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 DISC income amount (described in paragraph (d) of this section). To the extent the recognized gain exceeds the accumulated DISC income amount, it is taxable as gain from the sale or exchange of the stock.

(2) *Nonapplication of subparagraph (1).* The provisions of subparagraph (1) of this paragraph do not apply (i) to the extent gain is not recognized (such as, for example, in the case of a gift or an exchange of stock to which section 354 applies) and (ii) to the amount of any recognized gain which is taxable as a dividend (such as, for example, under section 301 or 356(a)(2)) or as gain from the sale or exchange of property which is not a capital asset. The amount taxable as a dividend under section 301 or 356(a)(2) is subject to the rules provided in § 1.995–1(c) for the treatment of actual distributions by a DISC.

(b) *Disposition in which separate corporate existence of DISC is terminated*—(1) *General.* If stock in a corporation that is a DISC, or former DISC, is disposed of in a transaction in which its separate corporate existence as a DISC, or former DISC, is terminated, then, notwithstanding any other provision of the Code, an amount of realized gain shall be recognized and included in the transferor's gross income as a dividend. The realized gain shall be recognized to the extent that such gain—

(i) Would not have been recognized but for the provisions of this paragraph, and

(ii) Does not exceed the accumulated DISC income amount (described in paragraph (d) of this section).

(2) *Cessation of separate corporate existence as a DISC, or former DISC.* For purposes of subparagraph (1) of this paragraph, separate corporate existence as a DISC, or former DISC, will be treated as having ceased if, as a result of the transaction, there is no separate entity which is a DISC and to which is carried over the accumulated DISC income and other tax attributes of the DISC, or former DISC, the stock of which is disposed of. Thus, for example, if stock in a DISC, or former DISC, is exchanged in a transaction described in section 381(a) (relating to carryovers in certain corporate acquisitions), the gain realized on the transfer of such stock will not be recognized under subparagraph (1) of this paragraph if the assets of such DISC, or former DISC, are acquired by a corporation which immediately after the acquisition qualifies as a DISC. For a further example, if a DISC, or former DISC, is liquidated in a transaction to which section 332 (relating to complete liquidations of subsidiaries) applies, the transaction will be subject to subparagraph (1) of this paragraph if the basis to the transferee corporation of the assets acquired on the liquidation is determined under section 334(b)(2) (as in effect prior to amendment by the Tax Equity and Fiscal Responsibility Act of 1982) or if immediately after such liquidation the transferee of such assets does not qualify as a DISC. However, separate corporate existence as a DISC, or former DISC, will not be treated as having ceased in the case of a mere change in place of organization, however effected. See §1.996–7 for rules for the carryover of the divisions of a DISC's earnings and profits to one or more DISC's.

(c) *Disposition to which section 311, 336, or 337 applies*—(1) *In general.* If, after December 31, 1976, a shareholder distributes, sells, or exchanges stock in a DISC, or former DISC, in a transaction to which section 311, 336, or 337 applies, then an amount equal to the excess of the fair market value of such stock over its adjusted basis in the hands of the shareholder shall, notwithstanding any other provision of the Code, be included in gross income of the shareholder as a dividend to the extent of the accumulated DISC income amount (described in paragraph (d) of this section).

(2) *Nonapplication of subparagraph (1).* Subparagraph (1) shall not apply if the person receiving the stock in the disposition has a holding period for the stock which includes the period for which the stock was held by the shareholder disposing of such stock.

(d) *Accumulated DISC income amount*—(1) *General.* For purposes of this section, the accumulated DISC income amount is the accumulated DISC income of the DISC or former DISC which is attributable to the stock disposed of and which was accumulated in taxable years of such DISC or former DISC during the period or periods such stock was held by the shareholder who disposed of such stock.

(2) *Period during which a shareholder has held stock.* For purposes of this section, the period during which a shareholder has held stock includes the period he is considered to have held it by reason of the application of section 1223 and, if his basis is determined in whole or in part under the provisions of section 1014(d) (relating to special rule for DISC stock acquired from decedent), the holding period of the decedent. Such holding period is to exclude the day of acquisition but include the day of disposition. Thus, for example, if A purchases stock in a DISC on December 31, 1972, and makes a gift of such stock to B on June 30, 1973, then on December 31, 1974, B will be treated as having held the stock for 2 full years. If the basis of the stock in C's hands is determined under section 1014(d) upon a transfer from B's estate on December 31, 1976, by reason of B's death on June 30, 1974, then on December 31, 1976, C will be treated as having held the stock for 4 full years.

(e) *Accumulated DISC income allocable to shareholder under section 995(c)(2)*—(1) *In general.* Under this paragraph, rules are prescribed for purposes of paragraph (d) of this section as to the manner of determining, with respect to the stock of a DISC, or former DISC, disposed of, the amount of accumulated DISC income which is attributable to such stock and which was accumulated in taxable years of the corporation during the period or periods the stock disposed of was held or treated under paragraph (d)(2) of this section as held by the transferor. Subparagraphs (2), (3), and (4) of this paragraph set forth a method of computation which may be employed to determine such amount. Any other method may be employed so long as the result obtained would be the same as the result obtained under such method.

(2) *Step 1.* Determine the increase (or decrease) in accumulated DISC income for each taxable year of the DISC, or former DISC, by subtracting from the amount of accumulated DISC income (as defined in § 1.996–3(b)) at the close of each taxable year the amount thereof as of the close of the immediately preceding taxable year.

(3) *Step 2.* (i) Determine for each taxable year of the DISC, or former DISC, the increase (or decrease) in accumulated DISC income per share by dividing such increase (or decrease) for the year by the number of shares outstanding or deemed outstanding on each day of such year.

(ii) If the number of shares of stock in the corporation outstanding on each day of a taxable year of the DISC, or former DISC, is not constant, then the number of such shares deemed outstanding on each day of such year shall be the sum of the fractional amounts in respect of each share which was outstanding on any day of the taxable year. The fractional amount in respect of a share shall be determined by dividing the number of days in the taxable year on which such share was outstanding (excluding the day the share became outstanding, but including the day the share ceased to be outstanding), by the total number of days in such taxable year.

(iii) If for any taxable year of a DISC, or former DISC, the share disposed of was not held (or treated under paragraph (d)(2) of this section as held) by the disposing shareholder for the entire year, then the amount of increase (or decrease) in accumulated DISC income attributable to such share for such year is the amount determined as if he held the share until the end of such year multiplied by a fraction the numerator of which is the number of days in the taxable year on which the shareholder held (or under paragraph (d)(2) of this section is treated as having held) such share and the denominator of which is the total number of days in the taxable year.

(4) *Step 3.* Add the amounts computed in step 2 for each taxable year of the DISC, or former DISC, in which the shareholder held such share of stock.

(5) *Examples.* This paragraph may be illustrated by the following examples:

Example 1. X Corporation uses the calendar year as its taxable year and elects to be a DISC for the first time for 1973. On January 1, 1973, X has 20 shares issued and outstanding. A and B each own 10 shares. On July 1, 1976, X issues 10 shares to C. On December 31, 1977, A sells his 10 shares to D and recognizes a gain of $120. Under these facts and other facts assumed in the table below, A includes in his gross income for 1977 a dividend under paragraph (b) of this section of $61.30 and long-term capital gain of $58.70.

Year	(a)—Year end accumulated DISC income	(b)—Increase (decrease) in accumulated DISC income	(c)—Shares outstanding	(d)—Increase (decrease) per share (column (b) divided by column (c))
1973	$80	$80	20	$4.00
1974	50	(30)	20	(1.50)
1975	80	30	20	1.50
1976	100	20	[1] 25	.80
1977	140	40	30	1.33
(1) Total increase in accumulated DISC income for each share disposed of (sum of amounts in column (d))				6.13
Multiply by number of shares disposed of				10
(2) Total amount of accumulated DISC income attributable to A's shares disposed of				61.30
(3) A's gain				120.00
(4) Portion of A's gain taxable as a dividend (lower of lines (2) and (3))				61.30

Year	(a)—Year end accumulated DISC income	(b)—Increase (decrease) in accumulated DISC income	(c)—Shares outstanding	(d)—Increase (decrease) per share (column (b) divided by column (c))
(5) Portion of A's gain taxable as long-term capital gain (line (3) minus line (4))	....	....	....	58.70

[1] Under subparagraph (3)(ii) of this paragraph, the aggregate fractional amounts of the 10 shares issued on July 1, 1976, is 5 shares, i.e., 10 shares, multiplied by (183 days/366 days). Thus, the number of shares deemed outstanding for 1976 is 25 shares, i.e., 20 shares plus 5 shares.

Example 2. Assume the same facts as in example 1, except that A sells his 10 shares to D on July 1, 1977. Under subparagraph (3)(iii) of this paragraph, the amount of increase in accumulated DISC income for 1977 which is attributable to each share disposed of is limited to $.67, *i.e.,* $1.33 multiplied by 182 days/365 days. Therefore, the sum of the yearly increases (and decreases) in accumulated DISC income for each share is reduced by $.66 (*i.e.,* $1.33 minus $.67). The total increase in accumulated DISC income for each share disposed of is $5.47 (i.e., $6.13 minus $.66). Under these facts, A would include in his gross income for 1977 a dividend of $54.70 and long-term capital gain of $65.30 determined as follows:

(1) Total increase in accumulated DISC income for each share disposed of	$5.47
Multiplied by number of shares disposed of	10
(2) Total amount of accumulated DISC income attributable of to all shares disposed of	54.70
(3) A's gain	120.00
(4) Portion of A's gain taxable as a dividend (lower of lines (2) and (3))	54.70
(5) Portion of A's gain taxable as long-term capital gain (line (3) minus line (4))	65.30

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

§ 1.995–5 Foreign investment attributable to producer's loans.

(a) *In general*—(1) *Limitation.* Under section 995(d), the amount as of the close of a ''group taxable year'' (as defined in subparagraph (3) of this paragraph) of foreign investment attributable to producer's loans of a DISC for purposes of section 995(b)(1)(G) shall be the excess (as of the close of such year) of—

(i) The smallest of—

(*a*) The amount of the net increase in foreign assets (as defined in paragraph (b) of this section) by domestic and foreign members of the controlled group which includes the DISC,

(*b*) The amount of the actual foreign investment by the domestic members of such group (as determined under paragraph (c) of this section), or

(*c*) The amount of outstanding producer's loans (as determined under § 1.993–4) by such DISC to members of such controlled group, over

(ii) The amount (determined under § 1.995–2 (a)(5) and (b)(2)) of foreign investment attributable to producer's loans treated under section 995(b)(1)(G) as deemed distributions by the particular DISC taxable as dividends for prior taxable years of that particular DISC.

Thus, for example, if the shareholders of a DISC which uses the calendar year as its taxable year (and which is a member of a controlled group in which all of the members use the calendar year as their taxable year) are treated under section 995(b)(1)(G) as receiving foreign investment attributable to producer's loans of a DISC of $0 in 1972, $10 in 1973, and $30 in 1974, or a total of $40, and if the smallest of the amounts described in subdivision (i) of this subparagraph at the end of 1975 is $90, then the amount of the foreign investment attributable to producer's loans of a DISC at the end of 1975 is $50, *i.e.,* the excess (as of the close of 1975) of the smallest of the amounts described in subdivision (i) of this subparagraph ($90) over the sum of the amounts of foreign investment attributable to producer's loans treated under section 995(b)(1)(G) as deemed distributions by the DISC taxable as dividends for prior taxable years of the DISC ($40). If the separate corporate existence of the DISC as to which the amount described in subdivision (ii) of this subparagraph