

§ 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) *Stock options.* The rules of this section shall apply to an option to buy or sell *P* stock issued by *P* in the same manner as the rules of this section apply to *P* stock.

(f) *Effective dates.* This section applies to triangular reorganizations occurring on or after December 23, 1994, except for paragraph (e) of this section, which applies to transfers of stock options occurring on or after May 16, 2000.

[T.D. 8648, 60 FR 66081, Dec. 21, 1995, as amended by T.D. 8883, 65 FR 31076, May 16, 2000]

§ 1.1032-3 Disposition of stock or stock options in certain transactions not qualifying under any other non-recognition provision.

(a) *Scope.* This section provides rules for certain transactions in which a corporation or a partnership (the acquiring entity) acquires money or other

property (as defined in § 1.1032-1) in exchange, in whole or in part, for stock of a corporation (the issuing corporation).

(b) *Nonrecognition of gain or loss*—(1) *General rule.* In a transaction to which this section applies, no gain or loss is recognized on the disposition of the issuing corporation's stock by the acquiring entity. The transaction is treated as if, immediately before the acquiring entity disposes of the stock of the issuing corporation, the acquiring entity purchased the issuing corporation's stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships). For rules that may apply in determining the issuing corporation's adjustment to basis in the acquiring entity (or, if necessary, in determining the adjustment to basis in intermediate entities), see sections 358, 722, and the regulations thereunder.

(2) *Special rule for actual payment for stock of the issuing corporation.* If the issuing corporation receives money or other property in payment for its stock, the amount of cash deemed contributed under paragraph (b)(1) of this section is the difference between the fair market value of the issuing corporation stock and the amount of money or the fair market value of other property that the issuing corporation receives as payment.

(c) *Applicability.* The rules of this section apply only if, pursuant to a plan to acquire money or other property—

(1) The acquiring entity acquires stock of the issuing corporation directly or indirectly from the issuing corporation in a transaction in which, but for this section, the basis of the stock of the issuing corporation in the hands of the acquiring entity would be determined, in whole or in part, with respect to the issuing corporation's basis in the issuing corporation's stock under section 362(a) or 723 (provided that, in the case of an indirect acquisition by the acquiring entity, the transfers of issuing corporation stock through intermediate entities occur immediately after one another);

(2) The acquiring entity immediately transfers the stock of the issuing cor-

poration to acquire money or other property (from a person other than an entity from which the stock was directly or indirectly acquired);

(3) The party receiving stock of the issuing corporation in the exchange specified in paragraph (c)(2) of this section from the acquiring entity does not receive a substituted basis in the stock of the issuing corporation within the meaning of section 7701(a)(42); and

(4) The issuing corporation stock is not exchanged for stock of the issuing corporation.

(d) *Stock options.* The rules of this section shall apply to an option issued by a corporation to buy or sell its own stock in the same manner as the rules of this section apply to the stock of an issuing corporation.

(e) *Examples.* The following examples illustrate the application of this section:

Example 1. (i) *X*, a corporation, owns all of the stock of *Y* corporation. *Y* reaches an agreement with *C*, an individual, to acquire a truck from *C* in exchange for 10 shares of *X* stock with a fair market value of \$100. To effectuate *Y*'s agreement with *C*, *X* transfers to *Y* the *X* stock in a transaction in which, but for this section, the basis of the *X* stock in the hands of *Y* would be determined with respect to *X*'s basis in the *X* stock under section 362(a). *Y* immediately transfers the *X* stock to *C* to acquire the truck.

(ii) In this *Example 1*, no gain or loss is recognized on the disposition of the *X* stock by *Y*. Immediately before *Y*'s disposition of the *X* stock, *Y* is treated as purchasing the *X* stock from *X* for \$100 of cash contributed to *Y* by *X*. Under section 358, *X*'s basis in its *Y* stock is increased by \$100.

Example 2. (i) Assume the same facts as *Example 1*, except that, rather than *X* stock, *X* transfers an option with a fair market value of \$100 to purchase *X* stock.

(ii) In this *Example 2*, no gain or loss is recognized on the disposition of the *X* stock option by *Y*. Immediately before *Y*'s disposition of the *X* stock option, *Y* is treated as purchasing the *X* stock option from *X* for \$100 of cash contributed to *Y* by *X*. Under section 358, *X*'s basis in its *Y* stock is increased by \$100.

Example 3. (i) *X*, a corporation, owns all of the outstanding stock of *Y* corporation. *Y* is a partner in partnership *Z*. *Z* reaches an agreement with *C*, an individual, to acquire a truck from *C* in exchange for 10 shares of *X* stock with a fair market value of \$100. To effectuate *Z*'s agreement with *C*, *X* transfers to *Y* the *X* stock in a transaction in which, but for this section, the basis of the *X* stock

in the hands of Y would be determined with respect to X's basis in the X stock under section 362(a). Y immediately transfers the X stock to Z in a transaction in which, but for this section, the basis of the X stock in the hands of Z would be determined under section 723. Z immediately transfers the X stock to C to acquire the truck.

(ii) In this *Example 3*, no gain or loss is recognized on the disposition of the X stock by Z. Immediately before Z's disposition of the X stock, Z is treated as purchasing the X stock from X for \$100 of cash indirectly contributed to Z by X through an intermediate corporation, Y. Under section 722, Y's basis in its Z partnership interest is increased by \$100, and, under section 358, X's basis in its Y stock is increased by \$100.

Example 4. (i) X, a corporation, owns all of the outstanding stock of Y corporation. B, an individual, is an employee of Y. Pursuant to an agreement between X and Y to compensate B for services provided to Y, X transfers to B 10 shares of X stock with a fair market value of \$100. Under § 1.83-6(d), but for this section, the transfer of X stock by X to B would be treated as a contribution of the X stock by X to the capital of Y, and immediately thereafter, a transfer of the X stock by Y to B. But for this section, the basis of the X stock in the hands of Y would be determined with respect to X's basis in the X stock under section 362(a).

(ii) In this *Example 4*, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

Example 5. (i) X, a corporation, owns all of the outstanding stock of Y corporation. B, an individual, is an employee of Y. To compensate B for services provided to Y, B is offered the opportunity to purchase 10 shares of X stock with a fair market value of \$100 at a reduced price of \$80. B transfers \$80 and Y transfers \$10 to X as partial payment for the X stock.

(ii) In this *Example 5*, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for \$100, \$80 of which Y is deemed to have received from B, \$10 of which originated with Y, and \$10 of which is deemed to have been contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$10.

Example 6. (i) X, a corporation, owns stock of Y. To compensate Y's employee, B, for services provided to Y, X issues 10 shares of X stock to B, subject to a substantial risk of forfeiture. B does not have an election under section 83(b) in effect with respect to the X stock. X retains the only reversionary inter-

est in the X stock in the event that B forfeits the right to the stock. Several years after X's transfer of the X shares, the stock vests. At the time the stock vests, the 10 shares of X stock have a fair market value of \$100. Under § 1.83-6(d), but for this section, the transfer of the X stock by X to B would be treated, at the time the stock vests, as a contribution of the X stock by X to the capital of Y, and immediately thereafter, a disposition of the X stock by Y to B. The basis of the X stock in the hands of Y, but for this section, would be determined with respect to X's basis in the X stock under section 362(a).

(ii) In this *Example 6*, no gain or loss is recognized on the deemed disposition of X stock by Y when the stock vests. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing X's stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

Example 7. (i) Assume the same facts as in *Example 6*, except that Y (rather than X) retains a reversionary interest in the X stock in the event that B forfeits the right to the stock. Several years after X's transfer of the X shares, the stock vests.

(ii) In this *Example 7*, this section does not apply to Y's deemed disposition of the X shares because Y is not deemed to have transferred the X stock to B immediately after receiving the stock from X. For the tax consequences to Y on the deemed disposition of the X stock, see § 1.83-6(b).

Example 8. (i) X, a corporation, owns all of the outstanding stock of Y corporation. In Year 1, X issues to Y's employee, B, a non-statutory stock option to purchase 10 shares of X stock as compensation for services provided to Y. The option is exercisable against X and does not have a readily ascertainable fair market value (determined under § 1.83-7(b)) at the time the option is granted. In Year 2, B exercises the option by paying X the strike price of \$80 for the X stock, which then has a fair market value of \$100.

(ii) In this *Example 8*, because, under section 83(e)(3), section 83(a) does not apply to the grant of the option, paragraph (d) of this section also does not apply to the grant of the option. Section 83 and § 1.1032-3 apply in Year 2 when the option is exercised; thus, no gain or loss is recognized on the deemed disposition of X stock by Y in Year 2. Immediately before Y's deemed disposition of the X stock in Year 2, Y is treated as purchasing the X stock from X for \$100, \$80 of which Y is deemed to have received from B and the remaining \$20 of which is deemed to have been contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$20.

Example 9. (i) A, an individual, owns a majority of the stock of X. X owns stock of Y constituting control of Y within the meaning of section 368(c). A transfers 10 shares of its

X stock to B, a key employee of Y. The fair market value of the 10 shares on the date of transfer was \$100.

(ii) In this *Example 9*, A is treated as making a nondeductible contribution of the 10 shares of X to the capital of X, and no gain or loss is recognized by A as a result of this transfer. See *Commissioner v. Fink*, 483 U.S. 89 (1987). A must allocate his basis in the transferred shares to his remaining shares of X stock. No gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

Example 10. (i) In Year 1, X, a corporation, forms a trust which will be used to satisfy deferred compensation obligations owed by Y, X's wholly owned subsidiary, to Y's employees. X funds the trust with X stock, which would revert to X upon termination of the trust, subject to the employees' rights to be paid the deferred compensation due to them. The creditors of X can reach all the trust assets upon the insolvency of X. Similarly, Y's creditors can reach all the trust assets upon the insolvency of Y. In Year 5, the trust transfers X stock to the employees of Y in satisfaction of the deferred compensation obligation.

(ii) In this *Example 10*, X is considered to be the grantor of the trust, and, under section 677, X is also the owner of the trust. Any income earned by the trust would be reflected on X's income tax return. Y is not considered a grantor or owner of the trust corpus at the time X transfers X stock to the trust. In Year 5, when employees of Y receive X stock in satisfaction of the deferred compensation obligation, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for fair market value using cash contributed to Y by X. Under section 358, X's basis in its Y stock increases by the amount of cash deemed contributed.

(f) *Effective date.* This section applies to transfers of stock or stock options of the issuing corporation occurring on or after May 16, 2000.

[T.D. 8883, 65 FR 31076, May 16, 2000; 65 FR 37482, June 15, 2000]

§ 1.1033(a)-1 Involuntary conversions; nonrecognition of gain.

(a) *In general.* Section 1033 applies to cases where property is compulsorily or involuntarily converted. An *involuntary conversion* may be the result of the destruction of property in whole or in part, the theft of property, the seizure

of property, the requisition or condemnation of property, or the threat or imminence of requisition or condemnation of property. An *involuntary conversion* may be a conversion into similar property or into money or into dissimilar property. Section 1033 provides that, under certain specified circumstances, any gain which is realized from an involuntary conversion shall not be recognized. In cases where property is converted into other property similar or related in service or use to the converted property, no gain shall be recognized regardless of when the disposition of the converted property occurred and regardless of whether or not the taxpayer elects to have the gain not recognized. In other types of involuntary conversion cases, however, the proceeds arising from the disposition of the converted property must (within the time limits specified) be re-invested in similar property in order to avoid recognition of any gain realized. Section 1033 applies only with respect to gains; losses from involuntary conversions are recognized or not recognized without regard to this section.

(b) *Special rules.* For rules relating to the application of section 1033 to involuntary conversions of a principal residence with respect to which an election has been made under section 121 (relating to gain from sale or exchange of residence of individual who has attained age 65), see paragraph (g) of § 1.121-5. For rules applicable to involuntary conversions of a principal residence occurring before January 1, 1951, see § 1.1033(a)-3. For rules applicable to involuntary conversions of a principal residence occurring after December 31, 1950, and before January 1, 1954, see paragraph (h)(1) of § 1.1034-1. For rules applicable to involuntary conversions of a personal residence occurring after December 31, 1953, see § 1.1033(a)-3. For special rules relating to the election to have section 1034 apply to certain involuntary conversions of a principal residence occurring after December 31, 1957, see paragraph (h)(2) of § 1.1034-1. For special rules relating to certain involuntary conversions of real property held either for productive use in trade or business or for investment and occurring after December 31, 1957, see