a)–5T, 1.367(a)–6T, and 1.367(d)–1T apply to transfers of property whether or not the property is transferred for use in the active conduct of a trade or business outside the United States. See § 1.367(d)–1T(g)(2)(ii) for a special election with respect to compulsory transfers of intangible property.

(h) *Transfers of certain property to FSCs*—(1) *In general.* The provisions of section 367 (a) and (d) and the regulations thereunder shall not apply to a transfer of property by a U.S. person to a foreign corporation that constitutes a FSC, as defined in section 922(a), if—

(i) The transferee FSC uses the property to generate exempt foreign trade income, as defined in section 923(a);

(ii) The property is not excluded property, as defined in section 927(a)(2); and

(iii) The property consists of a corporate name or tangible property that is appropriate for use in the operation of a FSC office.

(2) *Exception.* The general rule in paragraph (g)(1) of this section shall not apply if, within three years after the original transfer, the original transferee FSC (or a subsequent transferee FSC) disposes of the property other than in the ordinary course of business or through a transfer to another FSC. Thus, the U.S. transferor may recognize gain in the taxable year in which the original transfer occurred through the application of section 367 and the regulations thereunder.

**§ 1.367(a)–5T Property subject to section 367(a)(1) regardless of use in trade or business (temporary).**

(a) *In general.* Section 367(a)(1) shall apply to a transfer of property described in this section regardless of whether the property is transferred for use in the active conduct of a trade or business. Certain exceptions to the operation of this rule are provided in this section, and a special gain limitation rule is provided in paragraph (e). A transfer of property described in this section is subject to section 367(a)(1) even if the transfer is a compulsory transfer described in § 1.367(a)–4T(f).

(b) *Inventory, etc.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of—

(1) Stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business; and

(2) A copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(i) A taxpayer whose personal efforts created such property;

(ii) In the case of a letter, memorandum, or similar property, a taxpayer from whom such property was prepared or produced; or

(iii) A taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subdivision (i) or (ii) of this paragraph (b)(2).

For purposes of this section, the term "inventory" includes raw materials and supplies, partially completed goods, and finished products.

(c) *Installment obligations, etc.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of installment obligations, accounts receivable, or similar property, but only to the extent that the principal amount of any such obligation has not previously been included by the taxpayer in its taxable income.

(d) *Foreign currency, etc.*—(1) *In general.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to the transfer of foreign currency or other property denominated in foreign currency, including installment obligations, futures contracts, forward contracts, accounts receivable, or any other obligation entitling its payee to receive payment in a currency other than U.S. dollars.

(2) *Exception for certain obligations.* If transferred property denominated in a foreign currency—

(i) Is denominated in the currency of the country in which the transferee foreign corporation is organized; and

(ii) Was acquired in the ordinary course of the business of the transferor that will be carried on by the transferee foreign corporation,

then section 367(a)(1) shall apply to the transfer only to the extent that gain is required to be recognized with respect to previously realized income reflected in installment obligations subject to paragraph (c) of this section. The rule of this paragraph (d)(2) shall not apply to transfers of foreign currency.

(3) *Limitation of gain required to be recognized.* If section 367(a)(1) applies to a transfer of property described in this paragraph, then the gain required to be recognized shall be limited to—

(i) The gain realized upon the transfer of property described in this paragraph (d), minus

(ii) Any loss realized as part of the same transaction upon the transfer of property described in this paragraph (d).

This limitation applies in lieu of the rule in § 1.367(a)–1T(b)(1). No loss shall be recognized with respect to property described in this paragraph (d).

(e) *Intangible property.* Regardless of use in an active trade or business, a transfer of intangible property pursuant to section 332 shall be subject to section 367(a)(1), unless it constitutes foreign goodwill or going concern value, as defined in § 1.367(a)–1T(d)(5)(iii). For rules concerning transfers of intangible property pursuant to section 351 or 361, see section 367(d) and § 1.367(d)–1T.

(f) *Leased tangible property.* Regardless of use in an active trade or business, section 367(a)(1) shall apply to a transfer of tangible property with respect to which the transferor is a lessor at the time of the transfer, unless—

(1) With respect to property that will not be leased by the transferee to third persons, the transferee was the lessee of the property at the time of the transfer; or

(2) With respect to property that will be leased by the transferee to third persons, the transferee satisfies the conditions set forth in § 1.367(a)–4T(c)(1) or (2).

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

(a) *In general.* This section provides special rules relating to the transfer of the assets of a foreign branch with previously deducted losses. Paragraph (b) of this section provides generally that such losses must be recaptured by the recognition of the gain realized on the transfer. Paragraph (c) of this section sets forth rules concerning the character of, and limitations on, the gain required to be recognized. Paragraph (d) of this section defines the term "previously deducted losses." Paragraph (e) of this section describes certain reductions that are made to the previously deducted losses before they are taken into income under this section. Finally, paragraph (g) of this section defines the term "foreign branch."

(b) *Recognition of gain required*—(1) *In general.* If a U.S. person transfers any assets of a foreign branch to a foreign corporation in an exchange described in section 367(a)(1), then the transferor shall recognize gain equal to—

(i) The sum of the previously deducted branch ordinary losses as defined and reduced in paragraphs (d) and (e) of this section; and

(ii) The sum of the previously deducted branch capital losses as defined and reduced in paragraphs (d) and (e) of this section.

(2) *No active conduct exception.* The rules of this paragraph (b) shall apply regardless of whether the assets of the foreign branch are transferred for use in the active conduct of a trade or business outside the United States.

(c) *Special rules concerning gain recognized*—(1) *Character and source of gain.* The gain described in paragraph (b)(1)(i) of this section shall be treated as ordinary income of the transferor, and the gain described in paragraph (b)(1)(ii) of this section shall be treated as long-term capital gain of the transferor. Gain that is recognized pursuant to the rules of this section shall be treated as income from sources outside the United States. Such recognized gain shall be treated as foreign oil and gas extraction income (as defined in section 907) in the same proportion that previously deducted foreign oil and gas extraction losses bore to the total amount of previously deducted losses.

(2) *Gain limitation.* For a rule limiting the amount of gain required to be recognized under section 367(a) upon any transfer of property to a foreign corporation, including the transfer of assets of a foreign branch with previously deducted losses, see § 1.367(a)–1T(b)(3).

(3) *Foreign goodwill and going concern value.* For purposes of this section, the assets of a foreign branch shall include foreign goodwill and going concern value related to the business of the foreign branch, as defined in § 1.367(a)–1T(d)(5)(iii). Thus, gain realized upon the transfer of the foreign goodwill or going concern value of a foreign branch to a foreign corporation will be taken into account in computing the limitation on loss recapture under paragraph (c)(2) of this section.

(4) *Transfers of certain intangible property.* Gain realized on the transfer of intangible property (computed with reference to the fair market value of the intangible property as of the date of the transfer) that is an asset of a foreign branch shall be taken into account in computing the limitation on loss recapture under paragraph (c)(2) of this section. For rules relating to the crediting of gain recognized under this section against income deemed to arise by operation of section 367(d), see § 1.367(d)–1T(g)(3).

(d) *Previously deducted losses*—(1) *In general.* This paragraph (d) provides rules for determining, for purposes of paragraph (b)(1) of this section, the previously deducted losses of a foreign branch any of whose assets are transferred to a foreign corporation in an exchange described in section 367(a)(1). Initially, the two previously deducted losses of a foreign branch for a taxable year are the total ordinary loss ("previously deducted branch ordinary loss") and the total capital loss ("previously deducted branch capital loss") that were realized by the foreign branch in that taxable year (a "branch loss year") prior to the transfer and that were or will be reflected on a U.S. income tax return of the transferor. The previously deducted branch ordinary loss for each branch loss year is reduced by expired net ordinary losses under paragraph (d)(2) of this section, while the previously deducted capital loss for each loss year is reduced by expired net capital losses under paragraph (d)(3) of this section. For each branch loss year, the remaining previously deducted branch ordinary loss and the remaining previously deducted branch capital loss are then reduced, proceeding from the first branch loss year to the last branch loss year, to reflect expired foreign tax credits under paragraph (d)(4) of this section. The reductions are made in the order of the taxable years in which the foreign tax credits arose. Finally, similar reductions are made to reflect expired investment credits under paragraph (d)(5) of this section.

(2) *Reduction by expired net ordinary loss*—(i) *In general.* The previously deducted branch ordinary loss for each branch loss year shall be reduced under this paragraph (d)(2) by the amount of any expired net ordinary loss with respect to that branch loss year. Expired net ordinary losses arising in years other than the branch loss year shall reduce the previously deducted branch ordinary loss for the branch loss year only to the extent that the previously deducted branch ordinary loss exceeds the net operating loss, if any, incurred by the transferor in the branch loss year. The previously deducted branch ordinary losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss

year, expired net operating losses shall be applied to reduce the previously deducted branch ordinary loss for that year in the order in which the expired net ordinary losses arose.

(ii) *Existence of expired net ordinary loss.* An expired net ordinary loss exists with respect to a branch loss year to the extent that—

(A) The transferor incurred a net operating loss (within the meaning of section 172(c));

(B) That net operating loss arose in the branch loss year or was available for carryover or carryback to the branch loss year under section 172(b)(1);

(C) That net operating loss has neither given rise to a net operating loss deduction (within the meaning of section 172(a)) for any taxable year prior to the year of the transfer, nor given rise to a reduction of any previously deducted branch ordinary loss (pursuant to paragraph (d)(2) of this section) of any foreign branch of the transferor upon a previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim a net operating loss deduction with respect to that net operating loss has expired.

(3) *Reduction by expired net capital loss*—(i) *In general.* The previously deducted branch capital loss for each branch loss year shall be reduced under this paragraph (d)(3) by the amount of any expired net capital loss with respect to that branch loss year. Expired net capital losses arising in years other than the branch loss year shall reduce the previously deducted branch capital loss for the branch loss year only to the extent that the previously deducted branch capital loss exceeds the net capital loss, if any, incurred by the transferor in the branch loss year. The previously deducted branch capital losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired net capital losses shall be applied to reduce the previously deducted branch capital loss for that year in the order in which the expired net capital losses arose.

(ii) *Existence of expired net capital loss.* An expired net capital loss exists with respect to a branch loss year to the extent that—

(A) The transferor incurred a net capital loss (within the meaning of section 1222(10));

(B) That net capital loss arose in the branch loss year or was available for carryover or carryback to the branch loss year under section 1212;

(C) That net capital loss has neither been allowed for any taxable year prior to the year of the transfer, nor given rise to a reduction of any previously deducted branch capital loss (pursuant to paragraph (c)(3) of this section) of any foreign branch of the transferor upon any previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim a capital loss deduction with respect to that net capital loss has expired.

(4) *Reduction for expired foreign tax credit*—(i) *In general.* The previously deducted branch ordinary loss and the previously deducted branch capital loss for each branch loss year remaining after the reductions described in paragraph (d) (2) and (3) of this section shall be further reduced under this paragraph (d)(4) proportionately by the amount of any expired foreign tax credit loss equivalent with respect to that branch loss year. The previously deducted branch losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired foreign tax credit loss equivalents shall be applied to reduce the previously deducted branch loss for that year in the order in which the expired foreign tax credits arose.

(ii) *Existence of foreign tax credit loss equivalent.* A foreign tax credit loss equivalent exists with respect to a branch loss year if—

(A) The transferor paid, accrued, or is deemed under section 902 or 960 to have paid creditable foreign taxes in a taxable year;

(B) The creditable foreign taxes were paid, accrued, or deemed paid in the branch loss year or were available for carryover or carryback to the branch loss year under section 904(c);

(C) No foreign tax credit with respect to the foreign taxes paid, accrued, or deemed paid has been taken because of the operation of section 904(a) or similar limitations provided by the Code or an applicable treaty, and such taxes have not given rise to a reduction (pursuant to this paragraph (d)(5)) of any previously deducted branch loss of the foreign branch for a prior taxable year or of any previously deducted branch losses of any foreign branch of the transferor upon a prior transfer to a foreign corporation; and

(D) The period during which the transferor may claim a foreign tax credit for the foreign taxes paid, accrued, or deemed paid has expired.

(iii) *Amount of foreign tax credit loss equivalent.* The amount of the foreign tax credit loss equivalent for the branch loss year with respect to the creditable foreign taxes described in paragraph (d)(4)(ii) of this section is the amount of those creditable foreign taxes divided by the highest rate of tax to which the transferor was subject in the loss year.

(5) *Reduction for expired investment credits*—(i) *In general.* The previously deducted branch ordinary loss and the previously deducted branch capital loss for each branch loss year shall be further reduced under this paragraph (d)(5) proportionately by the amount of any expired investment credit loss equivalent with respect to that branch year. The previously deducted branch losses shall be reduced proceeding from the first branch loss year to the last branch loss year. For each branch loss year, expired investment credit loss equivalents shall be applied to reduce the previously deducted branch loss for that year in the order in which the expired investment credits were earned.

(ii) *Existence of investment credit loss equivalent.* An investment credit loss equivalent exists with respect to a branch loss year if—

(A) The transferor earned an investment credit (within the meaning of section 46(a)) in a taxable year;

(B) The investment credit was earned in the branch loss year or was available for carryover or carryback to the branch loss year under section 39;

(C) The investment credit earned by the transferor in the credit year has been denied by section 38(a) or by similar provisions of the Code and has not given rise to a reduction (pursuant to this paragraph (d)(5)) of any previously deducted branch loss of the foreign branch for a preceding taxable year or of the previously deducted losses of any foreign branch of the transferor upon any previous transfer to a foreign corporation; and

(D) The period during which the transferor may claim the investment credit has expired.

(iii) *Amount of investment tax credit loss equivalent.* The amount of the investment credit loss equivalent for the branch loss year with respect to the investment credit described in paragraph (d)(5)(ii) of this section is 85 percent of the amount of that investment credit divided by the highest rate of tax to which the transferor was subject in the loss year.

(e) *Amounts that reduce previously deducted losses subject to recapture*—(1) *In general.* This paragraph (e) describes five amounts that reduce the sum of the previously deducted branch ordinary losses and the sum of the previously deducted branch capital losses before they are taken into income under paragraph (b) of this section. Amounts representing ordinary income shall be applied to reduce first the sum of the previously deducted branch

ordinary losses to the extent thereof, and then the sum of the previously deducted branch capital losses to the extent thereof. Similarly, amounts representing capital gains shall be applied to reduce first the sum of the previously deducted branch capital losses and then the sum of the previously deducted branch ordinary losses.

(2) *Taxable income.* The previously deducted losses shall be reduced by any taxable income of the foreign branch recognized through the close of the taxable year of the transfer, whether before or after any taxable year in which losses were incurred.

(3) *Amounts currently recaptured under section 904(f)(3).* The previously deducted losses shall be reduced by the amount recognized under section 904(f)(3) on account of the transfer.

(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.

(5) *Amounts previously recaptured under section 904(f)(3)*—(i) *In general.* The previously deducted branch losses shall be reduced by the portion of any amount recognized under section 904(f)(3) upon a previous transfer of property that was attributable to the losses of the foreign branch, provided that the amount did not reduce any gain otherwise required to be recognized under section 367(a)(3)(C) and this section (or Revenue Ruling 78–201, 1978–1 C.B. 91).

(ii) *Portion attributable to the losses of the foreign branch*—(A) *Branch property.* The full amount recognized under section 904(f)(3) upon a previous transfer of property of the branch shall be treated as attributable to the losses of the foreign branch.

(B) *Non-branch property.* The portion of the amount previously recognized under section 904(f)(3) upon a transfer of non-branch property that was attributable to the losses of the foreign branch shall be the sum, over the taxable years in which the transferor sustained an overall foreign loss some portion of which was recaptured on the disposition, of the recaptured portions of those overall foreign losses after multiplication by the following fraction:

$$\frac{\text{Losses of the foreign branch for the year}}{\text{All foreign losses for the year}}$$

For purposes of this fraction, the term "losses of the foreign branch for the year" means the losses of the foreign branch that were taken into account under section 904(f)(2) in determining the amount of the transferor's overall foreign loss for the year, and the term "all foreign losses for the year" means all of the losses of the transferor that were taken into account under section 904(f)(2).

(6) *Amounts previously recognized under the rules of this section.* The previously deducted losses shall be reduced by the amounts previously recognized under the rules of this section upon a previous transfer of assets of the foreign branch.

(f) *Example.* The rules of paragraphs (b) through (e) of this section are illustrated by the following example.

*Example.* (i) *Facts.* X, a U.S. corporation, is a calendar year taxpayer. On January 1, 1981, X established a branch in foreign country A to manufacture and sell X's products in country A. On July 1, 1986, X organized corporation Y, a country A subsidiary, and transferred to Y all of the assets of its country A branch, including goodwill and going concern value. During the period from January 1, 1981, through July 1, 1986, X's country A branch earned income and incurred losses in the following amounts:

COUNTRY A BRANCH

| Year | Ordinary income (loss) | Capital gain (loss) |
|---|---|---|
| 1981 | (200) | 0 |
| 1982 | (300) | (100) |
| 1983 | (400) | 0 |
| 1984 | (200) | 0 |
| 1985 | (100) | 0 |
| 1986 | 50 | 0 |

At the time of the transfer of X's country A branch assets to Y, those assets had a fair market value of $2,500 and an adjusted basis of $1,000. For each of the assets, fair market value exceeded adjusted basis. X had no net capital loss or unused investment credit during any taxable year relevant to the transfer. In 1984, X incurred a net operating loss of $400, $200 of which was carried back to prior years. An additional $50 of the 1984 net operating loss was carried over to 1985. The remaining $150 of the 1984 net operating loss was not used in any year prior to the transfer. In 1979, X paid creditable foreign taxes of $330 that could not be claimed as a credit in that year or any earlier year because of section 904. Of those foreign taxes, $100 were carried over and claimed as a credit in 1983, but the remaining $230 were not used in any year prior to the transfer. X was not required to recognize any gain under section 904(f)(3) on account of the 1986 transfer or any prior transfer. X was not required to recognize gain upon the transfer under section 367(a) (other than by reason of the provisions of this section).

(ii) *Previously deducted losses.* The previously deducted losses of X's country A branch are $575 of ordinary losses and $25 of capital losses, computed as follows: Initially, the branch has previously deducted ordinary losses of $1,000 ($200+$300+$400+$100), and previously deducted capital losses of $100. (See paragraph (d)(1) of this section.)

(iii) *Expired losses and credits.* Under the facts of this example, there are no reductions for expired net ordinary losses or expired net capital losses under paragraph (d) (2) or (3) of this section. However, the previously deducted losses are reduced proceeding from the first branch loss year to the last branch loss year to reflect the expired foreign tax credit from 1979. The amount of the foreign tax credit loss equivalent with respect to 1981 is $500 ($230/.46). It reduces the previously deducted losses for 1981 proportionately. Thus, the previously deducted ordinary loss for 1981 is reduced from $200 to $0. (See paragraph (d)(4) of this section.) The amount of the foreign tax credit loss equivalent with respect to 1982 is $300 ($500−$200, *i.e.*, $138/.46). (See paragraph (d)(4)(ii)(C) of this section.) It reduces the previously deducted losses for 1982 proportionately. Thus, the previously deducted ordinary loss for 1982 is reduced from $300 to $75, and the previously deducted capital loss for 1982 is reduced from $100 to $25.

(iv) *Further reductions.* The previously deducted ordinary losses of $575 and the previously deducted capital losses of $25 are reduced by the taxable income earned by the branch prior to the date of the transfer ($250). (See paragraph (e)(2) of this section.) Since that income was ordinary income, it is applied first to reduce the previously deducted ordinary losses of $575 to $325. (See paragraph (e)(1) of this section.)

(v) *Recapture.* Since the gain realized by X upon its transfer of the branch assets to Y exceeds the sum of the previously deducted branch losses as defined and reduced above ($325+$25), the limitation in paragraph (c)(2) of this section does not apply. Thus, X is required to recognize $325 of ordinary income and $25 of long-term capital gain upon the transfer. (See paragraph (b) and (c)(1) of this section.)

(g) *Definition of foreign branch*—(1) *In general.* For purposes of this section, the term "foreign branch" means an integral business operation carried on by a U.S. person outside the United States. Whether the activities of a U.S. person outside the United States constitute a foreign branch operation must be determined under all the facts and circumstances. Evidence of the existence of a foreign branch includes, but is not limited to, the existence of a

separate set of books and records, and the existence of an office or other fixed place of business used by employees or officers of the U.S. person in carrying out business activities outside the United States. Activities outside the United States shall be deemed to constitute a foreign branch for purposes of this section if the activities constitute a permanent establishment under the terms of a treaty between the United States and the country in which the activities are carried out. Any U.S. person may be treated as having a foreign branch for purposes of this section, whether that person is a corporation, partnership, trust, estate, or individual.

(2) *More than one branch.* If a U.S. person carries on more than one branch operation outside the United States, then the rules of this section must be separately applied with respect to each foreign branch that is transferred to a foreign corporation. Thus, the previously deducted losses of one branch may not be offset, for purposes of determining the gain required to be recognized under the rules of this section, by the income of another branch that is also transferred to a foreign corporation. Similarly, the losses of one branch shall not be recaptured upon a transfer of the assets of a separate branch. Whether the foreign activities of a U.S. person are carried out through more than one branch must be determined under all of the facts and circumstances. In general, a separate branch exists if a particular group of activities is sufficiently integrated to constitute a single business that could be operated as an independent enterprise. For purposes of determining the combination of activities that constitute a branch operation as defined in this paragraph (g), the nominal relationship among those activities shall not be controlling. Factors suggesting that nominally separate business operations constitute a single foreign branch include a substantial identity of products, customers, operational facilities, operational processes, accounting and record-keeping functions, management, employees, distribution channels, or sales and purchasing forces. For examples of the application of the principles of this paragraph (g)(2), see Revenue Ruling 81–82, 1981–1 C.B. 127.

(3) *Consolidated group.* For purposes of this section, the activities of each of two domestic corporations outside the United States will be considered to constitute a single foreign branch if—

(i) The two corporations are members of the same consolidated group of corporations; and

(ii) The activities of the two corporations in the aggregate would constitute a single foreign branch if conducted by a single corporation.

Notwithstanding the preceding rule of this paragraph (g)(3), gains of a foreign branch of a domestic corporation arising in a year in which that corporation did not file a consolidated return with a second domestic corporation shall not be applied to reduce the previously deducted losses of a foreign branch of the second corporation (but may be applied to reduce such losses of the foreign branch of the first corporation) upon the transfer of the two branches to a foreign corporation, even though the two domestic corporations file a consolidated return for the year in which the transfer occurs and the two branches are considered at that time to constitute a single foreign branch. For an example of the application of the principles of this paragraph (g)(3), see Revenue Ruling 81–89, 1981–1 C.B. 129.

(4) *Property not transferred.* A U.S. transferor's failure to transfer any property of a foreign branch shall be irrelevant to the determination of the previously deducted losses of the branch subject to recapture under the rules of this section. Thus, if the activities with respect to untransferred property constituted a part of the branch operation under the rules of this paragraph (g), then the losses generated by those activities shall be subject to recapture, notwithstanding the failure to transfer the property. For an example of the application of the principles of this paragraph (g)(4), see Revenue Ruling 80–247, 1980–2 C.B. 127, relating to property abandoned by the U.S. transferor.

(h) *Anti-abuse rule.* If—

(1) A U.S. person transfers property of a foreign branch to a domestic corporation for a principal purpose of avoiding the effect of this section; and

(2) The domestic corporation thereafter transfers the property of the foreign branch to a foreign corporation, then, solely for purposes of this section, that U.S. person shall be treated as having transferred the property of the branch directly to the foreign corporation. A U.S. person shall be presumed to have transferred property of a foreign branch for a principal purpose of avoiding the effect of this section if the property is transferred to the domestic corporation less than two years prior to the domestic corporation's transfer of the property to a foreign corporation. This presumption may be rebutted by clear evidence that the subsequent transfer of the property was not contemplated at the time of the initial transfer to the domestic corporation and that avoidance of the effect of this section was not a principal purpose for the transaction. A transfer may have more than one principal purpose.

(i) *Basis adjustments.* Basis adjustments reflecting gain recognized pursuant to this section shall be made as described in § 1.367(a)–1T(b)(4)(ii).

**Par. 5.** Section 1.367(d)–1T is added immediately after § 1.367(c)–2, to read as follows:

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

(a) *Purpose and scope.* This section provides rules under section 367(d) concerning transfers of intangible property by U.S. persons to foreign corporations pursuant to section 351 or 361. Paragraph (b) of this section specifies the transfers that are subject to section 367(d) and the rules of this section, while paragraph (c) provides rules concerning the consequences of such a transfer. In general, the U.S. transferor will be treated as receiving annual payments contingent on productivity or use of the transferred property, over the useful life of the property (regardless of whether such payments are in fact made by the transferee). Paragraphs (d), (e), and (f) of this section provide rules for cases in which there is a later direct or indirect disposition of the intangible property transferred. In general, deemed annual license payments will continue if a transfer is made to a related person, while gain must be recognized immediately if the transfer is to an unrelated person. Paragraph (g) of this section provides several special rules, including a rule allowing appropriate adjustments where deemed payments under section 367(d) are not in fact received by the U.S. transferor of the intangible property, and a rule providing for a limited election to treat certain transfers of intangible property as sales at fair market value (in lieu of applying the general useful life-contingent payment rule). In addition, paragraph (g) of this section provides rules coordinating the application of section 367(d) with other relevant Code sections. Paragraph (h) of this section defines the term "related person" for purposes of this section. Finally, paragraph (i) of this section provides the effective date of this section. For rules concerning transfers of intangible property pursuant to section 332, see § 1.367(a)–5T(e).

(b) *Intangible property subject to section 367(d).* Section 367(d) and the rules of this section shall apply to the

transfer of any intangible property, as defined in § 1.367(a)–1T(d)(5)(i). However, section 367(d) and the rules of this section shall not apply to the transfer of foreign goodwill or going concern value, as defined in §1.367(a)–1T(d)(5)(iii), or to the transfer of intangible property described in §1.367(a)–5T(b)(2). However, the transfer of those items to a foreign corporation is subject to the rules set forth in § 1.367(a)–6T, and the transfer of intangible property described in § 1.367(a)–5T(b)(2) is subject to the rules set forth in § 1.367(a)–5T. For a special rule relating to the transfer of operating intangibles, as defined in § 1.367(a)–1T(d)(5)(ii), see paragraph (g)(3) of this section. Transfers of intangible property to foreign corporations pursuant to section 351 or 361 are subject to the rules of this section regardless of whether the property is to be used in the United States, in connection with goods to be sold or consumed in the United States, or in connection with a trade or business outside the United States.

(c) *Deemed payments upon transfer of intangible property to foreign corporation*—(1) *In general.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, then such person shall be treated as having transferred that property in exchange for annual payments contingent on the productivity or use of the property. Such person shall, over the useful life of the property, annually include in gross income an amount that represents an appropriate arms-length charge for the use of the property. The appropriate charge shall be determined in accordance with the provisions of section 482 and regulations thereunder. See § 1.482–2(d). The amount of the deemed payment thus calculated shall be reduced by any royalty or other periodic payment made or accrued by the transferee to an unrelated person during that taxable year for the right to use the intangible property. Amounts so included in the transferor's income shall be treated as ordinary income from sources within the United States. For purposes of computing estimated tax payments, deemed payments under this paragraph (c) shall be treated as received by the transferor on the last day of its taxable year.

(2) *Required adjustments.* The following adjustments shall be made with respect to a U.S. person's recognition of a deemed payment for the use of intangible property under this paragraph (c):

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of such deemed payment; and

(ii) For purposes of Subpart F of Part III of subchapter N of the Code, the transferee foreign corporation may treat such deemed payment as an expense (whether or not that amount is actually paid), properly allocated and apportioned to gross income subject to Subpart F, in accordance with the provisions of §§ 1.954–1(c) and 1.861–8. No other special adjustments to earning the profits, basis, or gross income shall be permitted by reason of the recognition of a deemed payment under this paragraph (c). However, see paragraph (g)(1) of this section for rules permitting the establishment of an account receivable with respect to deemed payments not actually received by the U.S. person.

(3) *Useful life.* For purposes of this section, the useful life of intangible property is the entire period during which the property has value. However, in no event shall the useful life of an item of intangible property be considered to exceed twenty years. If intangible property derives its value from secrecy or from protections afforded by law, the useful life of such property shall terminate when the property is no longer secret or no longer legally protected.

(4) *Blocked income.* No deemed payment included in a taxpayer's income under paragraph (c)(1) of this section shall be treated as deferrable income for purposes of applying rules relating to blocked foreign income. See Revenue Ruling 74–351, 1974–2 C.B. 144.

(d) *Subsequent transfer of stock of transferee foreign corporation to unrelated person*—(1) *Treatment as sale of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that U.S. transferor subsequently disposes of the stock of the transferee foreign corporation to a person that is not a related person (within the meaning of paragraph (h) of this section), then the U.S. transferor shall be treated as having simultaneously sold the intangible property to the person acquiring the stock of the transferee foreign corporation. The U.S. transferor shall be required to recognize gain (but not loss) from sources within the United States in an amount equal to the difference between the fair market value of the transferred intangible property on the date of the subsequent disposition and the U.S. transferor's former adjusted basis in that property (determined as of the original transfer). If the U.S. transferor's disposition of the stock of the transferee foreign corporation is subject to U.S. tax other than by reason of this paragraph (d), then the amount of gain otherwise required to be recognized with respect to the stock of the transferee foreign corporation shall be reduced by the amount of gain recognized with respect to the intangible property pursuant to this paragraph (d).

(2) *Required adjustments.* If a U.S. person disposes of the stock of a transferee foreign corporation, and under paragraph (d)(1) of this section is treated as having simultaneously sold intangible property, then, for purposes of computing basis and earnings and profits, the person acquiring the stock of the transferee foreign corporation shall be deemed to have purchased that property at fair market value and to have immediately thereafter contributed it to the transferee foreign corporation in a transaction not covered by section 367(d). Therefore, for purposes of chapter 1 of the Code—

(i) The transferee foreign corporation's basis in the intangible property will be equal to its fair market value (as calculated for purposes of determining the gain required to be recognized by the U.S. transferor);

(ii) The acquiring person's basis in the stock of the transferee foreign corporation shall be determined as if no portion of the consideration given by the acquiring person for the stock is attributable to the intangible property; and

(iii) The earnings and profits of the transferee foreign corporation will not be affected by the transfer of its stock or the deemed transfer to it of the intangible property.

(e) *Subsequent transfer of stock of transferee foreign corporation to related person*—(1) *Transfer to related U.S. person treated as disposition of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361 and, within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers the stock of the transferee foreign corporation to U.S. persons that are related to the transferor within the meaning of paragraph (h) of this section, then the following rules shall apply:

(i) Each such related U.S. person shall be treated as having received (with the

stock of the transferee foreign corporation) a right to receive a proportionate share of the contingent annual payments that would otherwise be deemed to be received by the U.S. transferor under paragraph (c) of this section.

(ii) Each such related U.S. person shall, over the useful life of the property, annually include in gross income a proportionate share of the amount that would have been included in the income of the U.S. transferor pursuant to paragraph (c) of this section. Such amounts shall be treated as ordinary income from sources within the United States.

(iii) The amount of income required to be recognized by the U.S. transferor pursuant to the rule of paragraph (d)(1) of this section shall be reduced to the amount determined in accordance with the following formula:

(d)(1) amount × (100% − (e) percentage)

For purposes of the above formula, the "(d)(1) amount" is the income that would otherwise be required to be recognized by the transferor corporation pursuant to paragraph (d)(1) of this section, and the "(e) percentage" is the percentage of the transferor corporation's total deemed rights to receive contingent annual payments under paragraph (c) of this section that is deemed to be transferred to related U.S. persons under the rules of this paragraph (e).

(iv) The rules of paragraphs (d) and (e) of this section shall be reapplied in the case of any later transfer of the stock of the transferee foreign corporation by a related U.S. person that received such stock in a transfer that was subject to the rules of this paragraph (e). For purposes of reapplying the rules of paragraphs (d) and (e), each such related U.S. person shall be treated as a U.S. transferor of intangible property to the transferee foreign corporation (to the extent of the interest attributed to such person pursuant to subdivision (i) of this paragraph (e)(1)).

(2) *Required adjustments.* If a U.S. person transfers stock of a transferee foreign corporation to a U.S. related person in a transaction that is subject to the rules of paragraph (e)(1) of this section, the following adjustments shall be made:

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of any payment deemed to be received by a related U.S. person under paragraph (e)(1)(ii) of this section;

(ii) For purposes of Subpart F of Part III of subchapter N of the Code, the transferee foreign corporation may allocate and apportion such deemed payments (whether or not such payments are actually made to gross income subject to Subpart F to the extent appropriate under the provisions of §§ 1.954–1(c) and 1.861–8;

(iii) For purposes of reapplying the rules of paragraph (d) and (e) of this section, if the related U.S. person is deemed to have received a right to contingent annual payments for the use of intangible property, then the U.S. related person shall be deemed to have held a proportionate share of the property with a basis equal to a proportionate share of the U.S. transferor's adjusted basis plus the gain, if any, recognized by the U.S. transferor on the earlier transfer of the stock to the U.S. related person, and then to have transferred that proportionate share of the property to the foreign corporation in a transfer subject to section 367(d); and

(iv) If the U.S. transferor is itself required to recognize gain upon the transfer by reason of the operation of paragraphs (d)(1) and (e)(1)(iii) of this section (because stock of the transferee foreign corporation is also transferred to unrelated persons), then those unrelated persons shall be deemed to have purchased a proportionate share of the transferred intangible property at fair market value and immediately contributed that property to the transferee foreign corporation, consistent with the general rule of paragraph (d)(2) of this section concerning transfers of stock to unrelated persons. Therefore, for purposes of chapter 1 of the Code—

(A) Each unrelated person's basis in the stock of the transferee foreign corporation shall be increased to the extent of the gain recognized by the U.S. transferor upon the deemed purchase of intangible property by that person; and

(B) The transferee foreign corporation will receive an increase in its basis in the transferred intangible property equal to the fair market value of that portion of the intangible property deemed to be contributed to the transferee foreign corporation by unrelated persons (as calculated for purposes of determining the gain required to be recognized by the U.S. transferor).

(3) *Transfer to related foreign person not treated as disposition of intangible property.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers any of the stock of the transferee foreign corporation to one or more foreign persons that are related to the transferor within the meaning of paragraph (h) of this section, then the U.S. transferor shall continue to include in its income the deemed payments described in paragraph (c) of this section in the same manner as if the subsequent transfer of stock had not occurred. The rule of this paragraph (e)(3) shall not apply with respect to the subsequent transfer by the U.S. person of any of the remaining stock to any related U.S. person or unrelated person.

(4) *Proportionate share.* For purposes of this paragraph (e), any "proportionate share" shall be determined by reference to the fair market value (at the time of the original transfer) of the stock of the transferee foreign corporation that was transferred by the U.S. transferor and the fair market value of all of the stock of the transferee foreign corporation originally received by the U.S. transferor.

(f) *Subsequent disposition of transferred intangible property by transferee foreign corporation*—(1) *In general.* If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that transferee foreign corporation subsequently disposes of the intangible property to an unrelated person, then—

(i) The U.S. transferor of the intangible property (or any person treated as such pursuant to paragraph (e)(1) of this section) shall be required to recognize gain from U.S. sources (but not loss) in an amount equal to the difference between the fair market value of the transferred intangible property on the date of the subsequent disposition and the U.S. transferor's former adjusted basis in that property (determined as of the orginial transfer); and

(ii) The U.S. transferor shall be required to recognize a deemed payment under paragraph (c) of this section for that part of its taxable year that the intangible property was held by the transferee foreign corporation and thereafter shall not be required to recognize any further deemed payments under paragraph (c) or (e)(1) of this section with respect to the transferred intangible property disposed of by the transferee foreign corporation.

(2) *Required adjustments.* If a U.S. transferor is required to recognize gain

under paragraph (f)(1) of this section, then—

(i) For purposes of chapter 1 of the Code, the earnings and profits of the transferee foreign corporation shall be reduced by the amount of gain required to be recognized; and

(ii) The U.S. transferor's recognition of gain will permit the establishment of an account receivable from the transferee foreign corporation, in accordance with paragraph (g)(1) of this section.

(3) *Subsequent transfer of intangible property to related person.* The requirement that a U.S. person recognize gain under paragraph (c) or (e) of this section shall not be affected by the transferee foreign corporation's subsequent disposition of the transferred intangible property to a related person. For purposes of any required adjustments, and of any accounts receivable created under paragraph (g)(1) of this section, the related person that receives the intangible property shall be treated as the transferee foreign corporation.

(g) *Special rules*—(1) *Establishment of accounts receivable*—(i) *In general.* If a U.S. person is required to recognize income under the provisions of paragraph (c), (e), or (f) of this section, and the amount deemed to be received is not actually paid by the transferee foreign corporation, then the U.S. person may establish an account receivable from the transferee foreign corporation equal to the amount deemed paid that was not actually paid. A separate account receivable must be established for each taxable year in which payments deemed to be received are not actually made. Payments received from the transferee foreign corporation must be designated as payments upon a particular account and must be deducted from that account. Accounts receivable under this paragraph (g)(1) may be established and paid without further U.S. income tax consequences to the U.S. transferor or the transferee foreign corporation. No interest shall be paid or accrued on an account receivable created under this paragraph (g)(1), nor shall any bad debt deduction be allowed under section 166 with respect to any failure to receive payment on an account.

(ii) *Unpaid receivable treated as contribution to capital.* If any portion of an account receivable established under this paragraph (g)(1) remains unpaid as of the last day of the third taxable year following the taxable year to which the account relates, then—

(A) Such portion shall be deemed to have been paid on that date; and

(B) The U.S. person shall be deemed to have contributed an equivalent amount to the capital of the foreign corporation, and the U.S. person's basis in the stock of the foreign corporation shall, therefore, be increased by that amount.

(2) *Election to treat transfer as sale.* A U.S. person that transfers intangible property to a foreign corporation in a transaction subject to section 367(d) may elect to recognize income in accordance with the rules of this paragraph (g)(2), if—

(i) The intangible property transferred constitutes an operating intangible, as defined in § 1.367(a)–1T(d)(5)(ii); or

(ii) The transfer of the intangible property is either legally required by the government of the country in which the transferee corporation is organized as a condition of doing business in that country, or compelled by a genuine threat of immediate expropriation by the foreign government; or

(iii)(A) The U.S. person transferred the intangible property to the foreign corporation within three months of the organization of that corporation and as part of the original plan of capitalization of that corporation;

(B) Immediately after the transfer, the U.S. person owns at least 40 percent but not more than 60 percent of the total voting power and total value of the stock of the transferee foreign corporation;

(C) Immediately after the transfer, at least 40 percent of the total voting power and total value of the stock of the transferee foreign corporation is owned by foreign persons unrelated to the U.S. person;

(D) Intangible property constitutes at least 50 percent of the fair market value of the property transferred to the foreign corporation by the U.S. transferor; and

(E) The transferred intangible property will be used in the active conduct of a trade or business outside of the United States within the meaning of § 1.367(a)–2T and will not be used in connection with the manufacture or sale of products in or for use or consumption in the United States.

A person that makes the election under this paragraph (g)(2) shall not be subject to the provisions of paragraphs (c) through (f) of this section. Such person shall instead recognize in the year of the transfer ordinary income from sources within the United States in an amount equal to the difference between the fair market value of the intangible property transferred and its adjusted basis. A U.S. person shall make an election under this paragraph (g)(2) by notifying the Internal Revenue Service of the election in accordance with the requirements of section 6038B and regulations thereunder, and subsequently including the appropriate amounts in gross income in a timely filed tax return for the year of the transfer.

(3) *Intangible property transferred from branch with previously deducted losses.* If income is required to be recognized under section 904(f)(3) and the regulations thereunder or under § 1.367(a)–6T upon the transfer of intangible property of a foreign branch that had previously deducted losses, then the income recognized under those sections with respect to that property shall be credited against amounts that would otherwise be required to be recognized with respect to that same property under paragraphs (c) through (f) of this section in either the current or future taxable years. The amount recognized under section 904(f)(3) or § 1.367(a)–6T with respect to the transferred intangible property shall be determined in accordance with the following formula:

$$\text{loss recapture income} \times \frac{\text{gain from intangibles}}{\text{gain from all branch assets}}$$

For purposes of the above formula, the "loss recapture income" is the total amount required to be recognized by the U.S. transferor pursuant to section 904(f)(3) or § 1.367(a)–6T. The "gain from intangibles" is the total amount of gain realized by the U.S. transferor pursuant to section 904(f)(3) and § 1.367(a)–6T upon the transfer of items of intangible property that are subject to section 367(d). ("Gain from intangibles" does not include gain realized upon the transfer of property described in § 1.367(a)–5T(b)(2), foreign goodwill or going concern value, or intangible property with respect to which the taxpayer has made the election provided for in § 1.367(d)–1T(g)(2).) The "gain from all branch assets" is the total amount of gain realized by the transferor upon the transfer of items of property of the branch in which gain is realized. The fraction shall not exceed 1.

(4) *Coordination with section 482*—(i) *In general.* Section 367(d) and the rules of this section shall not apply in the case of an actual sale or license of intangible property by a U.S. person to a foreign

corporation. If an adjustment under section 482 is required with respect to an actual sale or license of intangible property, then section 367(d) and the rules of this section shall not apply with respect to the required adjustment. If a U.S. person transfers intangible property to a related foreign corporation without consideration, or in exchange for stock or securities of the transferee in a transaction described in sections 351 or 361, no sale or license subject to adjustment under section 482 will be deemed to have occurred. Instead, the U.S. person shall be treated as having made a transfer of the intangible property that is subject to section 367(d).

(ii) *Sham licenses and sales.* For purposes of paragraph (g)(4)(i) of this section, a purported sale or license of intangible property may be disregarded, and treated as a transfer subject to section 367(d) and the rules of this section, if—

(A) The purported sale or license is made to a foreign corporation in which the transferor holds (or is acquiring) an interest; and

(B) The terms of the purported sale or license differ so greatly from the economic substance of the transaction or the terms that would obtain between unrelated persons that the purported sale or license is a sham.

The terms of a purported sale or license, for purposes of applying the rule of this paragraph (g)(4)(ii), shall be determined by reference not only to the nominal terms of the agreement but also to the actual practice of the parties under that agreement. A sale or license of intangible property shall not be disregarded under this paragraph (g)(4)(ii) solely because other property of an integrated business is simultaneously transferred to the foreign corporation by the U.S. transferor in a transaction described in section 367(a)(1) or any statutory or regulatory exception to section 367(a)(1).

(5) *Determination of fair market value.* For purposes of determining the gain required to be recognized immediately under paragraph (d), (f), or (g)(2) of this section, the fair market value of transferred property shall be the single payment arm's-length price that would be paid for the property by an unrelated purchaser determined in accordance with the principles of section 482 and regulations thereunder. The allocation of a portion of the purchase price to intangible property agreed to by the parties to the transaction shall not necessarily be controlling for this purpose.

(6) *Anti-abuse rule.* If a U.S. person—

(i) Transfers intangible property to a domestic corporation with a principal purpose of avoiding the effect of section 367(d) and the rules of this section; and

(ii) Thereafter transfers the stock of that domestic corporation to a related foreign corporation,

then solely for purposes of section 367(d) that U.S. person shall be treated as having transferred the intangible property directly to the foreign corporation. A U.S. person shall be presumed to have transferred intangible property for a principal purpose of avoiding the effect of section 367(d) if the property is transferred to the domestic corporation less than two years prior to the transfer of the stock of that domestic corporation to a foreign corporation. The presumption created by the previous sentence may be rebutted by clear evidence that the subsequent transfer of the stock of the domestic transferee corporation was not contemplated at the time the intangible property was transferred to that corporation and that avoidance of section 367(d) and the rules of this section was not a principal purpose of the transaction. A transfer may have more than one principal purpose.

(h) *Related person.* For purposes of this section, persons are considered to be related if—

(1) They are partners or partnerships described in section 707(b)(1) of the Code; or

(2) They are related within the meaning of section 267 (b), (c), and (f) of the Code, except that—

(i) "10 percent or more" shall be substituted for "more than 50 percent" each place it appears; and

(ii) Section 1563 shall apply (for purposes of section 267(d)), without regard to section 1563(b)(2).

(i) *Effective date.* Except as specifically provided to the contrary elsewhere in this section, this section applies to transfers occurring after December 31, 1984.

**Par. 6.** Section 1.6038B–1T is added immediately after § 1.6038A–1, to read as follows:

**§ 1.6038B–1T Reporting of transactions described in section 367 (temporary).**

(a) *Purpose and scope.* This section sets forth information reporting requirements under section 6038B, concerning certain transfers of property to foreign persons. Paragraph (b) of this section provides general rules explaining when and how to carry out the reporting required under section 6038B. Paragraphs (c) and (d) of this section specify the information that is required to be reported with respect to transfers of property that are described in section 367 (a) and (d), respectively. Finally, paragraph (f) of this section sets forth the consequences of a failure to comply with the requirements of section 6038B and this section. Except as specifically provided to the contrary elsewhere in this section, this section applies to transfers occurring after December 31, 1984.

(b) *Time and manner of reporting*—(1) *In general.* Any U.S. person that is required to report pursuant to section 6038B and the rules of this section must attach the required information to Form 926 (Return by Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership). Form 926 and the required attachments must be filed at the Internal Revenue Service Center where the U.S. person is required to file its Federal income tax return. Notwithstanding any statement to the contrary on Form 926, the form and attachments must be filed with the transferor's tax return for the taxable year that includes the date of the transfer (as defined in paragraph (b)(3) of this section). However, in the case of a transfer that occurred prior to June 16, 1986, Form 926 and the required attachments must be filed by September 16, 1986, if that date is later than the date the filing would otherwise be required under the preceding sentence. Section 7502 and regulations thereunder shall apply in determining whether the form and attachments are timely filed. Any attachment to Form 926 required under the rules of this section is filed subject to the transferor's declaration under penalties of perjury on Form 926 that the information submitted is true, correct and complete to the best of the transferor's knowledge and belief.

(2) *Person required to file*—(i) *In general.* Form 926 and the attachments required under the rules of this section must be filed by each U.S. person that makes a transfer described in section 367 (a) or (d). No notice shall be required under this section with respect to a distribution described in section 367(e). No notice shall be required under this section with respect to a transfer of stock of securities described in § 1.367(a)–3T(f)(1) or with respect to a transfer described in section 367(a)(2). If two or more persons transfer jointly-owned property to a foreign corporation in a transfer with respect to which a notice is required under this section, then each person must report with respect to the particular interest he transferred, specifying the nature and extent of the interest. However, a husband and wife (and their minor children) may jointly file a single information return. If two or more U.S.

persons owning stock or securities in a corporation transfer such stock or securities to a foreign corporation in the same transaction, then the corporation whose stock or securities are transferred may, at its choice, file the notice required by this section on behalf of its shareholders. In that case, a single Form 926, signed by the responsible officer of the corporation, shall be filed, containing the required information with respect to each shareholder, other than shareholders described in § 1.367(a)–3T(f)(1).

(ii) *Indirect transfers.* If a U.S. person that holds an interest in an entity is considered to make an indirect transfer (when the entity transfers property to a foreign corporation) under the provisions of—

(A) Section 367(a)–1T(c)(2)(i)(B) (concerning mergers to which section 368(a)(2)(D) applies);

(B) Section 367(a)–1T(c)(2)(i)(C) (concerning mergers to which section 368(a)(2)(E) applies);

(C) Section 367(a)–1T(c)(2)(ii) (concerning reorganizations described in section 368(a)(1)(B));

(D) Section 367(a)–1T(c)(2)(iii) (concerning reorganizations described in section 368(a)(1)(C));

(E) Section 367(a)–1T(c)(3)(i) (concerning transfers of property by a partnership); or

(F) Section 367(a)–1T(c)(4) (concerning transfers of property by a trust or estate),

then the requirements of this section shall apply with respect to each such person. However, the requirements of this section may be satisfied by the entity, on behalf of its interest-holders, by the filing of a single information return containing the required information with respect to each interest-holder (other than persons described in § 1.367(a)–3T(f)(1)) that is considered to make a transfer described in section 367(a). If the entity chooses to satisfy the requirements of this section on behalf of its interest-holders, Form 926 must be signed by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, and by a trustee, executor, or equivalent fiduciary in the case of a trust or estate.

(3) *Date of transfer*—(i) *In general.* For purposes of this section, the date of a transfer described in section 367 is the first date on which title to, possession of, or rights to the use of stock, securities, or other property passes pursuant to the plan for purposes of subtitle A of the Internal Revenue Code. A transfer will not be considered to begin with a decision of a board of directors or similar action unless the transaction otherwise takes effect for purposes of subtitle A of the Internal Revenue Code on that date.

(ii) *Termination of section 1504(d) election.* A transfer deemed to occur as a result of the termination of an election under section 1504(d) will be considered to occur on the date the contiguous country corporation first fails to continue to qualify for the election under section 1504(d). The rule of this paragraph (b)(3)(ii) is illustrated by the following example.

*Example.* Domestic corporation W previously made a valid election under section 1504(d) to have its Mexican subsidiary S treated as a domestic corporation. On August 1, 1986, W disposes of its right, title, and interest in 10 percent of the stock of S by selling such stock to an unrelated United States person who is not a director of S. S first fails to continue to qualify for the election under section 1504(d) on August 1, 1986, since on such date it ceases to be directly or indirectly wholly owned or controlled by W. The constructive transfer of assets from "domestic" corporation S to Mexican corporation S is considered to occur on that date.

(iii) *Change in classification.* A transfer deemed to occur as a result of a change in classification of an entity caused by a change in the governing documents, articles, or agreements of the entity (as described in § 1.367(a)–1T(c)(6)) will be considered to occur on the date that such changes take effect for purposes of subtitle A of the Internal Revenue Code.

(iv) *U.S. resident under section 6013 (g) or (h).* A transfer made by an alien individual who is considered to be a U.S. resident by reason of a timely election under section 6013 (g) or (h) will be considered to occur, for purposes of this section (but not for purposes of section 367), on the later of—

(A) The date on which the election under section 6013 (g) or (h) is made; or

(B) The date on which the transfer would otherwise be considered to occur under the rules of this paragraph (b)(3).

The rule of this paragraph (b)(3)(iv) is illustrated by the following example.

*Example.* D is a nonresident alien individual who is married to a United States citizen. On March 1, 1986, D transfers property to a foreign corporation in an exchange described in section 351. On April 15, 1987, D and the spouse timely file with their tax return for the taxable year ended December 31, 1986, an election under section 6013(g) for D to be treated as a United States resident. The election is effective on January 1, 1986. For purposes of section 6038 B, the transfer described in section 367(a) made by D in connection with the section 351 exchange is considered to occur on April 15, 1987, the date on which the timely election was made under section 6013(g).

(c) *Information required with respect to transfers described in section 367 (a)(1).* A U.S. person that transfers property to a foreign corporation in an exchange described in section 367(a)(1) (other than a transfer described in section 367(a)(2)) must provide the following information in paragraphs labelled to correspond with the number or letter set forth below. If a particular item is not applicable to the subject transfer, list its heading and state that it is not applicable.

(1) *Transferor.* Provide the name, U.S. taxpayer identification number, and address of the U.S. person making the transfer.

(2) *Transfer.* Provide the following information concerning the transfer:

(i) Name, U.S. taxpayer identification number (if any), address, and country of incorporation of transferee foreign corporation;

(ii) A general description of the transfer, and any wider transaction of which it forms a part, including a chronology of the transfers involved and an identification of the other parties to the transaction to the extent known.

(3) *Consideration received.* Provide a description of the consideration received by the U.S. person making the transfer, including its estimated fair market value and, in the case of stock or securities, the class or type, amount, and characteristics of the interest received.

(4) *Property transferred.* Provide a description of the property transferred. The description must be divided into the following categories, and must include the estimated fair market value and adjusted basis of the property, as well as any additional information specified below.

(i) *Active business property.* Describe any transferred property (other than stock or securities) to be used in the active conduct of a trade or business outisde of the United States. Provide here a general description of the business conducted (or to be conducted) by the transferee, including the location of the business, the number of its employees, the nature of the business, and copies of the most recently prepared balance sheet and profit and loss statement. Property listed within this category may be identified by general type. For example, upon the transfer of the assets of a manufacturing operation, a reasonable description of the property to be used in the business might include the categories of office equipment and supplies, computers and related equipment, motor vehicles, and several major categories of manufacturing

equipment. However, any property that is includible both in this subdivision (i) and in subdivision (iii) of this paragraph (c)(4) (property subject to depreciation recapture under § 1.367(a)–4T (b)) must be identified in the manner required in subdivision (iii). If property is considered to be transferred for use in the active conduct of a trade or business under a special rule in § 1.367(a)–4T, specify the applicable rule and provide information supporting the application of the rule. If property is subject to section 367(a)(1) regardless of its use in a trade or business under the rules of §§ 1.367(a)–4T or 1.367(a)–5T, list the property only in response to subdivision (vii) of this paragraph (c)(4).

(ii) *Stock or securities.* Describe any transferred stock or securities, including the class or type, amount, and characteristics of the transferred stock or securities, as well as the name, address, place of incorporation, and general description of the corporation issuing the stock. In addition, provide the following information if applicable:

(A) *Active trade or business stock.* If the stock or securities are considered to be transferred for use in the active conduct of a trade or business outside of the United States under the rules of § 1.367(a)–3T(d)(2), provide information supporting the application of the rule.

(B) *Application of special rules.* If any provision of § 1.367(a)–3T applies to except the transfer of stock or securities from the rule of section 367(a)(1), provide information supporting the claimed application of such provision (including information supporting the nonapplicability of either anti-abuse rule under § 1.367(a)–3T(h)). If the transferor is entering into an agreement to recognize gain upon a later disposition of the transferred stock by the transferee foreign corporation under § 1.367(a)–3T(g), attach the agreement and waiver as required by the rules of that paragraph.

(iii) *Depreciated property.* Describe any property that is subject to depreciation recapture under the rules of § 1.367(a)–4T(b). Property within this category must be separately identified to the same extent as was required for purposes of the previously claimed depreciation deduction. Specify with respect to each such asset the relevant recapture provision, the number of months in which such property was in use within the United States, the total number of months the property was in use, the fair market value of the property, a schedule of the depreciation deduction taken with respect to the property, and a calculation of the amount of depreciation required to be recaptured.

(iv) *Property to be leased.* Describe any property to be leased to other persons by the transferee foreign corporation (unless such property is considered to be transferred for use in the active conduct of a trade or business and was thus listed under subdivision (i) of this paragraph (c)(4)). If the rules of § 1.367(a)–4T(c)(2) apply to except the transfer from the rule of section 367(a)(1), provide information supporting the claimed application of such provision.

(v) *Property to be sold.* Describe any transferred property that is to be sold or otherwise disposed of by the transferee foreign corporation, as described in § 1.367(a)–4T(d).

(vi) *Transfers to FSCs.* Describe any property that is subject to the special rule of § 1.367(a)–4T(g) for transfers to FSCs. Provide information supporting the claimed application of that rule.

(vii) *Tainted property.* Describe any property that is subject to § 1.367(a)–5T (concerning property that is subject to the rule of section 367(a)(1) regardless of whether it is transferred for use in the active conduct of a trade or business outside of the United States). Such description must be divided into the relevant categories, as follows:

(A) *Inventory, etc.* Property described in § 1.367(a)–5T(b);

(B) *Installment obligations, etc.* Property described in § 1.367(a)–5T(c);

(C) *Foreign currency, etc.* Property described in § 1.367(a)–5T(d);

(D) *Intangible property.* Property described in § 1.367(a)–5T(e); and

(E) *Leased property.* Property described in § 1.367(a)–4T(f).

If any exception provided in § 1.367(a)–5T applies to the transferred property (making section 367(a)(1) not applicable to the transfer), provide information supporting the claimed application of such exception.

(viii) *Foreign loss branch.* Provide the information specified in paragraph (c)(5) of this section.

(ix) *Other intangibles.* Describe an intangible property sold or licensed by the transferor to the transferee foreign corporation, and set forth the general terms of each sale or license.

(5) *Transfer of foreign branch with previously deducted losses.* If the property transferred is property of a foreign branch with previously deducted losses subject to the rules of § 1.367(a)–6T, provide the following information:

(i) *Branch operation.* Describe the foreign branch the property of which is transferred, in accordance with the definition of § 1.367(a)–6T(g).

(ii) *Branch property.* Describe the property of the foreign branch, including its adjusted basis and fair market value. For this purpose property must be identified with reasonable particularity, but may be identified by category rather than listing every asset separately. Substantially similar property may be listed together for this purpose, and property of minor value may be grouped into functional categories. For example, a reasonable description of the property of a business office might include the following categories: word processing or data processing equipment, other office equipment and furniture, and office supplies.

(iii) *Previously deducted losses.* Set forth a detailed calculation of the sum of the losses incurred by the foreign branch before the transfer, and a detailed calculation of any reduction of such losses, in accordance with § 1.367(a)–6T (d) and (e).

(iv) *Character of gain.* Set forth a statement of the character of the gain required to be recognized, in accordance with § 1.367(a)–6T(c)(1).

(d) *Transfers subject to section 367(d)*—(1) *Initial transfer.* A U.S. person that transfers inntangible property to a foreign corporation in an exchange described in section 351 or 361 must provide the following information in paragraphs labelled to correspond with the number or letter set forth below. If a particular item is not applicable to the subject transfer, list its heading and state that it is not applicable. The information required by subdivisions (i) through (iii) need only be provided if such information was not otherwise provided under paragraph (c) of this section. (Note that the U.S. transferor may subsequently be required to file another return under paragraph (d)(2) of this section.)

(i) *Transferor.* Provide the name, U.S. taxpayer identification number, and address of the U.S. person making the transfer.

(ii) *Transfer.* Provide information concerning the transfer, including:

(A) Name, U.S. taxpayer identification number (if any), address, and country of incorporation of the transferee foreign corporation; (B) A general description of the transfer, and any wider transaction of which it forms a part, including a chronology of the transfers involved and an identification of the other parties to the transaction to the extent known.

(iii) *Consideration received.* Provide a description of the consideration received by the U.S. person making the transfer, including its estimated fair market value and, in the case of stock or securities, the class or type, amount, and characteristics of the interest received.

(iv) *Intangible property transferred.* Provide a description of the intangible property transferred, including its adjusted basis. Generally, each intangible asset must be separately identified. Operating intangibles and foreign goodwill or going concern value, as defined in § 1.367(a)–1T(d)(5) (ii) and (iii), should be so identified and classified.

(v) *Annual payment.* Provide and explain the calculation of the annual deemed payment for the use of the intangible property required to be recognized by the transferor under the rules of section 367(d).

(vi) *Election to treat as sale.* List any intangible with respect to which an election is being made under § 1.367(d)–1T(g)(2) to treat the transfer as a sale. Include the fair market value of the intangible on the date of the transfer and a calculation of the gain required to be recognized in the year of the transfer by reason of the election.

(vii) *Coordination with loss rules.* List any intangible property subject to section 367(d) the transfer of which also gives rise to the recognition of gain under section 904(f)(3) or § 1.367(a)–6T. Provide a calculation of the gain required to be recognized with respect to such property, in accordance with the provisions of § 1.367(d)–1T(g)(4).

(viii) *Other intangibles.* Describe any intangible property sold or licensed by the transferor to the transferee foreign corporation, and set forth the general terms of each sale or license.

(2) *Subsequent transfers.* If a U.S. person transfers intangible property to a foreign corporation in an exchange described in section 351 or 361, and at any time thereafter (within the useful life of the intangible property) either that U.S. person disposes of the stock of the transferee foreign corporation or the transferee foreign corporation disposes of the transferred intangible, then the U.S. person must provide the following information in paragraphs labelled to correspond with the number or letter set forth below. The information required by subdivisions (i) and (ii) need only be provided if such information was not otherwise provided in the same return, pursuant to paragraph (c) or (d)(1) of this section. For purposes of determining the date on which a return under this subparagraph (2) is required to be filed, the date of transfer is the date of the subsequent transfer of stock or intangible property.

(i) *Transferor.* Provide the name, U.S. taxpayer identification number, and address of the U.S. person making the transfer.

(ii) *Initial transfer.* Provide the following information concerning the initial transfer:

(A) The date of the transfer;

(B) The name, U.S. taxpayer identification number (if any), address, and country of incorporation of the transferee foreign corporation; and

(C) A general description of the transfer and any wider transaction of which it formed a part.

(iii) *Subsequent transfer.* Provide the following information concerning the subsequent transfer:

(A) A general description of the subsequent transfer and any wider transaction of which it forms a part;

(B) A calculation of any gain required to be recognized by the U.S. person under the rules of § 1.367(d)–1T (d) through (f); and

(C) The name, address, and identifying number of each person that under the rules of § 1.367(d)–1T (e) or (f) will be considered to receive contingent annual payments for the use of the intangible property.

(e) *Transfers subject to section 367(e).* [Reserved]

(f) *Failure to comply with reporting requirements*—(1) *Consequences of failure.* If a U.S. person is required to file a notice under § 1.6038B–1T(b) and fails to comply with the applicable reporting requirements of section 6038B and this section, then with respect to the particular property as to which there was a failure to comply—

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

(ii) The U.S. person shall pay a penalty equal to 25 percent of the amount of gain realized on the exchange of that property (without regard to whether gain is recognized on the transfer); and

(iii) The period of limitations on assessment of tax upon the transfer of that property shall not begin to run until the date on which the transferor does comply with the applicable reporting requirements.

Thus, the time for assessment of tax is extended indefinitely if the transferor's failure to comply is continued indefinitely.

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

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

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

Thus, a transferor that timely files Form 926 with the attachments required under the rules of this section shall, nevertheless, have failed to comply if, for example, the transferor reports therein that property will be used in the active conduct of a trade or business outside of the United States, but in fact such property continues to be used in a trade or business within the United States.

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

**Par. 7.** The authority for Part 7 is amended by adding the following citation:

**Authority:** 26 U.S.C. 7805. * * * Section 7.367(b)–1 and 7.367(b)–4 also issued under 26 U.S.C. 367(b).

**Par. 8.** Section 7.367(b)–1 is amended by removing the last sentence of paragraph (a) and adding in lieu thereof the following two new sentences.

**§ 7.367(b)–1 Other transfers.**

(a) *Scope.* * * * An exchange to which section 367(b) applies is an exchange described in section 367(b) and in section 332, 351, 354, 355, 356, or 361 with respect to which the status of a foreign corporation as a corporation is relevant for determining the extent to which gain shall be recognized and in connection with which there is no transfer described in section 367(a). An election by a domestic corporation under section 1504(d) to treat a corporation organized under the laws of a contiguous foreign country as a domestic corporation shall be considered to be a transfer of property made pursuant to an exchange to which section 367(b) applies.

**Par. 9.** Section 7.367(b)–4 is amended by revising paragraph (b)(2)(i) to read as follows:

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

* * * * *

(b) *Treatment of certain exchanges described in both section 354 and in either section 351 or 361*

* * * * *

(2) *Exceptions.* * * *

(i) *Specified treatment.* If an exchange of stock in a foreign corporation by a U.S. person is an exchange to which the rules under section 367(a) apply, then the gain required to be included in gross income under paragraph (b)(1)(i)(B) or paragraph (b)(1)(ii) of this section shall not be required to be immediately recognized under this paragraph (b), and instead the transaction shall be treated in accordance with the regulations under section 367(a). See § 1.367(a)-3T.

**Par. 10.** The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

**§ 602.101 [Amended]**

**Par. 11.** Section 602.101(c) is amended by inserting in the appropriate place in the table "§ 1.367(a)-1T. . .1545-0026" "§ 1.367(a)-2T. . .1545-0026" "§ 1.367(a)-3T. . .1545-0026" "§ 1.367(a)-6T. . .1545-0026" "§ 1.367(a)-1T. . .1545-0026" "§ 1.6038B-1T. . . 1545-0026"

Roscoe L. Egger, Jr.,
*Commissioner of Internal Revenue.*
Approved: April 29, 1986.

J. Roger Mentz,
*Assistant Secretary of the Treasury.*

[FR Doc. 86-10831 Filed 5-15-86; 8:45 am]
BILLING CODE 4830-01-M

## DEPARTMENT OF DEFENSE

### Department of the Army

### 32 CFR Part 513

[Army Reg. 600-15]

### Indebtedness of Military Personnel; Claim Processing Policies; Correction

**AGENCY:** Department of the Army Community and Family Support, Defense.

**ACTION:** Final rule.

**SUMMARY:** This rule gives the Army's policies and procedures governing private indebtedness of Army members. It also provides for processing claims. It forbid debt collectors from contacting commanders without prior consent of the debtor or without a court order.

**EFFECTIVE DATE:** May 16, 1986.

**ADDRESS:** Commander, U.S. Army Community and Family Support Center (DACF-IS-PA), Room 468, Hoffman I, Eisenhower Avenue, Alexandria, VA 22331-0522.

**FOR FURTHER INFORMATION CONTACT:** LTC Milton J. Brolcaw, (202) 325-8951.

**SUPPLEMENTARY INFORMATION:** On Monday, March 3, 1986 the Department of the Army published a final rule (51 FR 7268) FR Doc. 86-4290, concerning Indebtedness of Military Personnel; Claim Processing Policies. The rule contained some administrative errors which require the Army to remove § 513.1(j) in its entirety until corrections can be made.

This regulation will not have a significant economic impact on a substantial number of small entities as they are defined in the Regulatory Flexibility Act (RFA), 5 U.S.C. 601 et al. Further, this regulation does not meet the economic requirements of Executive Order 2291. And, this regulation does not contain information collection requirements which require approval by the Office of Management and Budget under 44 U.S.C. 3507.

**List of Subjects in 32 CFR Part 513**

Credit, Debts, Wages, Military personnel.

1. The authority citation for Part 513 continues to read:

Authority: 10 U.S.C. 3012.

2. According 32 CFR Part 513 is amended by removing § 513.1(j).

John O. Roach, II,
*Army Liaison Officer with the Federal Register.*

[FR Doc. 86-10935 Filed 5-15-86; 8:45 am]
BILLING CODE 3710-08-M

## DEPARTMENT OF TRANSPORTATION

### Coast Guard

### 33 CFR Part 100

[CGD 05-86-11]

### Special Local Regulations: Norfolk Harborfest 1986, Elizabeth River, Norfolk, Virginia

**AGENCY:** Coast Guard, DOT.

**ACTION:** Final rule.

**SUMMARY:** Special local regulations are being adopted for the City of Norfolk Harborfest. This event will be held on the Elizabeth River, between the Norfolk and Portsmouth downtown areas. These special local regulations are needed to control vessel traffic within the immediate vicinity of the Harborfest activities due to the confined nature of the waterway and the expected congestion at the time of the events. The effect will be to restrict general navigation in the area for the safety of spectators and participants in the event.

**EFFECTIVE DATES:** These regulations effective as follows.

a. 6 June 1986, 10:00 am until 10:00 pm
b. 7 June 1986, 8:30 am until 10:30 pm
c. 8 June 1986, 9:30 am until 6:00 pm

**FOR FURTHER INFORMATION CONTACT:** B.J. Stephenson, Chief, Boating Affairs Branch, Boating Safety Division, Fifth Coast Guard District, 431 Crawford Street, Portsmouth, Virginia 23705 (804-398-6204).

**SUPPLEMENTARY INFORMATION:** In accordance with 5 U.S.C. 553, a notice of proposed rule making has not been published for these regulations, and good cause exists for making them effective in less than 30 days from the date of publication. There was not sufficient time remaining to publish proposed rules in advance of the event or to provide for a delayed effective date.

Drafting Information: The drafters of this notice are Mr. Billy J. Stephenson, project officer, Chief, Boating Affairs Branch, Fifth Coast Guard District, and LT. Wade Mitchell, project attorney, Fifth Coast Guard District Legal Office.

Discussion of Regulations: The three-day City of Norfolk Harborfest, sponsored by Norfolk Festevents, Inc., will consist of numerous water events, including: parade of vessels, water ski exhibitions, boat races, military vessel and helicopter demonstrations, and fireworks. Commercial vessels will be permitted to transit the regulated area between events, and thus commercial traffic should not be severely disrupted at any given time.

**List of Subjects in 33 CFR Part 100**

Marine safety, Navigation (water).

Regulations: In consideration of the foregoing, Part 100 of Title 33, Code of Federal Regulations, is amended as follows:

1. The authority citation for Part 100 continues to read as follows:

Authority 33: U.S.C. 1233; 49 CFR 1.46 and 33 CFR 100.35.

2. A temporary section 100.35-0511 is added to read as follows:

**100.35-0511. Elizabeth River, Norfolk, Virginia.**

(a) *Regulated Area:* The waters of the Elizabeth River and its branches from shore to shore, except marinas, piers, and shipyards, bounded to the northwest by a line drawn over the Midtown Tunnel, located in the Port Norfolk Reach section of the Elizabeth River between Pinners Point at latitude 36°51'26.0" North, longitude 76°18'59.0"