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Total	45
(c) Accumulated DISC income on 12/31/76	55

[T.D. 7324, 39 FR 35121, Sept. 30, 1974]

§ 1.996–5 Adjustment to basis.

(a) *Addition to basis.* Under section 996(e)(1) amounts representing deemed distributions as provided in section 995(b) shall increase the basis of the stock with respect to which the distribution is made.

(b) *Reductions of basis.* Under section 996(e)(2), the portion of an actual distribution treated as made out of previously taxed income shall reduce the basis of the stock with respect to which it is made and, to the extent that it exceeds the adjusted basis of such stock, shall be treated as gain from the sale or exchange of property. In the case of stock includible in the gross estate of a decedent for which an election is made under section 2032 (relating to alternate valuation), this paragraph shall not apply to any distribution made after the date of the decedent's death and before the alternate valuation date provided by section 2032. See section 1014(d) for a special rule for determining the basis of stock in a DISC, or former DISC, acquired from a decedent.

[T.D. 7324, 39 FR 35124, Sept. 30, 1974]

§ 1.996–6 Effectively connected income.

In the case of a shareholder who is a nonresident alien individual or a foreign corporation, trust, or estate, amounts taxable as dividends by reason of the application of §1.995–4 (relating to gain on disposition of stock in a DISC), amounts treated under §1.996–1 as distributed out of accumulated DISC income, and amounts deemed distributed under §1.995–2(a) (1) through (4) shall be treated as gains and distributions which are effectively connected with the conduct of a trade or business conducted through a permanent establishment of such shareholder within the United States, and shall be subject to tax in accordance with the provisions of section 871(b) and the regulations thereunder in the case of nonresident alien individuals, trusts, or estates, or section 882 and the regulations thereunder in the case of foreign corporations. In no case, however shall other income of such shareholder be taxable as effectively connected with the conduct of a trade or business through a permanent establishment in the United States solely because of the application of this section.

[T.D. 7324, 39 FR 35124, Sept. 30, 1974]

§ 1.996–7 Carryover of DISC tax attributes.

(a) *In general.* Carryover of a DISC's divisions of earnings and profits to acquiring corporations in nontaxable transactions shall be subject to rules generally applicable to other corporate tax attributes. For example, a DISC which acquires the assets of another DISC in a transaction to which section 381(a) applies shall succeed to, and take into account, the divisions of the earnings and profits of the transferor DISC in accordance with section 381(c)(2).

(b) *Allocation of divisions of earnings and profits in corporate separations.* (1) If one DISC transfers part of its assets to a controlled DISC in a transaction to which section 368(a)(1)(D) applies and immediately thereafter the stock of the controlled DISC is distributed in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, then—

(i) The earnings and profits of the distributing DISC immediately before the transaction shall be allocated between the distributing DISC and the controlled DISC in accordance with the provisions of §1.312–10.

(ii) Each of the divisions of such earnings and profits, namely previously taxed income, accumulated DISC income, and other earnings and profits, shall be allocated between the distributing DISC and the controlled DISC on the same basis as the earnings and profits are allocated.

(iii) Any assets of the distributing DISC whose status as qualified export assets is limited by its accumulated DISC income (e.g., producer's loans described in §1.993–4, Export-Import Bank and other obligations described in §1.993–2(h), and financing obligations described in §1.993–2(i)) shall be treated as having been allocated, for the purpose of determining the classification of such assets in the hands of the distributing DISC or the controlled DISC,

on the same basis as the earnings and profits are allocated regardless of how such assets are actually allocated.

(2) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. On January 1, 1974, P Corporation transfers part of its assets to S Corporation, a newly organized subsidiary of P, in a transaction described in section 368(a)(1)(D) and distributes all the S stock in a transaction which qualifies under section 355. Immediately before such transfer, P had earnings and profits of $120,000 of which $100,000 constitutes accumulated DISC income. The unpaid balance of P's producer's loans is $80,000 all of which is retained by P. Pursuant to §1.312–10, 25 percent of P's accumulated DISC income is allocated to S (*i.e.*, $25,000). P's producer's loans will be treated as allocated to S in the same proportion. Accordingly, for purposes of determining, under §1.993–4(a)(3), the amount of producer's loans which S is entitled to make, S is treated as having an unpaid balance of producer's loans of $20,000 (*i.e.*, 25% × $80,000) and P is treated as having an unpaid balance of $60,000 (*i.e.*, 75% × $80,000).

(c) *Accumulated DISC income accounts of separate DISC's maintained after corporate combination.* If two or more DISC's combine to form a new DISC, or if the assets of one DISC are acquired by another DISC, in a transaction described in section 381(a), accumulated DISC income of the acquired DISC or DISC's shall carry over and be taken into account by the acquiring or new DISC, except that a separate account shall be maintained for the accumulated DISC income of any DISC scheduled to be received as a deemed distribution by its shareholders under §1.995–3 (relating to deemed distributions upon disqualification). If, as a part of such transaction, the stock of the DISC which has accumulated DISC income scheduled to be deemed distributed is exchanged for stock of the acquiring or new DISC to which such accumulated DISC income is carried over and which maintains a separate account, then such accumulated DISC income shall be deemed distributed pro rata to shareholders of the acquiring or new DISC on the basis of stock ownership immediately after the exchange.

[T.D. 7324, 39 FR 35125, Sept. 30, 1974]

§ 1.996–8 Effect of carryback of capital loss or net operating loss to prior DISC taxable year.

(a) Under §1.995–2(e), the deduction under section 172 for a net operating loss carryback or under section 1212 for a capital loss carryback is determined as if the DISC were a domestic corporation which had not elected to be treated as a DISC. A carryback of a net operating loss or of a capital loss of any corporation which reduces its taxable income for a preceding taxable year for which it qualified as a DISC will have the consequences enumerated in paragraphs (b) through (e) of this section.

(b) For such preceding taxable year, the amount of a deemed distribution of one-half of certain taxable income described in §1.995–2(a)(4) will ordinarily be reduced in effect (but not below zero) by one-half of the sum of the amount of the deduction under section 172 for such year for net operating loss carrybacks and the amount of the deduction under section 1212 for such year for capital loss carrybacks.

(c) The amount of reduction in the deemed distribution under paragraph (b) of this section will have the effect of increasing the limitation, provided in §1.995–2(b)(2), on the amount of foreign investment attributable to producer's loans which is deemed distributed under §1.995–2(a)(5).

(d) If the amount of a deemed distribution for a preceding taxable year is reduced as described in paragraph (b) of this section, then for such preceding taxable year the previously taxed income (as defined in §1.996–3(c)) shall be decreased by the amount of such reduction and the accumulated DISC income (as defined in §1.996–3(b)) shall be increased by the amount of such reduction. Such adjustments shall be made as of the time the deemed distribution for such preceding taxable year is treated as having occurred. See §1.996–1(d) for the priority of such deemed distribution in relation to other distributions made in that preceding taxable year.

(e) The amount and treatment of any actual distribution made in such preceding taxable year or a year subsequent to such preceding year, and the treatment of gain on a disposition (in any such year) of the DISC's stock to