

(10) The term *relevant foreign country* means the foreign country in which, or under the law of which, the foreign corporation was created or organized.

(11) The term *testing period* means the one-year period ending on the applicable date.

(e) *Treatment of partnerships.* For purposes of this section, if one or more members of the expanded affiliated group own, in the aggregate, more than 50 percent (by value) of the interests in a partnership, such partnership will be treated as a corporation that is a member of the expanded affiliated group. Thus, all items of such a partnership are taken into account for purposes of this section. No items of a partnership are taken into account for purposes of this section unless the partnership is treated as a member of the expanded affiliated group pursuant to this paragraph.

(f) *Effective/applicability and expiration dates.* Except as otherwise provided in this paragraph, this section shall apply to acquisitions that are completed on or after June 7, 2012. For acquisitions completed on or after June 7, 2012 that were either described in a filing with the Securities and Exchange Commission on or before June 7, 2012, or that were subject to a written agreement that was binding on June 7, 2012, and at all times thereafter, taxpayers may apply either the rules in § 1.7874-2T(g), as contained in 26 CFR part 1 revised as of April 12, 2012, or the rules set forth in this section. The applicability of this section expires on June 5, 2015.

[T.D. 9592, 77 FR 34787, June 12, 2012]

§ 1.7874-4T Disregard of certain stock related to the acquisition (temporary).

(a) *Scope.* This section identifies certain stock of the foreign acquiring corporation that is disregarded in determining the ownership fraction (as defined in paragraph (i)(9) of this section) and modifies the scope of section 7874(c)(2)(B). Paragraph (b) of this section sets forth the general rule that certain stock of the foreign acquiring corporation, and only such stock, is treated as stock described in section 7874(c)(2)(B) and therefore is excluded from the denominator of the ownership fraction. Paragraph (c) of this section

identifies the stock of the foreign acquiring corporation that is subject to paragraph (b) of this section. Paragraph (d) of this section provides a de minimis exception to the application of the general exclusion rule of paragraph (b) of this section. Paragraph (e) of this section addresses transfers of stock of the foreign acquiring corporation involving certain obligations. Paragraph (f) of this section provides rules for certain transfers of stock of the foreign acquiring corporation involving multiple properties or obligations. Paragraph (g) of this section provides rules for the treatment of partnerships, and paragraph (h) of this section provides rules addressing the interaction of this section with the expanded affiliated group rules of section 7874(c)(2)(A) and § 1.7874-1. Paragraph (i) of this section provides definitions. Paragraph (j) of this section provides examples illustrating the application of the rules of this section. Paragraph (k) of this section provides dates of applicability, and paragraph (l) of this section provides the date of expiration.

(b) *Exclusion of disqualified stock under section 7874(c)(2)(B).* Except as provided in paragraph (d) of this section, disqualified stock (as determined under paragraph (c) of this section) is treated as stock described in section 7874(c)(2)(B) and therefore is not included in the denominator of the ownership fraction. Section 7874(c)(2)(B) shall not apply to exclude stock from the denominator of the ownership fraction that is not disqualified stock.

(c) *Disqualified stock—(1) General rule.* Except as provided in paragraph (c)(2) of this section, disqualified stock is stock of the foreign acquiring corporation that is transferred in an exchange described in paragraph (c)(1)(i) or (c)(1)(ii) of this section that is related to the acquisition. This paragraph (c) applies without regard to whether the stock of the foreign acquiring corporation is publicly traded at the time of the transfer or at any other time.

(i) *Exchange for nonqualified property.* The stock is transferred to a person other than the domestic entity in exchange for nonqualified property. See *Example 1, Example 2, Example 5, Example 7, and Example 8* of paragraph (j) of

this section for illustrations of this paragraph (c)(1)(i).

(ii) *Certain obligations associated with property exchanged for stock.* Except as otherwise provided in this paragraph (c)(1)(ii), the stock is transferred to a person in exchange for property and, pursuant to the same plan (or series of related transactions), the transferee subsequently transfers such stock in exchange for the satisfaction or the assumption of one or more obligations associated with the property exchanged. An obligation is associated with property exchanged if, for example, the obligation arose from the conduct of a trade or business in which the property exchanged has been used, regardless of whether the obligation is a non-recourse obligation. If any of the property exchanged constitutes non-qualified property and the transferee is not the domestic entity, the amount of stock described in this paragraph (c)(1)(ii) is limited to the product of:

(A) The fair market value of the stock subsequently transferred by the transferee in exchange for the satisfaction or the assumption of such obligations; and

(B) A fraction, the numerator of which is the amount of qualified property exchanged by the transferee, and the denominator of which is the total amount of property exchanged by the transferee. See *Example 5* of paragraph (j) of this section for an illustration of this paragraph (c)(1)(ii).

(2) *Stock transferred in an exchange that does not increase the fair market value of the assets or decrease the amount of liabilities of the foreign acquiring corporation.* Stock is disqualified stock only to the extent that the transfer of the stock in the exchange increases the fair market value of the assets of the foreign acquiring corporation or decreases the amount of its liabilities. This paragraph (c)(2) is applied to an exchange without regard to any other exchange described in paragraph (c)(1)(i) or (c)(1)(ii) of this section or any other transaction related to the acquisition. See *Example 3* and *Example 6* of paragraph (j) of this section for illustrations of this paragraph (c)(2).

(d) *Exception to exclusion of disqualified stock—(1) De minimis ownership.* Except as provided in paragraph (d)(2) of

this section, paragraph (b) of this section does not apply if both:

(i) The ownership percentage described in section 7874(a)(2)(B)(ii), determined without regard to the application of paragraph (b) of this section, is less than five percent (by vote and value); and

(ii) After the acquisition and all transactions related to the acquisition, if any, are completed, former shareholders (within the meaning of § 1.7874-2(b)(2)) or former partners (within the meaning of § 1.7874-2(b)(3)), as applicable, in the aggregate, own (applying the attribution rules of section 318(a) with the modifications described in section 304(c)(3)(B)) less than five percent (by vote and value) of the stock of (or a partnership interest in) any member of the expanded affiliated group that includes the foreign acquiring corporation. See *Example 4* of paragraph (j) of this section for an illustration of this paragraph (d).

(2) *Stock issued to avoid the purposes of section 7874.* The exception in paragraph (d)(1) of this section does not apply to disqualified stock that is transferred in a transaction (or series of transactions) related to the acquisition with a principal purpose of avoiding the purposes of section 7874.

(e) *Satisfaction or assumption of obligations.* Except to the extent paragraph (c)(1)(ii) of this section applies, this paragraph (e) applies if, in a transaction related to the acquisition, stock of the foreign acquiring corporation is transferred to a person other than the domestic entity in exchange for the satisfaction or the assumption of one or more obligations of the transferor. In such a case, solely for purposes of this section, the stock of the foreign acquiring corporation is treated as if it is transferred in exchange for an amount of cash equal to the fair market value of such stock.

(f) *Transactions involving multiple properties.* For purposes of this section, if stock and other property are exchanged for qualified property and non-qualified property, the stock is treated as transferred in exchange for the qualified property or nonqualified property, respectively, based on the relative value of the property. See also § 1.7874-2(f)(2) (allocating stock of the

foreign acquiring corporation between an interest in the domestic entity and other property).

(g) *Treatment of partnerships.* For purposes of this section, if one or more members of the expanded affiliated group own, in the aggregate, more than 50 percent (by value) of the interests in a partnership, such partnership is treated as a corporation that is a member of the expanded affiliated group.

(h) *Interaction with expanded affiliated group rules.* Disqualified stock that is excluded from the denominator of the ownership fraction pursuant to paragraph (b) of this section is taken into account for purposes of determining whether an entity is a member of the expanded affiliated group for purposes of applying section 7874(c)(2)(A) and determining whether an acquisition qualifies as an internal group restructuring or results in a loss of control, as described in § 1.7874-1(c)(2) and (c)(3), respectively. However, such disqualified stock is excluded from the denominator of the ownership fraction for purposes of section 7874(a)(2)(B)(ii) regardless of whether it would otherwise be included in the denominator of the ownership fraction as a result of the application of § 1.7874-1(c). See *Example 7* and *Example 8* of paragraph (j) of this section for illustrations of this paragraph (h).

(i) *Definitions.* The following definitions apply for purposes of this section:

(1) An *acquisition* is an acquisition described in section 7874(a)(2)(B)(i).

(2) A *domestic entity* is a domestic corporation or domestic partnership described in section 7874(a)(2)(B)(i).

(3) An *expanded affiliated group* is an affiliated group defined in section 7874(c)(1) determined as of the end of the day on which the acquisition is completed. A *member of the expanded affiliated group* is an entity included in the expanded affiliated group.

(4) A *foreign acquiring corporation* is a foreign corporation described in section 7874(a)(2)(B).

(5) An *interest in a partnership* has the meaning provided under § 1.7874-2(b)(4), and therefore includes a capital or profits interest.

(6) *Marketable securities* has the meaning set forth in section 453(f)(2), except that the term marketable securities

does not include stock of a corporation or an interest in a partnership that becomes a member of the expanded affiliated group that includes the foreign acquiring corporation in a transaction (or series of transactions) related to the acquisition, unless a principal purpose for acquiring such stock or partnership interest is to avoid the purposes of section 7874. See *Example 3* of paragraph (j) of this section for an illustration of this paragraph (i)(6).

(7) *Nonqualified property* is property described in paragraphs (i)(7)(i) through (i)(7)(iv) of this section. *Qualified property* is property other than nonqualified property.

(i) Cash or cash equivalents.

(ii) Marketable securities, within the meaning of paragraph (i)(6) of this section.

(iii) An obligation owed by any of the following:

(A) A member of the expanded affiliated group that includes the foreign acquiring corporation;

(B) A former shareholder (within the meaning of § 1.7874-2(b)(2)) or former partner (within the meaning of § 1.7874-2(b)(3)) of the domestic entity; or

(C) A person that, before or after the acquisition, either owns stock of, or a partnership interest in, a person described in paragraph (i)(7)(iii)(A) or (i)(7)(iii)(B) of this section or is related (within the meaning of section 267 or 707(b)) to such a person. See *Example 5* of paragraph (j) of this section for an illustration of this paragraph (i)(7)(iii).

(iv) Any other property acquired in a transaction (or series of transactions) related to the acquisition with a principal purpose of avoiding the purposes of section 7874. See *Example 2* of paragraph (j) of this section for an illustration of this paragraph (i)(7)(iv).

(8) An *obligation* has the meaning set forth in § 1.752-1(a)(4)(ii), provided that the obligation is not otherwise treated as stock for purposes of section 7874 (see, for example, § 1.7874-2(i), which treats certain interests, including certain creditor claims, as stock).

(9) The *ownership fraction* is the ownership percentage described in section 7874(a)(2)(B)(ii), expressed as a fraction.

(10) A *transfer* is, with respect to stock of the foreign acquiring corporation, an issuance, sale, distribution, exchange, or any other disposition of such stock.

(j) *Examples.* The following examples illustrate the rules of this section. For purposes of the examples, unless otherwise indicated, assume the following facts in addition to the facts stated in the examples:

(1) FA, FMS, FS, and FT are foreign corporations, all of which have only one class of stock issued and outstanding;

(2) DMS and DT are domestic corporations;

(3) P and R are corporations that may be either domestic or foreign;

(4) PRS is a partnership with individual partners;

(5) The de minimis ownership exception in paragraph (d)(1) of this section does not apply;

(6) None of the shareholders or partners in the entities described in the examples are related persons;

(7) All transactions described in each example occur pursuant to the same plan; and

(8) No property is acquired with a principal purpose of avoiding the purposes of section 7874.

Example 1. Stock transferred in exchange for marketable securities. (i) *Facts.* Individual A wholly owns DT. PRS transfers marketable securities (within the meaning of paragraph (i)(6) of this section) to FA, a newly formed corporation, in exchange solely for 25 shares of FA stock. Then Individual A transfers all the DT stock to FA in exchange solely for 75 shares of FA stock.

(ii) *Analysis.* Under paragraphs (i)(6) and (i)(7)(ii) of this section, the marketable securities constitute nonqualified property. Accordingly, the 25 shares of FA stock transferred by FA to PRS in exchange for the marketable securities constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for the marketable securities increases the fair market value of the assets of FA by the fair market value of the marketable securities transferred. Under paragraph (b) of this section, the 25 shares of FA stock transferred to PRS are not included in the denominator of the ownership fraction. Accordingly, the only FA stock included in the

ownership fraction is the FA stock transferred to Individual A in exchange for the DT stock, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.

Example 2. Stock transferred in exchange for property acquired with a principal purpose of avoiding the purposes of section 7874. (i) *Facts.* Individual A wholly owns DT. PRS transfers marketable securities (within the meaning of paragraph (i)(6) of this section) to FT, a newly formed corporation, in exchange solely for all the FT stock. Then PRS transfers the FT stock to FA, a newly formed corporation, in exchange solely for 25 shares of FA stock. Finally, Individual A transfers all the DT stock to FA in exchange solely for 75 shares of FA stock. FA acquires the FT stock with a principal purpose of avoiding the purposes of section 7874.

(ii) *Analysis.* Under paragraph (i)(7)(iv) of this section, the FT stock constitutes nonqualified property because a principal purpose of FA acquiring the FT stock is to avoid the purposes of section 7874. Accordingly, the 25 shares of FA stock transferred by FA to PRS in exchange for the FT stock constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for the FT stock increases the fair market value of FA's assets by the fair market value of the FT stock. Under paragraph (b) of this section, the 25 shares of FA stock transferred to PRS are not included in the denominator of the ownership fraction. Accordingly, the only FA stock included in the ownership fraction is FA stock transferred to Individual A in exchange for the DT stock, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.

Example 3. Stock transferred in exchange for stock of a foreign corporation that becomes a member of the expanded affiliated group. (i) *Facts.* FT, a publicly traded corporation, forms FA, and then FA forms DMS and FMS. FMS merges with and into FT, with FT surviving the merger (FMS-FT merger). Pursuant to the FMS-FT merger, the FT shareholders exchange their FT stock solely for 1,000 shares of FA stock and FT becomes a wholly owned subsidiary of FA. Following the FMS-FT merger, DMS merges with and into DT, also a publicly traded corporation, with DT surviving the merger (DMS-DT merger). Pursuant to the DMS-DT merger, the DT shareholders exchange their DT stock solely for the remaining 1,000 shares of FA stock, and DT becomes a wholly owned subsidiary of FA. After the completion of the plan, FA wholly owns FT and DT, DMS and

FMS cease to exist, and the stock of FA is publicly traded.

(i) *Analysis.* Because FT becomes a member of the expanded affiliated group that includes FA in a transaction related to FA's acquisition of substantially all the properties of DT, the FT stock does not constitute marketable securities (within the meaning of paragraph (i)(6) of this section) and therefore does not constitute nonqualified property pursuant to paragraph (i)(7)(ii) of this section. Accordingly, no FA stock is disqualified stock described in paragraph (c)(1) of this section and therefore the FA stock transferred in exchange for the FT stock and DT stock is included in the denominator of the ownership fraction. Thus, the ownership fraction is 1,000/2,000.

(iii) *Alternative facts.* The facts are the same as in paragraph (i) of this *Example 3*, except that, instead of undertaking the FMS-FT merger, FT merges with and into FA with FA surviving the merger (FT-FA merger). Pursuant to the FT-FA merger, the FT shareholders exchange their FT stock solely for 1,000 shares of FA stock. At the time of the FT-FA merger, FT does not hold nonqualified property and has no obligations. Accordingly, FA stock transferred by FA to FT in exchange for the property of FT is not disqualified stock described in paragraph (c)(1) of this section. Furthermore, the 1,000 shares of FA stock transferred by FT to the shareholders of FT in exchange for their FT stock do not constitute disqualified stock described in paragraph (c)(1) of this section. Although the FT stock is nonqualified property (the FT stock constitutes marketable securities within the meaning of paragraph (i)(7)(ii) of this section because the stock of FT is publicly traded and FT is not a member of the expanded affiliated group that includes FA after the acquisition), under paragraph (c)(2) of this section, the transfer of FA stock by FT to the shareholders of FT neither increases the fair market value of the assets of FA nor decreases the liabilities of FA. Accordingly, no FA stock is disqualified stock described in paragraph (c)(1) of this section and, therefore, the FA stock transferred in exchange for the assets of FT and the DT stock is included in the denominator of the ownership fraction. Thus, the ownership fraction is 1,000/2,000.

Example 4. De minimis exception. (i) *Facts.* Individual A wholly owns DT. The fair market value of the DT stock is \$100x. PRS transfers \$96x of cash to FA, a newly formed corporation, in exchange solely for 96 shares of FA stock. Then Individual A transfers the DT stock to FA in exchange for \$96x of cash and 4 shares of FA stock.

(ii) *Analysis.* Under paragraph (i)(7)(i) of this section, cash constitutes nonqualified property. Accordingly, the 96 shares of FA stock transferred by FA to PRS in exchange for \$96x of cash constitute disqualified stock

described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Furthermore, paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for \$96x of cash increases the fair market value of the assets of FA by \$96x. However, without regard to the application of paragraph (b) of this section, the ownership percentage described in section 7874(a)(2)(B)(ii) would be less than 5% (by vote and value), or 4% (4/100, or 4 shares of FA stock held by Individual A by reason of owning the DT stock, determined under § 1.7874-2(f)(2), over 100 shares of FA stock outstanding after the acquisition). Furthermore, after the acquisition and all transactions related to the acquisition, Individual A owns less than 5% (by vote and value) of the stock of FA and DT (the members of the expanded affiliated group that includes FA). Accordingly, the de minimis exception in paragraph (d)(1) of this section applies and therefore paragraph (b) of this section does not apply to exclude the FA stock transferred to PRS from the denominator of the ownership fraction. Therefore, the FA stock transferred to Individual A and PRS is included in the denominator of the ownership fraction. Thus, the ownership fraction is 4/100.

Example 5. Obligation of the expanded affiliated group satisfied with stock. (i) *Facts.* Individual A wholly owns DT. The stock of DT held by Individual A has a fair market value of \$75x. Individual A also holds an obligation of DT with a value and face amount of \$25x. DT holds property with a value of \$100x, and the \$25x obligation is associated with the property. FA, a newly formed corporation, transfers 100 shares of FA stock to Individual A in exchange for all the DT stock and the \$25x obligation of DT.

(ii) *Analysis.* Under paragraph (i)(7)(iii)(A) of this section, the \$25x obligation of DT constitutes nonqualified property because DT is a member of the expanded affiliated group that includes FA. Thus, the shares of FA stock transferred by FA to Individual A in exchange for the obligation of DT constitute disqualified stock described in paragraph (c)(1)(i) of this section. Under § 1.7874-2(f)(2), Individual A is treated as receiving 75 shares of FA stock in exchange for the DT stock ($100 \times \$75x/\$100x$) and 25 shares of FA stock in exchange for the obligation of DT ($100 \times \$25x/\$100x$). Thus, 25 shares of FA stock constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock for the \$25x obligation increases the fair market value of FA's assets by \$25x.

Therefore, under paragraph (b) of this section, the 25 shares of FA stock transferred to Individual A in exchange for the obligation of DT are not included in the denominator of the ownership fraction. Accordingly, the only FA stock included in the ownership fraction is the 75 shares of FA stock transferred to Individual A in exchange for the DT stock, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.

(iii) *Alternative facts.* The facts are the same as in paragraph (i) of this *Example 5*, except that instead of acquiring the stock of DT and the \$25x obligation of DT, FA acquires the \$100x of property from DT in exchange solely for 100 shares of FA stock. DT distributes 75 shares of FA stock to Individual A in exchange for Individual A's DT stock and transfers 25 shares of FA stock to Individual A in satisfaction of DT's obligation to Individual A, and liquidates. The 25 shares of FA stock used to satisfy DT's obligation to Individual A after being transferred by FA to DT in exchange for the property of DT constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(ii) of this section. Paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(ii) of this section because the transfer of FA stock in exchange for the property of DT increases the fair market value of FA's assets by \$100x (although the amount of disqualified stock is limited to 25 shares of FA stock in this case). Therefore, under paragraph (b) of this section, the 25 shares of FA stock that constitute disqualified stock are not included in the denominator of the ownership fraction. Accordingly, only 75 shares of FA stock are included in the ownership fraction, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.

Example 6. "Over-the-top" stock transfer. (i) *Facts.* Individual A wholly owns DT. Individual B holds all 100 outstanding shares of FA stock. Individual C acquires 20 shares of FA stock from Individual B for cash, and then FA acquires all of the stock of DT from Individual A in exchange solely for 100 shares of FA stock.

(ii) *Analysis.* Under paragraph (i)(7)(i) of this section, cash constitutes nonqualified property. Accordingly, absent the application of paragraph (c)(2) of this section, the 20 shares of FA stock transferred by Individual B to Individual C in exchange for cash would constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Nevertheless, because Individual B's sale of FA stock neither increases the assets of FA nor decreases the liabilities of FA, such FA stock is not disqualified stock by reason of para-

graph (c)(2) of this section. Accordingly, paragraph (b) of this section does not apply to Individual B's sale of the 20 shares of FA stock to Individual C, and that FA stock is included in the denominator of the ownership fraction. The 100 shares of FA stock received by Individual A are the only shares included in the numerator of the ownership fraction. Thus, the ownership fraction is 100/200.

Example 7. Interaction with internal group restructuring rule. (i) *Facts.* P holds 85 shares of DT stock. The remaining 15 shares of DT stock are held by Individual A. P and Individual A transfer their shares of DT stock to FA, a newly formed corporation, in exchange for 85 and 15 shares of FA stock, respectively, and PRS transfers \$75x of cash to FA in exchange for the remaining 75 shares of FA stock.

(ii) *Analysis.* Under paragraph (i)(7)(i) of this section, cash constitutes nonqualified property. Accordingly, the 75 shares of FA stock transferred by FA to PRS in exchange for \$75x of cash constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Furthermore, paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for \$75x of cash increases the fair market value of the assets of FA by \$75x. Therefore, under paragraph (b) of this section, the 75 shares of FA stock transferred to PRS are not included in the denominator of the ownership fraction. Although PRS's shares of FA stock are excluded from the denominator of the ownership fraction under paragraph (b) of this section, such shares of FA stock nonetheless are taken into account for purposes of determining whether P is a member of the expanded affiliated group that includes FA under paragraph (h) of this section. Because P holds 48.6% of the FA stock (85/175) after the acquisition, it is not a member of the expanded affiliated group that includes FA. In addition, the acquisition does not qualify as an internal group restructuring described in § 1.7874-1(c)(2) because P does not hold, directly or indirectly, 80% or more of the shares of FA stock (by vote and value) after the acquisition. Therefore, the FA stock held by P (along with the FA stock held by Individual A) is included in the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 100/100.

Example 8. Interaction with loss of control rule. (i) *Facts.* P wholly owns DT. P transfers all of its shares of DT stock to FA, a newly formed corporation, in exchange for 49 shares of FA stock, and R transfers marketable securities (within the meaning of paragraph (i)(6) of this section) to FA in exchange for the remaining 51 shares of FA stock.

(ii) *Analysis.* Under paragraphs (i)(6) and (i)(7)(ii) of this section, the marketable securities constitute nonqualified property. Accordingly, the shares of FA stock transferred by FA to R in exchange for the marketable securities constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section. Paragraph (c)(2) of this section does not reduce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for the marketable securities increases the fair market value of the assets of FA by the fair market value of the marketable securities transferred. Therefore, under paragraph (b) of this section, the shares of FA stock transferred to R are not included in the denominator of the ownership fraction. Although under paragraph (b) of this section R's shares of FA stock are excluded from the denominator of the ownership fraction, under paragraph (h) of this section such stock is taken into account for purposes of determining whether P or R is a member of the expanded affiliated group that includes FA. Because P holds 49% of the shares of FA stock (49/100), P is not a member of the expanded affiliated group that includes FA, and P's FA stock is included in both the numerator and the denominator of the ownership fraction. Because R holds 51% of the shares of FA stock (51/100), R is a member of the expanded affiliated group that includes FA and, before taking into account § 1.7874-1(c), R's FA stock would be excluded from the numerator and denominator of the ownership fraction under section 7874(c)(2)(A) and § 1.7874-1(b). However, the acquisition results in a loss of control described in § 1.7874-1(c)(2) because P does not hold, in the aggregate, directly or indirectly, more than 50% of the shares of FA stock (by vote or value) of R, FA, or DT after the acquisition. Accordingly, the FA stock held by R would be included in the denominator of the ownership fraction under § 1.7874-1(c)(1). Nevertheless, the FA stock held by R is excluded from the denominator of the ownership fraction under paragraphs (b) and (h) of this section. Thus, the ownership fraction is 49/49.

(iii) *Alternative facts.* The facts are the same as in paragraph (i) of this *Example 8*, except that, in exchange for 51 shares of FA stock, R transfers marketable securities (within the meaning of paragraph (i)(6) of this section) with a value equal to that of 16 shares of FA stock and qualified property (within the meaning of paragraph (i)(7) of this section) with a value equal to that of 35 shares of FA stock. Accordingly, 16 of the 51 shares of FA stock transferred to R constitute disqualified stock described in paragraph (c)(1) of this section by reason of paragraph (c)(1)(i) of this section, and 35 of such shares do not constitute disqualified stock. Paragraph (c)(2) of this section does not re-

duce the amount of disqualified stock described in paragraph (c)(1)(i) of this section because the transfer of FA stock in exchange for the marketable securities increases the fair market value of the assets of FA by the fair market value of the marketable securities transferred. Therefore, under paragraph (b) of this section, 16 of the 51 shares of FA stock transferred to R are not included in the denominator of the ownership fraction. Although 16 of the 51 shares of FA stock that are transferred to R are excluded from the denominator of the ownership fraction, under paragraph (h) of this section, all 51 of R's shares of FA stock are taken into account for purposes of determining whether P or R is a member of the expanded affiliated group that includes FA. Because P holds 49% of the shares of FA stock (49/100), it is not a member of the expanded affiliated group that includes FA, and its FA stock is included in both the numerator and the denominator of the ownership fraction. Because R holds 51% of the shares of FA stock (51/100), it is a member of the expanded affiliated group that includes FA and, before taking into account § 1.7874-1(c), its FA stock is excluded from the numerator and denominator of the ownership fraction under section 7874(c)(2)(A) and § 1.7874-1(b). However, the acquisition results in a loss of control described in § 1.7874-1(c)(2) because P does not hold, in the aggregate, directly or indirectly, more than 50% of the shares of FA stock (by vote or value) of R, FA, or DT after the acquisition. Accordingly, the 51 shares of FA stock held by R would be included in the denominator of the ownership fraction under § 1.7874-1(c)(1). Nevertheless, the 16 shares of FA stock that constitute disqualified stock are excluded from the denominator of the ownership fraction under paragraphs (b) and (h) of this section. In addition, the 35 shares of FA stock received by R that do not constitute disqualified stock are included in the denominator. Thus, the ownership fraction is 49/84.

(k) *Effective/applicability dates—(1) General rule.* Except to the extent provided in paragraph (k)(2) of this section, this section applies to acquisitions completed on or after September 17, 2009.

(2) *Transitional rules.* For acquisitions completed on or after September 17, 2009, but before January 16, 2014, except as provided in paragraph (k)(3) of this section, this section shall be applied with the following modifications:

(i) Nonqualified property does not include property described in paragraph (i)(7)(iii) of this section.

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(ii) A transfer is limited to an issuance of stock of the foreign acquiring corporation.

(iii) The determination of whether stock of the foreign acquiring corporation is described in paragraph (c)(1) of this section is made without regard to paragraphs (c)(1)(ii), (c)(2), and (e) of this section.

(iv) Paragraphs (d) and (h) of this section do not apply.

(3) *Election.* A taxpayer may elect to apply paragraphs (a) through (j) of this section to acquisitions completed on or after September 17, 2009, but before January 16, 2014, if the taxpayer applies those paragraphs consistently to all acquisitions completed before such date. The election is made by applying paragraphs (a) through (j) of this section to all such acquisitions on a timely filed original return (including extensions) or an amended return filed no later than six months after January 16, 2014. A separate statement or form evidencing the election need not be filed.

(l) *Expiration date.* The applicability of this section expires on January 13, 2017.

[T.D. 9654, 79 FR 3100, Jan. 17, 2014]

§ 1.7874-5T Effect of certain transfers of stock related to the acquisition (temporary).

(a) *General rule.* Stock of a foreign corporation that is described in section 7874(a)(2)(B)(ii) shall not cease to be so described as a result of any subsequent transfer of the stock by the former shareholder (within the meaning of § 1.7874-2(b)(2)) or former partner (within the meaning of § 1.7874-2(b)(3)) that received such stock, even if the subsequent transfer is related to the acquisition described in section 7874(a)(2)(B)(i).

(b) *Example.* The rule of this section is illustrated by the following example:

Example. (i) *Facts.* Individual A wholly owns DT, a domestic corporation. FA, a newly formed foreign corporation, acquires all of the stock of DT from Individual A in exchange solely for 100 shares of FA stock. Pursuant to a binding commitment that was entered into in connection with FA's acquisition of the DT stock, Individual A sells 25 shares of FA stock to B, an unrelated person, in exchange for cash. For federal income tax purposes, the form of the steps of the transaction is respected.

(ii) *Analysis.* Under § 1.7874-2(f)(1), the 100 shares of FA stock received by Individual A are stock of a foreign corporation (FA) that is held by reason of holding stock in a domestic corporation (DT). Accordingly, such stock is described in section 7874(a)(2)(B)(ii). Under paragraph (a) of this section, all 100 shares of FA stock retain their status as being described in section 7874(a)(2)(B)(ii), even though Individual A sells 25 of the 100 shares in connection with the acquisition described in section 7874(a)(2)(B)(i) pursuant to the binding commitment. Therefore, all 100 of the shares of FA stock are included in both the numerator and denominator of the ownership fraction (as defined in § 1.7874-4T(i)(9)).

(c) *Effective/applicability dates.* This section applies to acquisitions that are completed on or after January 16, 2014.

(d) *Expiration date.* The applicability of this section expires on January 13, 2017.

[T.D. 9654, 79 FR 3104, Jan. 17, 2014]

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SOURCE: Sections 1.9000-1 through 1.9000-8 contained in T.D. 6500, 25 FR 12155, Nov. 26, 1960, unless otherwise noted.

§ 1.9000-1 Statutory provisions.

The Act of June 15, 1955 (Pub. L. 74, 84th Cong., 69 Stat. 134), provides as follows:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. *Repeal of sections 452 and 462—(a) Prepaid income.* Section 452 of the Internal Revenue Code of 1954 is hereby repealed.

(b) Reserves for estimated expenses, etc. Section 462 of the Internal Revenue Code of 1954 is hereby repealed.

SEC. 2. *Technical amendments.* The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Subsection (c) of section 381 is amended by striking out paragraph (7) (relating to carryover of prepaid income in certain corporate acquisitions).

(2) The table of sections for subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which items of gross income included) is amended by striking out "Sec. 452. Prepaid income."

(3) The table of sections for subpart C of such part II (relating to taxable year for which deductions are taken) is amended by striking out:

"Sec. 462. Reserves for estimated expenses, etc."