

decendent'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.

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§ 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).