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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

which §1.995–4 applies, shall be properly adjusted to reflect the adjustments to previously taxed income and accumulated DISC income described in paragraph (d) of this section.

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

§ 1.997–1 Special rules for subchapter C of the Code.

(a) For purposes of applying the provisions of sections 301 through 395 of the Code, any distribution in property to a corporation by a DISC, or former DISC, which is made out of previously taxed income or accumulated DISC income shall be treated as a distribution in the same amount as if such distribution of property were made to an individual, and have a basis, in the hands of the recipient corporation, equal to such amount treated as having been distributed.

(b) This section may be illustrated by the following example:

Example. X Corporation is the sole shareholder of Y Corporation which is a DISC. Y makes an actual distribution of property to X with respect to X's stock in Y. The property has a basis of $50 and a fair market value of $100. The distribution is treated as made out of accumulated DISC income under section 996(a) and is taxable as a dividend under section 301(c)(1). Even though X is a corporation, the amount of the distribution is $100 notwithstanding the provisions of section 301(b)(1)(B) and the basis the property in X's hands is $100 notwithstanding the provisions of section 301(d)(2).

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

§§ 1.998–1.1000 [Reserved]