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third transaction in 1974, Y sells such property and recognizes a gain of $25. With respect to Y's shareholders on December 31, 1974, the amount described in paragraph (a)(3)(ii) of this section would be limited to $13, which is the amount of the transferor's gain which was not recognized on the first transaction ($17) minus the amount of gain recognized by X on the second transaction ($4).

Example 2. Z is a DISC using the calendar year as its taxable year. In a first transaction in 1972, in exchange for its stock, Z acquires section 1245 property from A, an individual who is its sole shareholder, in a transaction in which A's realized gain of $30 is not recognized by reason of the application of section 351(a). In a second transaction in 1973, Z exchanges such property for other property in a like-kind exchange to which section 1031(b) applies and recognizes $10 of a realized gain of $35. (On December 31, 1973, A is treated as having received a deemed distribution of a dividend which includes such $10 under paragraph (a)(3) of this section, provided the limitation in paragraph (b) of this section is met.) In a third transaction in 1974, Z sells the property acquired in the like-kind exchange and recognizes a gain of $25. With respect to A on December 31, 1974, the amount described in paragraph (a)(3)(ii) of this section is limited to $20, which is the amount of A's gain which was not recognized on the first transaction ($30) minus the amount of gain recognized by Z on the second transaction ($10).

(e) *Carry back of net operating loss and capital loss to prior DISC taxable year.* For purposes of sections 991, 995, and 996, the amount of the deduction for the taxable year under section 172 for a net operating loss carryback or carryover or under section 1212 for a capital loss carryback or carryover shall be determined in the same manner as if the DISC were a domestic corporation which had not elected to be treated as a DISC. Thus, the amount of the deduction will be the same whether or not the corporation was a DISC in the year of the loss or in the year to which the loss is carried. For provisions setting forth adjustments to the DISC's, or former DISC's, deemed distributions, adjustments to its divisions of earnings and profits, and other tax consequences arising from such carrybacks, see §1.996–8.

(Secs. 995(e)(7), (8) and (10), 995(g) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1655, 26 U.S.C. 995 (e)(7), (8) and (10); 90 Stat. 1659, 26 U.S.C. 995(g); and 68A Stat 917, 26 U.S.C. 7805))

[T.D. 7324, 39 FR 35110, Sept. 30, 1974, as amended by T.D. 7862, 47 FR 56492, Dec. 17, 1982; T.D. 7984, 49 FR 40018, Oct. 12, 1984]

§1.995–3 Distributions upon disqualification.

(a) *General rule.* Under section 995(b)(2), a shareholder of a corporation which is disqualified from being a DISC, either because pursuant to §1.992–2(e)(2) it revoked its election to be treated as a DISC or because it has failed to satisfy the requirements as set forth in §1.992–1 to be a DISC for a taxable year, shall be deemed to have received (at the times specified in paragraph (b) of this section) distributions taxable as dividends aggregating an amount equal to his pro rata share of the accumulated DISC income (as defined in §1.996–3(b)) of such corporation which was accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC. The pro rata share referred to in the preceding sentence shall be determined as of the close of the last of such consecutive taxable years for which the corporation was a DISC. See §1.996–7(c) for rules relating to the carryover of, and maintaining a separate account for, such accumulated DISC income in certain reorganizations.

(b) *Time of receipt of deemed distributions.* Distributions described in paragraph (a) of this section shall be deemed to be received in equal installments on the last day of each of the 10 taxable years of the corporation following the year of the disqualification described in paragraph (a) of this section, except that in no case may the number of equal installments exceed the number of the immediately preceding consecutive taxable years for which the corporation was a DISC.

(c) *Transfer of shares.* Deemed distributions are includible under paragraphs (a) and (b) of this section in a shareholder's gross income as a dividend only so long as he continues to hold the shares with respect to which

the distribution is deemed made. Thus, the transferee of such shareholder will include in his gross income under paragraphs (a) and (b) of this section the remaining installments of the deemed distribution which the transferor would have included in his gross income as a dividend had he not transferred the shares. However, if the transferee acquires the shares in a transaction in which the transferor's gain is treated under §1.995–4 in whole or in part as a dividend, then under §1.996–4(a) such transferee does not include subsequent installments in his gross income to the extent that the transferee treats such subsequent installments as made out of previously taxed income.

(d) *Effect of requalification.* Deemed distributions under paragraphs (a) and (b) of this section continue and are includible in gross income as dividends by the shareholders whether or not the corporation subsequently requalifies and is treated as a DISC.

(e) *Effect of actual distributions and deemed distributions under section 995(b)(1)(G).* If, during the period a shareholder of a DISC, or former DISC, is taking into account deemed distributions under paragraphs (a) and (b) of this section, an actual distribution is made to him out of accumulated DISC income or a deemed distribution because of foreign investment attributable to producer's loans is made under §1.995–2(a)(5) out of accumulated DISC income, such actual or deemed distribution shall first reduce the last installment of the deemed distributions scheduled to be included in the shareholder's gross income as a dividend, and then the preceding scheduled installments in reverse order. If deemed distributions are scheduled to be included in gross income for two or more disqualifications, an actual distribution or a deemed distribution under §1.995–2 (a)(5) which is treated as made out of accumulated DISC income reduces the deemed distributions resulting from the earlier disqualification first.

(f) *Examples.* This section may be illustrated by the following examples:

Example 1. X Corporation, which uses the calendar year as its taxable year, elects to be treated as a DISC beginning with 1972. X qualifies as a DISC for taxable years 1972 through 1975, but, pursuant to §1.992–2(e)(2), revokes its election as of January 1, 1976, and is disqualified as a DISC. On that date, X has $24,000 of accumulated DISC income. X's shareholders will be deemed to receive $6,000 in distributions taxable as a dividend on the last day of each of X's four succeeding taxable years (1977, 1978, 1979, and 1980).

Example 2. Assume the same facts as in example 1, except that in 1978 X makes an actual distribution of $22,000 to its shareholders of which $10,000 is treated under §1.996–1 as made out of accumulated DISC income. (The remaining $12,000 of such distribution is treated as made out of previously taxed income.) The actual distribution would first reduce the $6,000 deemed distribution scheduled for 1980 to zero and then reduce the $6,000 deemed distribution scheduled for 1979 to $2,000. Thus, X's shareholders include in 1978 $16,000 is gross income as dividends ($10,000 of actual distributions and the $6,000 deemed distribution scheduled for that year) and $2,000 as a dividend in 1979.

Example 3. Assume the same facts as in example 2, except that X requalifies as a DISC for taxable year 1977 during which it derives $7,000 of DISC income (computed after taking into account a deemed distribution under §1.995–2(a)(4) of $7,000), but is again disqualified in 1978. In addition X makes an actual distribution in 1977 equal to the deemed distribution of $7,000. Such actual distribution is excluded from gross income under §1.996–1(c). In 1977. X's shareholders include in gross income as dividends the $6,000 deemed distribution upon disqualification (in addition to the deemed distributions of $7,000 under §1.995–2 for 1977 when it was treated as a DISC). The actual distribution in 1978 still reduces the installments resulting from the earlier disqualification. Thus, in 1978, X's shareholders include $16,000 in gross income as dividends. In 1979, X's shareholders include $9,000 in gross income as dividends (the final installment of $2,000 from the earlier disqualification plus the single deemed distribution of $7,000 resulting from the later disqualification).

[T.D. 7324, 39 FR 35112, Sept. 30, 1974, as amended by T.D. 7854, 47 FR 51741, Nov. 17, 1982]

§ 1.995–4 Gain on disposition of stock in a DISC.

(a) *Disposition in which gain is recognized*—(1) *In general.* If a shareholder disposes, or is treated as disposing, of stock in a DISC, or former DISC, then any gain recognized on such disposition shall be included in the shareholder's gross income as a dividend, notwithstanding any other provision of the Code, to the extent of the accumulated