

Section 358.—Basis to Distributees

26 CFR 1.358-6: Stock basis in certain triangular reorganizations.

T.D. 8648

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Controlling Corporation's Basis Adjustment in its Controlled Corporation's Stock Following a Triangular Reorganization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 358, 1032, and 1502 of the Internal Revenue Code of 1986. The final regulations provide rules for adjusting the basis of a controlling corporation in the stock of a controlled corporation as the result of certain triangular reorganizations involving the stock of the controlling corporation. They also generally provide that the use of the controlling corporation's stock provided by the controlling corporation pursuant to the plan of reorganization is treated as a disposition of those shares by the controlling corporation.

DATES: These regulations are effective December 21, 1995.

For dates of applicability, see the "Effective Dates" section under the "SUPPLEMENTARY INFORMATION" portion of the preamble and the effective date provisions of the new or revised regulations.

FOR FURTHER INFORMATION CONTACT: Curt Cutting, (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations under sections 358, 1032, and 1502. The proposed regulations were published in the Federal Register on December 23, 1994 (59 F.R. 66280 [CO-993-71], 1995-1 C.B. 832. The IRS received many comments on the proposed regulations and held a public hearing on March 31, 1995.

After consideration of the comments and the statements made at the hearing, the proposed regulations are adopted as revised by this Treasury decision.

Overview

The final regulations adopt the over-the-top model contained in the proposed regulations. Subject to certain modifications, the model generally adjusts a controlling corporation's (P's) basis in the stock of its controlled corporation (S or T) as a result of certain triangular reorganizations as if P had acquired the T assets (and any liabilities assumed or to which the T assets were subject) directly from T in a transaction in which P's basis in the T assets was determined under section 362(b), and P then had transferred the T assets (and liabilities) to S in a transaction in which P's basis in the S or T stock was adjusted under section 358. The preamble to the proposed regulations contains a discussion of the justification for the model. See 59 FR 66280-81.

The final regulations also provide a special rule that treats S's use of P's stock provided by P pursuant to the plan of reorganization as a disposition of those shares by P.

The final regulations apply only for the purpose of determining P's basis in its S or T stock following a transaction that otherwise qualifies as a reorganization within the meaning of section 368. They do not address issues concerning the qualification of a transaction as a reorganization.

With the publication of these final regulations, the IRS announces the closing of its study project referred to in §5.14 of Rev. Proc. 95-3, 1995-1 C.B. 385, 395.

The significant comments on the proposed regulations and revisions made are discussed below.

Summary of comments and explanation of revisions

P's basis in T stock owned before a reverse triangular merger

The proposed regulations adjusted basis as a result of a reverse triangular merger to reflect the amount of T stock received in the transaction. Comments on the proposed regulations questioned how an adjustment based on the amount of T stock received in the transaction would apply in the case in which P owns T stock before the transaction.

In response to these comments, the final regulations allow P to treat its T stock as acquired in the transaction or not, without regard to the form of the transaction. Thus, P may retain its basis in the T stock owned before the transaction, or may determine its basis in that stock as an allocable portion of T's net asset basis. The regulations require no explicit election. Instead, it is assumed P will pick the higher basis. This rule applies only for determining basis, and not for qualifying the transaction as a reverse triangular merger. See Rev. Rul. 74-564, 1974-2 C.B. 124.

The Treasury and the IRS continue to study issues relating to restructurings involving related parties and cross-ownership, and welcome comments and suggestions on these issues.

Net negative adjustment

Under the proposed regulations, P's basis adjustment was reduced by the fair market value of consideration not provided by P, and by the amount of

liabilities assumed by S or to which T assets are subject. These reductions did not result in a net negative basis adjustment to P's basis in its S stock before the transaction. This limitation did not apply, however, where P and S, or P and T, as applicable, were members of a consolidated group following the triangular reorganization. In the consolidated context, the negative adjustments could result in a net negative adjustment to P's basis in its S stock before the transaction, even if the adjustment resulted in an excess loss account under §1.1502-19.

Some comments on the proposed regulations argued against reducing P's basis in its S stock before the transaction by a net negative adjustment in the consolidated context. Other comments, however, agreed that it is appropriate not to limit the net negative adjustment in this context.

The Treasury and the IRS continue to believe that the proposed regulations reach the correct result. Therefore, the final regulations adopt the rules as proposed.

Overlap of reverse triangular merger and other transactions

The proposed regulations provided that if a transaction qualified as both a reverse triangular merger and a stock acquisition under section 368(a)(1)(B), P adjusted its basis in its T stock based either on T's net asset basis or on the aggregate basis of the T stock surrendered in the transaction (as if the transaction were a reorganization under section 368(a)(1)(B)).

One comment noted that a reverse triangular merger might overlap with a section 351 transfer and therefore requested that this rule also apply to such a case. The final regulations adopt this suggestion.

Manner of making elections

The proposed and final regulations provide P with elections for its basis adjustments when P owns stock of T and when a reverse triangular merger also qualifies as a section 351 transaction or B reorganization. In these situations, P does not have to declare how it will compute its basis. Rather, P must simply retain appropriate records. See §1.368-3.

Application of section 1032

The proposed regulations under section 1032 generally provided that P stock provided by P to S, or directly to T or T's shareholders on behalf of S, pursuant to the plan of reorganization would be treated as a disposition by P of shares of its own stock for T assets or stock, as applicable. Thus, no gain or loss was recognized on the use of such P stock in the transaction. S, however, recognized gain or loss on its use of P stock if S did not receive the stock from P as part of the plan of reorganization. This rule did not apply in the case of a reverse triangular merger; section 361 provides nonrecognition treatment for S's use of P stock in such a case. To clarify this treatment, a cross-reference has been added to the final regulations.

Comments to the proposed regulations requested that they be expanded to cover P debt, warrants and options provided by P to S, or directly to T or T's shareholders on behalf of S, pursuant to the plan of reorganization. Comments also requested that the rule be extended to taxable transactions.

The issues raised in these comments are beyond the scope of this project. However, the Treasury and the IRS are studying issues relating to the scope of section 1032 and welcome comments and suggestions.

Special analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Effective dates

Generally, §1.358-6 applies with respect to all triangular reorganizations occurring on or after December 23,

1994, the day that the proposed regulations were published in the Federal Register.

As stated in the preamble to the proposed regulations, any adjustment to P's basis in its S or T stock (as applicable) following a triangular reorganization occurring before December 23, 1994, must be consistent with the adjustment that would be made if P had made the acquisition directly and P then transferred the assets to a controlled subsidiary. However, with respect to reverse triangular mergers occurring before December 23, 1994, P may adjust its basis in its T stock as if P acquired the stock of the former T shareholders in a transaction in which its basis was determined under section 362(b).

Section 1.1032-2 applies with respect to certain triangular reorganizations occurring on or after December 23, 1994. With respect to triangular reorganizations occurring before December 23, 1994, see, e.g., §1.1032-1 and Rev. Rul. 57-278, 1957-1 C.B. 124.

Section 1.1502-30 applies with respect to triangular reorganizations occurring on or after December 21, 1995, in which P and S, or P and T, as applicable, are members of a consolidated group following the triangular reorganization. For similar triangular reorganizations occurring before December 21, 1995, any adjustments to P's basis in its S or T stock (as applicable) must be consistent with the rules applicable for nonconsolidated taxpayers, except to the extent that §1.1502-31 applies to a transaction that is a group structure change.

Drafting information

The principal authors of these regulations are Rose Williams and Curt Cutting, Office of Assistant Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.1502-30 also issued under 26 U.S.C. 1502 * * *

Par. 2. Section 1.358-2(d) is removed.

Par. 3. Section 1.358-6 is added to read as follows:

§1.358-6 Stock basis in certain triangular reorganizations.

(a) *Scope.* This section provides rules for computing the basis of a controlling corporation in the stock of a controlled corporation as the result of certain reorganizations involving the stock of the controlling corporation as described in paragraph (b) of this section. The rules of this section are in addition to rules under other provisions of the Internal Revenue Code and principles of law. See, e.g., section 1001 for the recognition of gain or loss by the controlled corporation on the exchange of property for the assets or stock of a target corporation in a reorganization described in section 368.

(b) *Triangular reorganizations—(1) Nomenclature.* For purposes of this section—

(i) *P* is a corporation—

(A) That is a party to a reorganization,

(B) That is in control (within the meaning of section 368(c)) of another party to the reorganization, and

(C) Whose stock is transferred pursuant to the reorganization.

(ii) *S* is a corporation—

(A) That is a party to the reorganization, and

(B) That is controlled by *P*.

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

(2) *Definitions of triangular reorganizations.* This section applies to the following reorganizations (which are referred to collectively as *triangular reorganizations*):

(i) *Forward triangular merger.* A forward triangular merger is a statutory merger of *T* and *S*, with *S* surviving, that qualifies as a reorganization under section 368(a)(1)(A) or (G) by reason of the application of section 368(a)(2)(D).

(ii) *Triangular C reorganization.* A triangular C reorganization is an acquisition by *S* of substantially all of *T*'s assets in exchange for *P* stock in a transaction that qualifies as a reorganization under section 368(a)(1)(C).

(iii) *Reverse triangular merger.* A reverse triangular merger is a statutory merger of *S* and *T*, with *T* surviving, that qualifies as a reorganization under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E).

(iv) *Triangular B reorganization.* A triangular B reorganization is an acquisition by *S* of *T* stock in exchange for *P* stock in a transaction that qualifies as a reorganization under section 368(a)(1)(B).

(c) *General rules.* Subject to the special rule provided in paragraph (d) of this section, *P*'s basis in the stock of *S* or *T*, as applicable, as a result of a triangular reorganization, is adjusted under the following rules—

(1) *Forward triangular merger or triangular C reorganization—(i) In general.* In a forward triangular merger or a triangular C reorganization, *P*'s basis in its *S* stock is adjusted as if—

(A) *P* acquired the *T* assets acquired by *S* in the reorganization (and *P* assumed any liabilities which *S* assumed or to which the *T* assets acquired by *S* were subject) directly from *T* in a transaction in which *P*'s basis in the *T* assets was determined under section 362(b); and

(B) *P* transferred the *T* assets (and liabilities which *S* assumed or to which the *T* assets acquired by *S* were subject) to *S* in a transaction in which *P*'s basis in *S* stock was determined under section 358.

(ii) *Limitation.* If, in applying section 358, the amount of *T* liabilities assumed by *S* or to which the *T* assets acquired by *S* are subject equals or exceeds *T*'s aggregate adjusted basis in its assets, the amount of the adjustment under paragraph (c)(1)(i) of this section is zero. *P* recognizes no gain under section 357(c) as a result of a triangular reorganization.

(2) *Reverse triangular merger—(i) In general—(A) Treated as a forward triangular merger.* Except as otherwise provided in this paragraph (c)(2), *P*'s basis in its *T* stock acquired in a reverse triangular merger equals its basis in its *S* stock immediately before the transaction adjusted as if *T* had merged into *S* in a forward triangular merger to which paragraph (c)(1) of this section applies.

(B) *Allocable share.* If *P* acquires less than all of the *T* stock in the transaction, the basis adjustment described in paragraph (c)(2)(i)(A) of this section is reduced in proportion to the

percentage of *T* stock not acquired in the transaction. The percentage of *T* stock not acquired in the transaction is determined by taking into account the fair market value of all classes of *T* stock.

(C) *Special rule if P owns T stock before the transaction.* Solely for purposes of paragraphs (c)(2)(i)(A) and (B) of this section, if *P* owns *T* stock before the transaction, *P* may treat that stock as acquired in the transaction or not, without regard to the form of the transaction.

(ii) *Reverse triangular merger that qualifies as a section 351 transfer or section 368(a)(1)(B) reorganization.* Notwithstanding paragraph (c)(2)(i) of this section, if a reorganization qualifies as both a reverse triangular merger and as a section 351 transfer or as both a reverse triangular merger and a reorganization under section 368(a)(1)(B), *P* can—

(A) Determine the basis in its *T* stock as if paragraph (c)(2)(i) of this section applies; or

(B) Determine the basis in the *T* stock acquired as if *P* acquired such stock from the former *T* shareholders in a transaction in which *P*'s basis in the *T* stock was determined under section 362(b).

(3) *Triangular B reorganization.* In a triangular B reorganization, *P*'s basis in its *S* stock is adjusted as if—

(i) *P* acquired the *T* stock acquired by *S* in the reorganization directly from the *T* shareholders in a transaction in which *P*'s basis in the *T* stock was determined under section 362(b); and

(ii) *P* transferred the *T* stock to *S* in a transaction in which *P*'s basis in its *S* stock was determined under section 358.

(4) *Examples.* The rules of this paragraph (c) are illustrated by the following examples. For purposes of these examples, *P*, *S*, and *T* are domestic corporations, *P* and *S* do not file consolidated returns, *P* owns all of the only class of *S* stock, the *P* stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, and the facts set forth the only corporate activity.

Example 1. Forward triangular merger. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. Pursuant to a plan, *P* forms *S* with \$5 cash (which *S* retains), and *T* merges into *S*. In

the merger, the *T* shareholders receive *P* stock worth \$100 in exchange for their *T* stock. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Basis adjustment.* Under §1.358-6(c)(1), *P*'s \$5 basis in its *S* stock is adjusted as if *P* acquired the *T* assets acquired by *S* in the reorganization directly from *T* in a transaction in which *P*'s basis in the *T* assets was determined under section 362(b). Under section 362(b), *P* would have an aggregate basis of \$60 in the *T* assets. *P* is then treated as if it transferred the *T* assets to *S* in a transaction in which *P*'s basis in the *S* stock was determined under section 358. Under section 358, *P*'s \$5 basis in its *S* stock would be increased by the \$60 basis in the *T* assets deemed transferred. Consequently, *P* has a \$65 basis in its *S* stock as a result of the reorganization.

(c) *Use of pre-existing S.* The facts are the same as paragraph (a) of this *Example 1*, except that *S* is an operating company with substantial assets that has been in existence for several years. *P* has a \$110 basis in the *S* stock. Under §1.358-6(c)(1), *P*'s \$110 basis in its *S* stock is increased by the \$60 basis in the *T* assets deemed transferred. Consequently, *P* has a \$170 basis in its *S* stock as a result of the reorganization.

(d) *Mixed consideration.* The facts are the same as paragraph (a) of this *Example 1*, except that the *T* shareholders receive *P* stock worth \$80 and \$20 cash from *P*. Under section 358, *P*'s \$5 basis in its *S* stock is increased by the \$60 basis in the *T* assets deemed transferred. Consequently, *P* has a \$65 basis in its *S* stock as a result of the reorganization.

(e) *Liabilities.* The facts are the same as paragraph (a) of this *Example 1*, except that *T*'s assets are subject to \$50 of liabilities, and the *T* shareholders receive \$50 of *P* stock in exchange for their *T* stock. Under section 358, *P*'s basis in its *S* stock is increased by the \$60 basis in the *T* assets deemed transferred and decreased by the \$50 of liabilities to which the *T* assets acquired by *S* are subject. Consequently, *P* has a net basis adjustment of \$10, and a \$15 basis in its *S* stock as a result of the reorganization.

(f) *Liabilities in excess of basis.* The facts are the same as in paragraph (a) of this *Example 1*, except that *T*'s assets are subject to liabilities of \$90, and the *T* shareholders receive \$10 of *P* stock in exchange for their *T* stock in the reorganization. Under §1.358-6(c)(1)(ii), the adjustment under §1.358-6(c) is zero if the amount of the liabilities which *S* assumed or to which the *T* assets acquired by *S* are subject exceeds the aggregate adjusted basis in *T*'s assets. Consequently, *P* has no adjustment in its *S* stock, and *P* has a \$5 basis in its *S* stock as a result of the reorganization.

Example 2. Reverse triangular merger. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and a fair market value of \$100 and no liabilities. *P* has a \$110 basis in its *S* stock. Pursuant to a plan, *S* merges into *T* with *T* surviving. In the merger, the *T* shareholders receive \$10 cash from *P* and *P* stock worth \$90 in exchange for their *T* stock. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(E) apply.

(b) *Basis adjustment.* Under §1.358-6(c)(2)(i)(A), *P*'s basis in the *T* stock acquired is *P*'s \$110 basis in its *S* stock before the transaction, adjusted as if *T* had merged into *S* in a forward triangular merger to which §1.358-6(c)(1) applies. In such a case, *P*'s \$110 basis in its *S*

stock before the transaction would have been increased by the \$60 basis of the *T* assets deemed transferred. Consequently, *P* has a \$170 basis in its *T* stock immediately after the transaction.

(c) *Reverse triangular merger that also qualifies under section 368(a)(1)(B).* The facts relating to *T* are the same as in paragraph (a) of this *Example 2*. *P*, however, forms *S* pursuant to the plan of reorganization. The *T* shareholders receive \$100 worth of *P* stock (and no cash) in exchange for their *T* stock. The *T* shareholders have an aggregate basis in their *T* stock of \$85 immediately before the reorganization. The reorganization qualifies as both a reverse triangular merger and a reorganization under section 368(a)(1)(B). Under §1.358-6(c)(2)(ii), *P* may determine its basis in its *T* stock either as if §1.358-6(c)(2)(i) applied to the *T* stock acquired, or as if *P* acquired the *T* stock from the former *T* shareholders in a transaction in which *P*'s basis in the *T* stock was determined under section 362(b). Accordingly, *P* may determine a basis in its *T* stock of \$60 (*T*'s net asset basis) or \$85 (the *T* shareholders' aggregate basis in the *T* stock immediately before the reorganization).

(d) *Allocable share in a reverse triangular merger.* The facts are the same as in paragraph (a) of this *Example 2*, except that *X*, a 10% shareholder of *T*, does not participate in the transaction. The remaining *T* shareholders receive \$10 cash from *P* and *P* stock worth \$80 for their *T* stock. *P* owns 90% of the *T* stock after the transaction. Under 1.358-6(c)(2)(i)(A), *P*'s basis in its *T* stock is *P*'s \$110 basis in its *S* stock before the reorganization, adjusted as if *T* had merged into *S* in a forward triangular merger. In such a case, *P*'s basis would have been adjusted by the \$60 basis in the *T* assets deemed transferred. Under §1.358-6(c)(2)(i)(B), however, the basis adjustment determined under §1.358-6(c)(2)(i)(A) is reduced in proportion to the percentage of *T* stock not acquired by *P* in the transaction. The percentage of *T* stock not acquired in the transaction is 10%. Therefore, *P* reduces its \$60 basis adjustment by 10%, resulting in a net basis adjustment of \$54. Consequently, *P* has a \$164 basis in its *T* stock as a result of the transaction.

(e) *P's ownership of T stock.* The facts are the same as in paragraph (a) of this *Example 2*, except that *P* owns 10% of the *T* stock before the transaction. *P*'s basis in that *T* stock is \$8. All the *T* shareholders other than *P* surrender their *T* stock for \$10 cash from *P* and *P* stock worth \$80. *P* does not surrender the stock in the transaction. Under §1.358-6(c)(2)(i)(C), *P* may treat its *T* stock owned before the transaction as acquired in the transaction or not. If *P* treats that *T* stock as acquired in the transaction, *P*'s basis in that *T* stock and the *T* stock actually acquired in the transaction equals *P*'s \$110 basis in its *S* stock before the transaction, adjusted by the \$60 basis of the *T* assets deemed transferred, for a total basis of \$170. If *P* treats its *T* stock as not acquired, *P* retains its \$8 pre-transaction basis in that stock. *P*'s basis in its other *T* shares equals *P*'s \$110 basis in its *S* stock before the transaction, adjusted by \$54 (the \$60 basis in the *T* assets deemed transferred, reduced by 10%), for a total basis of \$164 in those shares. See §1.358-6(c)(2)(i)(A) and (B). Consequently, if *P* treats its *T* shares as not acquired, *P*'s total basis in all of its *T* shares is \$172.

Example 3. Triangular B reorganization. (a) *Facts.* *T* has assets with a fair market value of \$100 and no liabilities. The *T* shareholders have

an aggregate basis in their *T* stock of \$85 immediately before the reorganization. Pursuant to a plan, *P* forms *S* with \$5 cash and *S* acquires all of the *T* stock in exchange for \$100 of *P* stock. The transaction is a reorganization to which section 368(a)(1)(B) applies.

(b) *Basis adjustment.* Under §1.358-6(c)(3), *P* adjusts its \$5 basis in its *S* stock by treating *P* as if it acquired the *T* stock acquired by *S* in the reorganization directly from the *T* shareholders in exchange for the *P* stock in a transaction in which *P*'s basis in the *T* stock was determined under section 362(b). Under section 362(b), *P* would have an aggregate basis of \$85 in the *T* stock received by *S* in the reorganization. *P* is then treated as if it transferred the *T* stock to *S* in a transaction in which *P*'s basis in the *S* stock was determined under section 358. Under section 358, *P*'s basis in its *S* stock would be increased by the \$85 basis in the *T* stock deemed transferred. Consequently, *P* has a \$90 basis in its *S* stock as a result of the reorganization.

(d) *Special rule for consideration not provided by P—(1) In general.* The amount of *P*'s adjustment to basis in its *S* or *T* stock, as applicable, described in paragraph (c) of this section is decreased by the fair market value of any consideration (including *P* stock in which gain or loss is recognized, see §1.1032-2(c)) that is exchanged in the reorganization and that is not provided by *P* pursuant to the plan of reorganization. This paragraph (d) does not apply to the amount of *T* liabilities assumed by *S* or to which the *T* assets acquired by *S* are subject under paragraph (c)(1) of this section (or deemed assumed or taken subject to by *S* under paragraph (c)(2)(i) of this section).

(2) *Limitation.* *P* makes no adjustment to basis under this section if the decrease required under paragraph (d)(1) of this section equals or exceeds the amount of the adjustment described in paragraph (c) of this section.

(3) *Example.* The rules of this paragraph (d) are illustrated by the following example. For purposes of this example, *P*, *S*, and *T* are domestic corporations, *P* and *S* do not file consolidated returns, *P* owns all of the only class of *S* stock, the *P* stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, and the facts set forth the only corporate activity.

Example. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. *S* is an operating company with substantial assets that has been in existence for several years. *P* has a \$100 basis in its *S* stock. Pursuant to a plan, *T* merges into *S* and the *T* shareholders receive \$70 of *P* stock provided by *P* pursuant to the plan and \$30 of cash provided by *S* in exchange for their *T* stock.

The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Basis adjustment.* Under §1.358-6(c)(1), *P*'s \$100 basis in its *S* stock is increased by the \$60 basis in the *T* assets deemed transferred. Under §1.358-6(d)(1), the \$60 adjustment is decreased by the \$30 of cash provided by *S* in the reorganization. Consequently, *P* has a net adjustment of \$30 in its *S* stock, and *P* has a \$130 basis in its *S* stock as a result of the reorganization.

(c) *Appreciated asset.* The facts are the same as in paragraph (a) of this *Example*, except that in the reorganization *S* provides an asset with a \$20 adjusted basis and \$30 fair market value instead of \$30 of cash. The basis results are the same as in paragraph (b) of this *Example*. In addition, *S* recognizes \$10 of gain under section 1001 on its disposition of the asset in the reorganization.

(d) *Depreciated asset.* The facts are the same as in paragraph (c) of this *Example*, except that *S* has a \$60 adjusted basis in the asset. The basis results are the same as in paragraph (b) of this *Example*. In addition, *S* recognizes \$30 of loss under section 1001 on its disposition of the asset in the reorganization.

(e) *P stock.* The facts are the same as in paragraph (a) of this *Example*, except that in the reorganization *S* provides *P* stock with a fair market value of \$30 instead of \$30 of cash. *S* acquired the *P* stock in an unrelated transaction several years before the reorganization. *S* has a \$20 adjusted basis in the *P* stock. The basis results are the same as in paragraph (b) of this *Example*. In addition, *S* recognizes \$10 of gain on its disposition of the *P* stock in the reorganization. See §1.1032-2(c).

(e) *Cross-reference.* For rules relating to stock basis adjustments made as a result of a triangular reorganization in which *P* and *S*, or *P* and *T*, as applicable, are, or become, members of a consolidated group, see §1.1502-30. For rules relating to stock basis adjustments after a group structure change, see §1.1502-31.

(f) *Effective dates—(1) General rule.* Except as otherwise provided in this paragraph (f), this section applies to triangular reorganizations occurring on or after December 23, 1994.

(2) *Special rule for reverse triangular mergers.* For a reverse triangular merger occurring before December 23, 1994, *P* may—

(i) Determine the basis in its *T* stock as if paragraph (c)(2)(i) of this section applied; or

(ii) Determine the basis in its *T* stock acquired as if *P* acquired such stock from the former *T* shareholders in a transaction in which *P*'s basis in the *T* stock was determined under section 362(b).

Par. 4. Section 1.1032-2 is added to read as follows:

§1.1032-2 *Disposition by a corporation of stock of a controlling corporation in certain triangular reorganizations.*

(a) *Scope.* This section provides rules for certain triangular reorganizations described in §1.358-6(b) when the acquiring corporation (*S*) acquires property or stock of another corporation (*T*) in exchange for stock of the corporation (*P*) in control of *S*.

(b) *General nonrecognition of gain or loss.* For purposes of §1.1032-1(a), in the case of a forward triangular merger, a triangular C reorganization, or a triangular B reorganization (as described in §1.358-6(b)), *P* stock provided by *P* to *S*, or directly to *T* or *T*'s shareholders on behalf of *S*, pursuant to the plan of reorganization is treated as a disposition by *P* of shares of its own stock for *T*'s assets or stock, as applicable. For rules governing the use of *P* stock in a reverse triangular merger, see section 361.

(c) *Treatment of S.* *S* must recognize gain or loss on its exchange of *P* stock as consideration in a forward triangular merger, a triangular C reorganization, or a triangular B reorganization (as described in §1.358-6(b)), if *S* did not receive the *P* stock from *P* pursuant to the plan of reorganization. See §1.358-6(d) for the effect on *P*'s basis in its *S* or *T* stock, as applicable. For rules governing *S*'s use of *P* stock in a reverse triangular merger, see section 361.

(d) *Examples.* The rules of this section are illustrated by the following examples. For purposes of these examples, *P*, *S*, and *T* are domestic corporations, *P* and *S* do not file consolidated returns, *P* owns all of the only class of *S* stock, the *P* stock exchanged in the transaction satisfies the requirements of the applicable reorganization provisions, and the facts set forth the only corporate activity.

Example 1. Forward triangular merger solely for P stock. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. Pursuant to a plan, *P* forms *S* by transferring \$100 of *P* stock to *S* and *T* merges into *S*. In the merger, the *T* shareholders receive, in exchange for their *T* stock, the *P* stock that *P* transferred to *S*. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *No gain or loss recognized on the use of P stock.* Under paragraph (b) of this section, the *P* stock provided by *P* pursuant to the plan of

reorganization is treated for purposes of §1.1032-1(a) as disposed of by *P* for the *T* assets acquired by *S* in the merger. Consequently, neither *P* nor *S* has taxable gain or deductible loss on the exchange.

Example 2. Forward triangular merger solely for P stock provided in part by S. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. *S* is an operating company with substantial assets that has been in existence for several years. *S* also owns *P* stock with a \$20 adjusted basis and \$30 fair market value. *S* acquired the *P* stock in an unrelated transaction several years before the reorganization. Pursuant to a plan, *P* transfers additional *P* stock worth \$70 to *S* and *T* merges into *S*. In the merger, the *T* shareholders receive \$100 of *P* stock (\$70 of *P* stock provided by *P* to *S* as part of the plan and \$30 of *P* stock held by *S* previously). The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Gain or loss recognized by S on the use of its P stock.* Under paragraph (b) of this section, the \$70 of *P* stock provided by *P* pursuant to the plan of reorganization is treated as disposed of by *P* for the *T* assets acquired by *S* in the merger. Consequently, neither *P* nor *S* has taxable gain or deductible loss on the exchange of those shares. Under paragraph (c) of this section, however, *S* recognizes \$10 of gain on the exchange of its *P* stock in the reorganization because *S* did not receive the *P* stock from *P* pursuant to the plan of reorganization. See §1.358-6(d) for the effect on *P*'s basis in its *S* stock.

(e) *Effective date.* This section applies to triangular reorganizations occurring on or after December 23, 1994.

Par. 5. Section 1.1502-30 is added to read as follows:

§1.1502-30 *Stock basis after certain triangular reorganizations.*

(a) *Scope.* This section provides rules for determining the basis of the stock of an acquiring corporation as a result of a triangular reorganization. The definitions and nomenclature contained in §1.358-6 apply to this section.

(b) *General rules—(1) Forward triangular merger, triangular C reorganization, or triangular B reorganization.* *P* adjusts its basis in the stock of *S* as a result of a forward triangular merger, triangular C reorganization, or triangular B reorganization under §1.358-6(c) and (d), except that §1.358-6(c)(1)(ii) and (d)(2) do not apply. Instead, *P* adjusts such basis by taking into account the full amount of—

(i) *T* liabilities assumed by *S* or the amount of liabilities to which the *T* assets acquired by *S* are subject, and

(ii) The fair market value of any consideration not provided by *P* pursuant to the plan of reorganization.

(2) *Reverse triangular merger.* If *P* adjusts its basis in the *T* stock acquired as a result of a reverse triangular merger under §1.358–6(c)(2)(i) and (d), §1.358–6(c)(1)(ii) and (d)(2) do not apply. Instead, *P* adjusts such basis by taking into account the full amount of—

(i) *T* liabilities deemed assumed by *S* or the amount of liabilities to which the *T* assets deemed acquired by *S* are subject, and

(ii) The fair market value of any consideration not provided by *P* pursuant to the plan of reorganization.

(3) *Excess loss accounts.* Negative adjustments under this section may exceed *P*'s basis in its *S* or *T* stock. The resulting negative amount is *P*'s excess loss account in its *S* or *T* stock. See §1.1502–19 for rules treating excess loss accounts as negative basis, and treating references to stock basis as including references to excess loss accounts.

(4) *Application of other rules of law.* The rules for this section are in addition to other rules of law. See §1.1502–80(d) for the non-application of section 357(c) to *P*.

(5) *Examples.* The rules of this paragraph (b) are illustrated by the following examples. For purposes of these examples, *P*, *S*, and *T* are domestic corporations, *P* and *S* file consolidated returns, *P* owns all of the only class of *S* stock, the *P* stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, the facts set forth the only corporate activity, and tax liabilities are disregarded.

Example 1. Liabilities. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100. *T*'s assets are subject to \$70 of liabilities. Pursuant to a plan, *P* forms *S* with \$5 of cash (which *S* retains), and *T* merges into *S*. In the merger, the *T* shareholders receive *P* stock worth \$30 in exchange for their *T* stock. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Basis adjustment.* Under §1.358–6, *P* adjusts its \$5 basis in the *S* stock as if *P* had acquired the *T* assets with a carryover basis under section 362 and transferred these assets to *S* in a transaction in which *P* determines its basis in the *S* stock under section 358. Under the rules of this section, the limitation described in §1.358–6(c)(1)(ii) does not apply. Thus, *P* adjusts its basis in the *S* stock by –\$10 (the aggregate adjusted basis of *T*'s assets decreased by the amount of liabilities to which the *T* assets are subject). Consequently, as a result of the reorganization, *P* has an excess loss account of \$5 in its *S* stock.

Example 2. Consideration not provided by P. (a) *Facts.* *T* has assets with an aggregate basis of \$10 and fair market value of \$100 and no liabilities. *S* is an operating company with substantial assets that has been in existence for several years. *P* has a \$5 basis in its *S* stock. Pursuant to a plan, *T* merges into *S* and the *T* shareholders receive \$70 of *P* stock provided by *P* pursuant to the plan of reorganization and \$30 of cash provided by *S* in exchange for their *T* stock. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(D) apply.

(b) *Basis adjustment.* Under §1.358–6, *P* adjusts its \$5 basis in the *S* stock as if *P* had acquired the *T* assets with a carryover basis under section 362 and transferred these assets to *S* in a transaction in which *P* determines its basis in the *S* stock under section 358. Under the rules of this section, the limitation described in §1.358–6(d)(2) does not apply. Thus, *P* adjusts its basis in the *S* stock by –\$20 (the aggregate adjusted basis of *T*'s assets decreased by the fair market value of the consideration provided by *S*). As a result of the reorganization, *P* has an excess loss account of \$15 in its *S* stock.

(c) *Appreciated asset.* The facts are the same as in paragraph (a) of this *Example 2*, except that in the reorganization *S* provides an asset with a \$20 adjusted basis and \$30 fair market value

instead of \$30 cash. The basis is adjusted in the same manner as in paragraph (b) of this *Example 2*. In addition, because *S* recognizes a \$10 gain from the asset under section 1001, *P*'s basis in its *S* stock is increased under §1.1502–32(b) by *S*'s \$10 gain. Consequently, as a result of the reorganization, *P* has an excess loss account of \$5 in its *S* stock. (The results would be the same if the appreciated asset provided by *S* was *P* stock with respect to which *S* recognized gain. See §1.1032–2(c)).

Example 3. Reverse triangular merger. (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100. *T*'s assets are subject to \$70 of liabilities. *P* owns all of the only class of *S* stock. *P* has a \$5 basis in its *S* stock. Pursuant to a plan, *S* merges into *T* with *T* surviving. In the merger, the *T* shareholders exchange their *T* stock for \$2 cash from *P* and \$28 worth of *P* stock provided by *P* pursuant to the plan. The transaction is a reorganization to which sections 368(a)(1)(A) and (a)(2)(E) apply.

(b) *Basis adjustment.* Under §1.358–6, *P*'s basis in the *T* stock acquired equals its \$5 basis in its *S* stock immediately before the transaction adjusted by the \$60 basis in the *T* assets deemed transferred, and the \$70 of liabilities to which the *T* assets are subject. Under the rules of this section, the limitation described in §1.358–6(c)(1)(ii) does not apply. Consequently, *P* has an excess loss account of \$5 in its *T* stock as a result of the transaction.

(c) *Effective date.* This section applies to reorganizations occurring on or after December 21, 1995.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 12, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

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