

property is \$80x (the sum of the gross values of Assets A, B, C, and D), the gross value of all foreign group nonqualified property is \$45x (the sum of the gross values of Assets A and C), and thus 56.25% of the gross value of all foreign group property constitutes foreign group nonqualified property ( $\$45x/\$80x$ ). The shares of FA stock that are excluded from the denominator of the ownership fraction pursuant to paragraph (b) of this section are calculated by multiplying \$40x ( $\$130x$ , the value of all the shares of FA stock, less \$50x, the value of the stock described in section 7874(a)(2)(B)(ii), less \$40x, the value of the stock excluded under § 1.7874-8(b)) by the foreign group nonqualified property fraction. The property taken into account for purposes of determining the foreign group nonqualified property fraction is Asset A, Asset B, and the portion of Asset C and Asset D that is not excluded property. Eighty percent of each of Asset C and Asset D are considered excluded property because FA indirectly acquired Asset C and Asset D in the DT1 acquisition (a prior domestic entity acquisition with respect to the DT2 acquisition); as a result of that acquisition, \$40x of FA stock is excluded from the denominator of the ownership fraction with respect to the DT2 acquisition under § 1.7874-8(b); and 80% of the consideration provided in the DT1 acquisition consisted of stock of FA ( $\$40x/\$50x$ ). Thus, the numerator of the foreign group nonqualified property fraction is \$21x (the sum of the gross values of Asset A, \$15x, and the portion of Asset C that is not excluded property, \$6x) and the denominator is \$40x (the sum of the gross values of Asset A, \$15x, Asset B, \$15x, and the portion of Asset C and Asset D that is not excluded property, \$6x and \$4x, respectively). Accordingly, \$21x of FA stock is excluded from the denominator of the ownership fraction pursuant to paragraph (b) of this section ( $\$40x$  multiplied by  $\$21x/\$40x$ ). Thus, a total of \$61x of FA stock is excluded from the denominator of the ownership fraction pursuant to paragraph (b) of this section ( $\$40x + \$21x$ ), making the denominator \$69x ( $\$130x - \$61x$ ). As a result, the ownership percentage with respect to D2 acquisition by value is 72.46 ( $\$50x/\$69x$ ).

(g) *Applicability dates.* This section applies to domestic entity acquisitions completed on or after July 12, 2018. For domestic entity acquisitions completed before July 12, 2018, see § 1.7874-7T, as contained in 26 CFR part 1 revised as of April 1, 2017. However, to the extent this section differs from § 1.7874-7T, as contained in 26 CFR part 1 revised as of April 1, 2017, taxpayers may elect to consistently apply the differences to

domestic entity acquisitions completed before July 12, 2018.

[T.D. 9834, 83 FR 32551, July 12, 2018]

**§ 1.7874-8 Disregard of certain stock attributable to serial acquisitions.**

(a) *Scope.* This section identifies stock of a foreign acquiring corporation that is disregarded in determining an ownership fraction by value because it is attributable to certain prior domestic entity acquisitions. Paragraph (b) of this section sets forth the general rule regarding the amount of stock of a foreign acquiring corporation that is excluded from the denominator of the ownership fraction by value under this section, and paragraphs (c) through (f) of this section provide rules for determining this amount. Paragraph (g) provides definitions. Paragraph (h) of this section provides examples illustrating the application of the rules of this section. Paragraph (i) of this section provides dates of applicability. This section applies after taking into account § 1.7874-2(e). See § 1.7874-1(d)(1) for rules addressing the interaction of this section with the expanded affiliated group rules of section 7874(c)(2)(A) and § 1.7874-1.

(b) *General rule.* This paragraph (b) applies to a domestic entity acquisition (relevant domestic entity acquisition) when the foreign acquiring corporation (including a predecessor, as defined in § 1.7874-10(f)(1)) has completed one or more prior domestic entity acquisitions. When this paragraph (b) applies, then, for purposes of determining the ownership percentage by value (but not vote) described in section 7874(a)(2)(B)(ii), stock of the foreign acquiring corporation is excluded from the denominator of the ownership fraction in an amount equal to the sum of the excluded amounts computed separately with respect to each prior domestic entity acquisition and each relevant share class.

(c) *Computation of excluded amounts.* With respect to each prior domestic entity acquisition and each relevant share class, the excluded amount is the product of—

(1) The total number of prior acquisition shares, reduced by the sum of the number of allocable redeemed shares for all redemption testing periods; and

(2) The fair market value of a single share of stock of the relevant share class on the completion date of the relevant domestic entity acquisition.

(d) *Computation of allocable redeemed shares*—(1) *In general.* With respect to each prior domestic entity acquisition and each relevant share class, the allocable redeemed shares, determined separately for each redemption testing period, is the product of the number of redeemed shares during the redemption testing period and the redemption fraction.

(2) *Redemption fraction.* The redemption fraction is determined separately with respect to each prior domestic entity acquisition, each relevant share class, and each redemption testing period, as follows:

(i) The numerator is the total number of prior acquisition shares, reduced by the sum of the number of allocable redeemed shares for all prior redemption testing periods.

(ii) The denominator is the sum of—

(A) The number of outstanding shares of the foreign acquiring corporation stock as of the end of the last day of the redemption testing period; and

(B) The number of redeemed shares during the redemption testing period.

(e) *Rules for determining redemption testing periods*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, a redemption testing period with respect to a prior domestic entity acquisition is the period beginning on the day after the completion date of the prior domestic entity acquisition and ending on the day prior to the completion date of the relevant domestic entity acquisition.

(2) *Election to use multiple redemption testing periods.* A foreign acquiring corporation may establish a reasonable method for dividing the period described in paragraph (e)(1) of this section into shorter periods (each such shorter period, a redemption testing period). A reasonable method would include a method based on a calendar convention (for example, daily, monthly, quarterly, or yearly), or on a convention that triggers the start of a new redemption testing period whenever a share issuance occurs that exceeds a certain threshold. In order to be reasonable, the method must be consist-

ently applied with respect to all prior domestic entity acquisitions and all relevant share classes.

(f) *Appropriate adjustments required to take into account share splits and similar transactions.* For purposes of this section, appropriate adjustments must be made to take into account changes in a foreign acquiring corporation's capital structure, including, for example, stock splits, reverse stock splits, stock distributions, recapitalizations, and similar transactions. Thus, for example, in determining the total number of prior acquisition shares with respect to a relevant share class, appropriate adjustments must be made to take into account a stock split with respect to that relevant share class that occurs after the completion date with respect to a prior domestic entity acquisition.

(g) *Definitions.* In addition to the definitions provided in §1.7874-12, the following definitions apply for purposes of this section.

(1) A *binding contract* means an instrument enforceable under applicable law against the parties to the instrument. The presence of a condition outside the control of the parties (including, for example, regulatory agency approval) does not prevent an instrument from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, does not prevent an instrument from being a binding contract. A tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934, (15 U.S.C. 78n(d)(1)), and Regulation 14D (17 CFR 240.14d-1 through 240.14d-103) and that is not pursuant to a binding contract, is treated as a binding contract made on the date of its announcement, notwithstanding that it may be modified by the offeror or that it is not enforceable against the offerees.

(2) A *relevant share class* means, with respect to a prior domestic entity acquisition, each separate legal class of shares in the foreign acquiring corporation from which prior acquisition shares were issued. See also paragraph (f) of this section (requiring appropriate adjustments in certain cases).

(3) *Total number of prior acquisition shares* means, with respect to a prior

domestic entity acquisition and each relevant share class, the total number of shares of stock of the foreign acquiring corporation that were described in section 7874(a)(2)(B)(ii) as a result of that acquisition (without regard to whether the 60 percent test of section 7874(a)(2)(B)(ii) was satisfied), other than stock treated as received by former domestic entity shareholders or former domestic entity partners under §1.7874-10(b) or section 7874(c)(4), adjusted as appropriate under paragraph (f) of this section.

(4) *A prior domestic entity acquisition—*

(i) *General rule.* Except as provided in this paragraph (g)(4), a prior domestic entity acquisition means, with respect to a relevant domestic entity acquisition, a domestic entity acquisition that occurred within the 36-month period ending on the signing date of the relevant domestic entity acquisition.

(ii) *Exception.* A domestic entity acquisition is not a prior domestic entity acquisition if it is described in paragraph (g)(4)(ii)(A) or (B) of this section.

(A) *De minimis.* A domestic entity acquisition is described in this paragraph (g)(4)(ii)(A) if—

(1) The ownership percentage described in section 7874(a)(2)(B)(ii) with respect to the domestic entity acquisition was less than five (by vote and value); and

(2) The fair market value of the stock of the foreign acquiring corporation described in section 7874(a)(2)(B)(ii) as a result of the domestic entity acquisition (without regard to whether the 60 percent test of section 7874(a)(2)(B)(ii) was satisfied) did not exceed \$50 million, as determined on the completion date with respect to the domestic entity acquisition.

(B) *Foreign-parented group.* A domestic entity acquisition is described in this paragraph (g)(4)(ii)(B) if—

(1) Before the domestic entity acquisition and any related transaction, the domestic entity was a member of a foreign-parented group (as described in §1.7874-6(f)(1)); and

(2) The domestic entity acquisition qualified for the internal group restructuring exception under §1.7874-1(c)(2).

(5) A *redeemed share* means a share of stock in a relevant share class that was

redeemed (within the meaning of section 317(b)).

(6) A *signing date* means the first date on which the contract to effect the relevant domestic entity acquisition is a binding contract, or if another binding contract to effect a substantially similar acquisition was terminated with a principal purpose of avoiding section 7874, the first date on which such other contract was a binding contract.

(h) *Examples.* The following examples illustrate the rules of this section.

*Example 1. Application of general rule—(i)*

*Facts.* Individual A wholly owns DT1, a domestic corporation. Individual B owns all 100 shares of the sole class of stock of FA, a foreign corporation. In Year 1, FA acquires all the stock of DT1 solely in exchange for 100 shares of newly issued FA stock (DT1 acquisition). On the completion date with respect to the DT1 acquisition, the fair market value of each share of FA stock is \$1x. In Year 3, FA enters into a binding contract to acquire all the stock of DT2, a domestic corporation wholly owned by Individual C. Thereafter, FA acquires all the stock of DT2 solely in exchange for 150 shares of newly issued FA stock (DT2 acquisition). On the completion date with respect to the DT2 acquisition, the fair market value of each share of FA stock is \$1.50x. FA did not complete the DT1 acquisition and DT2 acquisition pursuant to a plan (or series of related transactions) for purposes of applying §1.7874-2(e). In addition, there have been no redemptions of FA stock subsequent to the DT1 acquisition.

(ii) *Analysis.* The DT1 acquisition is a prior domestic entity acquisition with respect to the DT2 acquisition (the relevant domestic entity acquisition) because the DT1 acquisition occurred within the 36-month period ending on the signing date with respect to the DT2 acquisition. Accordingly, paragraph (b) of this section applies to the DT2 acquisition. As a result, and because there were no redemptions of FA stock, the excluded amount is \$150x, calculated as 100 (the total number of prior acquisition shares) multiplied by \$1.50x (the fair market value of a single share of FA stock on the completion date with respect to the DT2 acquisition). Accordingly, the numerator of the ownership fraction by value is \$225x (the fair market value of the stock of FA that, with respect to the DT2 acquisition, is described in section 7874(a)(2)(B)(ii)) (150 shares x \$1.50x per share). In addition, the denominator of the ownership fraction is \$375x (calculated as \$525x, the fair market value of all 350 shares of FA stock as of the completion date with respect to the DT2 acquisition, less \$150x, the excluded amount). Therefore, the ownership

percentage by value is 60 (\$225x divided by \$375x).

*Example 2. Effect of certain redemptions—(i) Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (h), except that in Year 2 FA redeems 50 shares of its stock (the Year 2 redemption).

(ii) *Analysis.* As is the case in paragraph (ii) of *Example 1* of this paragraph (h), the DT1 acquisition is a prior domestic entity acquisition with respect to the DT2 acquisition (the relevant domestic entity acquisition), and paragraph (b) of this section thus applies to the DT2 acquisition. Because of the Year 2 redemption, the allocable redeemed shares, and thus the redemption fraction, must be calculated. For this purpose, the redemption testing period is the period beginning on the day after the completion date with respect to the DT1 acquisition and ending on the day prior to the completion date with respect to the DT2 acquisition. The redemption fraction for the redemption testing period is thus 100/200, calculated as 100 (the total number of prior acquisition shares) divided by 200 (150, the number of outstanding shares of FA stock on the last day of the redemption testing period, plus 50, the number of redeemed shares during the redemption testing period), and the allocable redeemed shares for the redemption testing period is 25, calculated as 50 (the number of redeemed shares during the redemption testing period) multiplied by 100/200 (the redemption fraction for the redemption testing period). As a result, the excluded amount is \$112.50x, calculated as 75 (100, the total number of prior acquisition shares, less 25, the allocable redeemed shares) multiplied by \$1.50x (the fair market value of a single share of FA stock on the completion date with respect to the DT2 acquisition). Accordingly, the numerator of the ownership fraction by value is \$225x (the fair market value of the stock of FA that, with respect to the DT2 acquisition, is described in section 7874(a)(2)(B)(ii)) (150 shares × \$1.50x per share), and the denominator of the ownership fraction is \$337.50x (calculated as \$450x, the fair market value of all 300 shares of FA stock as of the completion date with respect to the DT2 acquisition, less \$112.50x, the excluded amount). Therefore, the ownership percentage by value is 66.67 (\$225x divided by \$337.50x).

*Example 3. Stock split—(i) Facts.* The facts are the same as in paragraph (i) of *Example 2* of this paragraph (h), except as follows. After the Year 2 redemption, but before the DT2 acquisition, FA undergoes a stock split and, as a result, each of the 150 shares of FA stock outstanding are converted into two shares (Year 2 stock split). Further, pursuant to the DT2 acquisition, FA acquires all the stock of DT2 solely in exchange for 300 shares of newly issued FA stock. Moreover, on the completion date with respect to the DT2 ac-

quisition, the fair market value of each share of FA stock is \$0.75x.

(ii) *Analysis.* As is the case in paragraph (ii) of *Example 1* of this paragraph (h), the DT1 acquisition is a prior domestic entity acquisition with respect to the DT2 acquisition (the relevant domestic entity acquisition), and paragraph (b) of this section thus applies to the DT2 acquisition. In addition, as is the case in paragraph (ii) of *Example 2* of this paragraph (h), the redemption testing period is the period beginning on the day after the completion date with respect to the DT1 acquisition and ending on the day prior to the completion date with respect to the DT2 acquisition. To calculate the redemption fraction, the total number of prior acquisition shares and the number of redeemed shares during the redemption testing period must be appropriately adjusted to take into account the Year 2 stock split. See paragraph (f) of this section. In this case, the appropriate adjustment is to increase the total number of prior acquisition shares from 100 to 200 and to increase the number of redeemed shares during the redemption testing period from 50 to 100. Thus, the redemption fraction for the redemption testing period is 200/400, calculated as 200 (the total number of prior acquisition shares) divided by 400 (300, the number of outstanding shares of FA stock on the last day of the redemption testing period, plus 100, the number of redeemed shares during the redemption testing period), and the allocable redeemed shares for the redemption testing period is 50, calculated as 100 (the number of redeemed shares during the redemption testing period) multiplied by 200/400 (the redemption fraction for the redemption testing period). In addition, for purposes of calculating the excluded amount, the total number of prior acquisition shares must be adjusted from 100 to 200. See paragraph (f) of this section. Accordingly, the excluded amount is \$112.50x, calculated as 150 (200, the total number of prior acquisition shares, less 50, the allocable redeemed shares) multiplied by \$0.75x (the fair market value of a single share of FA stock on the completion date with respect to the DT2 acquisition). Consequently, the numerator of the ownership fraction by value is \$225x (the fair market value of the stock of FA that, with respect to the DT2 acquisition, is described in section 7874(a)(2)(B)(ii)) (300 shares × \$0.75x per share), and the denominator of the ownership fraction is \$337.50x (calculated as \$450x, the fair market value of all 600 shares of FA stock as of the completion date with respect to the DT2 acquisition, less \$112.50x, the excluded amount). Therefore, the ownership percentage by value is 66.67 (\$225 divided by \$337.50x).

(i) *Applicability dates.* Except as provided in this paragraph (i), this section applies to domestic entity acquisitions

completed on or after April 4, 2016, regardless of when a prior domestic entity acquisition was completed. Paragraphs (g)(3) and (g)(4)(ii) of this section apply to domestic entity acquisitions completed on or after July 12, 2018. However, taxpayers may elect to consistently apply paragraphs (g)(3) and (g)(4)(ii) of this section to domestic entity acquisitions completed on or after April 4, 2016, and before July 12, 2018. For domestic entity acquisitions completed on or after April 4, 2016, and before July 12, 2018, see § 1.7874-8T(g)(3) and (g)(4)(ii) as contained in 26 CFR part 1 revised as of April 1, 2017.

[T.D. 9834, 83 FR 32553, July 12, 2018]

**§ 1.7874-9 Disregard of certain stock in third-country transactions.**

(a) *Scope.* This section identifies certain stock of a foreign acquiring corporation that is disregarded in determining the ownership fraction. Paragraph (b) of this section provides a rule that, in a third-country transaction, excludes from the denominator of the ownership fraction stock in the foreign acquiring corporation held by former shareholders of an acquired foreign corporation by reason of holding certain stock in that foreign corporation. Paragraph (c) of this section defines a third-country transaction, and paragraph (d) of this section provides other definitions. Paragraph (e) of this section provides operating rules. Paragraph (f) of this section provides an example illustrating the application of the rules of this section. Paragraph (g) of this section provides the dates of applicability. See § 1.7874-1(d)(1) for rules addressing the interaction of this section with the expanded affiliated group rules of section 7874(c)(2)(A) and § 1.7874-1.

(b) *Exclusion of certain stock of a foreign acquiring corporation from the ownership fraction.* When a domestic entity acquisition is a third-country transaction, stock of the foreign acquiring corporation held by reason of holding stock in the acquired foreign corporation (within the meaning of paragraph (e)(4) of this section) is, to the extent the stock otherwise would be included in the denominator of the ownership fraction, excluded from the denomi-

nator of the ownership fraction pursuant to this paragraph.

(c) *Third-country transaction.* A domestic entity acquisition is a third-country transaction if the following requirements are satisfied:

(1) The foreign acquiring corporation completes a covered foreign acquisition pursuant to a plan (or series of related transactions) that includes the domestic entity acquisition.

(2) After the covered foreign acquisition and all related transactions are complete, the foreign acquiring corporation is not a tax resident of the foreign country in which the acquired foreign corporation was a tax resident before the covered foreign acquisition and all related transactions.

(3) The ownership percentage described in section 7874(a)(2)(B)(ii), determined without regard to the application of paragraph (b) of this section, is at least 60.

(d) *Definitions.* In addition to the definitions provided in § 1.7874-12, the following definitions apply for purposes of this section.

(1) A *foreign acquisition* means a transaction in which a foreign acquiring corporation directly or indirectly acquires substantially all of the properties held directly or indirectly by an acquired foreign corporation (within the meaning of paragraph (e)(2) of this section).

(2) An *acquired foreign corporation* means a foreign corporation whose properties are acquired in a foreign acquisition.

(3) *Foreign ownership percentage* means, with respect to a foreign acquisition, the percentage of stock (by vote or value) of the foreign acquiring corporation held by reason of holding stock in the acquired foreign corporation (within the meaning of paragraph (e)(3) of this section).

(4) *Covered foreign acquisition*—(i) *In general.* Except as provided in paragraphs (d)(4)(ii) and (iii) of this section, a covered foreign acquisition means a foreign acquisition in which, after the acquisition and all related transactions are complete, the foreign ownership percentage is at least 60.

(ii) *Substantial business activities exception.* A foreign acquisition is not a covered foreign acquisition if, on the