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Section 1.7701(l)-1 also issued under 26 U.S.C. 7701(l).

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Section 1.7872-5T also issued under 26 U.S.C. 7872.

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SOURCE: Sections 1.1401-1 to 1.1403-1 contained in T.D. 6691, 28 FR 12796, Dec. 3, 1963, unless otherwise noted.

RELATED RULES

§ 1.1551-1 Disallowance of surtax exemption and accumulated earnings credit.

(a) *In general.* If:

(1) Any corporation transfers, on or after January 1, 1951, and before June 13, 1963, all or part of its property (other than money) to a transferee corporation,

(2) Any corporation transfers, directly or indirectly, after June 12, 1963, all or part of its property (other than money) to a transferee corporation, or

(3) Five or fewer individuals are in control of a corporation and one or more of them transfer, directly or indirectly, after June 12, 1963, property (other than money) to a transferee corporation, and the transferee was created for the purpose of acquiring such property or was not actively engaged in business at the time of such acquisition, and if after such transfer the transferor or transferors are in control of the transferee during any part of the taxable year of the transferee, then for such taxable year of the transferee the Secretary or his delegate may disallow the surtax exemption defined in section 11(d) or the accumulated earnings credit of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) provided in paragraph (2) or (3) of section 535(c), unless the transferee establishes by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of the transfer.

(b) *Purpose of section 1551.* The purpose of section 1551 is to prevent avoidance or evasion of the surtax imposed by section 11(c) or of the accumulated earnings tax imposed by section 531. It is not intended, however, that section 1551 be interpreted as delimiting or abrogating any principle of law established by judicial decision, or any existing provisions of the Code, such as sections 269 and 482, which have the effect of preventing the avoidance or evasion of income taxes. Such principles of law and such provisions of the Code, including section 1551, are not mutually exclusive, and in appropriate cases they may operate together or they may operate separately.

(c) *Application of section 269(b) to cases covered by section 1551.* The provisions of section 269(b) and the authority of the district director thereunder, to the extent not inconsistent with the provisions of section 1551, are applicable to cases covered by section 1551. Pursuant to the authority provided in section 269(b) the district director may allow to the transferee any part of a surtax exemption or accumulated earnings credit for a taxable year for which such

exemption or credit would otherwise be disallowed under section 1551(a); or he may apportion such exemption or credit among the corporations involved. For example, corporation A transfers on January 1, 1955, all of its property to corporations B and C in exchange for all of the stock of such corporations. Immediately thereafter, corporation A is dissolved and its stockholders become the sole stockholders of corporations B and C. Assuming that corporations B and C are unable to establish by the clear preponderance of the evidence that the securing of the surtax exemption defined in section 11(d) or the accumulated earnings credit provided in section 535, or both, was not a major purpose of the transfer, the district director is authorized under sections 1551(c) and 269(b) to allow one such exemption and credit and to apportion such exemption and credit between corporations B and C.

(d) *Actively engaged in business.* For purposes of this section, a corporation maintaining an office for the purpose of preserving its corporate existence is not considered to be "actively engaged in business" even though such corporation may be deemed to be "doing business" for other purposes. Similarly, for purposes of this section, a corporation engaged in winding up its affairs, prior to an acquisition to which section 1551 is applicable, is not considered to be "actively engaged in business."

(e) *Meaning and application of the term "control"*—(1) *In general.* For purposes of this section, the term "control" means:

(i) With respect to a transferee corporation described in paragraph (a) (1) or (2) of this section, the ownership by the transferor corporation, its shareholders, or both, of stock possessing either (a) at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or (b) at least 80 percent of the total value of shares of all classes of stock.

(ii) With respect to each corporation described in paragraph (a)(3) of this section, the ownership by five or fewer individuals of stock possessing (a) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes

of the stock of each corporation, and (b) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such individual only to the extent such stock ownership is identical with respect to each such corporation.

(2) *Special rules.* In determining for purposes of this section whether stock possessing at least 80 percent (or more than 50 percent in the case of subparagraph (1)(ii)(b) of this paragraph) of the total combined voting power of all classes of stock entitled to vote is owned, all classes of such stock shall be considered together; it is not necessary that at least 80 percent (or more than 50 percent) of each class of voting stock be owned. Likewise, in determining for purposes of this section whether stock possessing at least 80 percent (or more than 50 percent) of the total value of shares of all classes of stock is owned, all classes of stock of the corporation shall be considered together; it is not necessary that at least 80 percent (or more than 50 percent) of the value of shares of each class be owned. The fair market value of a share shall be considered as the value to be used for purposes of this computation. With respect to transfers described in paragraph (a) (2) or (3) of this section, the ownership of stock shall be determined in accordance with the provisions of section 1563(e) and the regulations thereunder. With respect to transfers described in paragraph (a)(1) of this section, the ownership of stock shall be determined in accordance with the provisions of section 544 and the regulations thereunder, except that constructive ownership under section 544(a)(2) shall be determined only with respect to the individual's spouse and minor children. In determining control, no stock shall be excluded because such stock was acquired before January 1, 1951 (the effective date of section 1551(a)(1)), or June 13, 1963 (the effective date of section 1551(a) (2) and (3)).

(3) *Example.* This paragraph may be illustrated by the following example:

Example. On January 1, 1964, individual A, who owns 50 percent of the voting stock of

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corporation X, and individual B, who owns 30 percent of such voting stock, transfer property (other than money) to corporation Y (newly created for the purpose of acquiring such property) in exchange for all of Y's voting stock. After the transfer, A and B own the voting stock of corporations X and Y in the following proportions:

Individual	Corp. X	Corp. Y	Identical ownership
A	50	30	30
B	30	50	30
Total	80	80	60

The transfer of property by A and B to corporation Y is a transfer described in paragraph (a)(3) of this section since (i) A and B own at least 80 percent of the voting stock of corporations X and Y, and (ii) taking into account each such individual's stock ownership only to the extent such ownership is identical with respect to each such corporation, A and B own more than 50 percent of the voting stock of corporations X and Y.

(f) *Taxable year of allowance or disallowance*—(1) *In general.* The district director's authority with respect to cases covered by section 1551 is not limited to the taxable year of the transferee corporation in which the transfer of property occurs. Such authority extends to the taxable year in which the transfer occurs or any subsequent taxable year of the transferee corporation if, during any part of such year, the transferor or transferors are in control of the transferee.

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

Example (1). On January 1, 1955, corporation D transfers property (other than money) to corporation E, a corporation not actively engaged in business at the time of the acquisition of such property, in exchange for 60 percent of the voting stock of E. During a later taxable year of E, corporation D acquires an additional 20 percent of such voting stock. As a result of such additional acquisition, D owns 80 percent of the voting stock of E. Accordingly, section 1551(a)(1) is applicable for the taxable year in which the later acquisition of stock occurred and for each taxable year thereafter in which the requisite control continues.

Example (2). On June 20, 1963, individual A, who owns all of the stock of corporation X, transfers property (other than money) to corporation Y, a corporation not actively engaged in business at the time of the acquisition of such property, in exchange for 60 percent of the voting stock of Y. During a later taxable year of Y, A acquires an addi-

tional 20 percent of such voting stock. After such acquisition A owns at least 80 percent of the voting stock of corporations X and Y. Accordingly, section 1551(a)(3) is applicable for the taxable year in which the later acquisition of stock occurred and for each taxable year thereafter in which the requisite control continues.

Example (3). Individuals A and B each owns 50 percent of the stock of corporation X. On January 15, 1964, A transfers property (other than money) to corporation Y (newly created by A for the purpose of acquiring such property) in exchange for all the stock of Y. In a subsequent taxable year of Y, individual B buys 50 percent of the stock which A owns in Y (or he transfers money to Y in exchange for its stock, as a result of which he owns 50 percent of Y's stock). Immediately thereafter the stock ownership of A and B in corporation Y is identical to their stock ownership in corporation X. Accordingly, section 1551(a)(3) is applicable for the taxable year in which B acquires stock in corporation Y (see paragraph (g)(3) of this section) and for each taxable year thereafter in which the requisite control continues. Moreover, if B's acquisition of stock in Y is pursuant to a pre-existing agreement with A, A's transfer to Y and B's acquisition of Y's stock are considered a single transaction and section 1551(a)(3) also would be applicable for the taxable year in which A's transfer to Y took place and for each taxable year thereafter in which the requisite control continues.

(g) *Nature of transfer*—(1) *Corporate transfers before June 13, 1963.* A transfer made before June 13, 1963, by any corporation of all or part of its assets, whether or not such transfer qualifies as a reorganization under section 368, is within the scope of section 1551(a)(1), except that section 1551(a)(1) does not apply to a transfer of money only. For example, the transfer of cash for the purpose of expanding the business of the transferor corporation through the formation of a new corporation is not a transfer within the scope of section 1551(a)(1), irrespective of whether the new corporation uses the cash to purchase from the transferor corporation stock in trade or similar property.

(2) *Corporate transfers after June 12, 1963.* A direct or indirect transfer made after June 12, 1963, by any corporation of all or part of its assets to a transferee corporation, whether or not such transfer qualifies as a reorganization under section 368, is within the scope of section 1551(a)(2) except that section 1551(a)(2) does not apply to a transfer of

money only. For example, if a transferor corporation transfers property to its shareholders or to a subsidiary, the transfer of that property by the shareholders or the subsidiary to a transferee corporation as part of the same transaction is a transfer of property by the transferor corporation to which section 1551(a)(2) applies. A transfer of property pursuant to a purchase by a transferee corporation from a transferor corporation controlling the transferee is within the scope of section 1551(a)(2), whether or not the purchase follows a transfer of cash from the controlling corporation.

(3) *Other transfers after June 12, 1963.* A direct or indirect transfer made after June 12, 1963, by five or fewer individuals to a transferee corporation, whether or not such transfer qualifies under one or more other provisions of the Code (for example, section 351), is within the scope of section 1551(a)(3) except that section 1551(a)(3) does not apply to a transfer of money only. Thus, if one of five or fewer individuals who are in control of a corporation transfers property (other than money) to a controlled transferee corporation, the transfer is within the scope of section 1551(a)(3) notwithstanding that the other individuals transfer nothing or transfer only money.

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

Example (1). Individuals A and B each owns 50 percent of the voting stock of corporation X. On January 15, 1964, A and B each acquires property (other than money) from X and, as part of the same transaction, each transfers such property to his wholly owned corporation (newly created for the purpose of acquiring such property). A and B retain substantial continuing interests in corporation X. The transfers to the two newly created corporations are within the scope of section 1551(a)(2).

Example (2). Corporation W organizes corporation X, a wholly owned subsidiary, for the purpose of acquiring the properties of corporation Y. Pursuant to a reorganization qualifying under section 368(a)(1)(C), substantially all of the properties of corporation Y are transferred on June 15, 1963, to corporation X solely in exchange for voting stock of corporation W. There is a transfer of property from W to X within the meaning of section 1551(a)(2).

Example (3). Individuals A and B, each owning 50 percent of the voting stock of corporation X, organize corporation Y to which each

transfers money only in exchange for 50 percent of the stock of Y. Subsequently, Y uses such money to acquire other property from A and B after June 12, 1963. Such acquisition is within the scope of section 1551(a)(3).

Example (4). Individual A owns 55 percent of the stock of corporation X. Another 25 percent of corporation X's stock is owned in the aggregate by individuals B, C, D, and E. On June 15, 1963, individual A transfers property to corporation Y (newly created for the purpose of acquiring such property) in exchange for 60 percent of the stock of Y, and B, C, and D acquire all of the remaining stock of Y. The transfer is within the scope of section 1551(a)(3).

(h) *Purpose of transfer.* In determining, for purposes of this section, whether the securing of the surtax exemption or accumulated earnings credit constituted "a major purpose" of the transfer, all circumstances relevant to the transfer shall be considered. "A major purpose" will not be inferred from the mere purchase of inventory by a subsidiary from a centralized warehouse maintained by its parent corporation or by another subsidiary of the parent corporation. For disallowance of the surtax exemption and accumulated earnings credit under section 1551, it is not necessary that the obtaining of either such credit or exemption, or both, have been the sole or principal purpose of the transfer of the property. It is sufficient if it appears, in the light of all the facts and circumstances, that the obtaining of such exemption or credit, or both, was one of the major considerations that prompted the transfer. Thus, the securing of the surtax exemption or the accumulated earnings credit may constitute "a major purpose" of the transfer, notwithstanding that such transfer was effected for a valid business purpose and qualified as a reorganization within the meaning of section 368. The taxpayer's burden of establishing by the clear preponderance of the evidence that the securing of either such exemption or credit or both was not "a major purpose" of the transfer may be met, for example, by showing that the obtaining of such exemption, or credit, or both, was not a major factor in relationship to the other consideration or

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considerations which prompted the transfer.

[T.D. 6911, 32 FR 3214, Feb. 24, 1967, as amended by T.D. 7376, 40 FR 42745, Sept. 16, 1975]

§ 1.1552-1 Earnings and profits.

(a) *General rule.* For the purpose of determining the earnings and profits of each member of an affiliated group which is required to be included in a consolidated return for such group filed for a taxable year beginning after December 31, 1953, and ending after August 16, 1954, the tax liability of the group shall be allocated among the members of the group in accordance with one of the following methods, pursuant to an election under paragraph (c) of this section:

(1)(i) The tax liability of the group shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(ii) For consolidated return years beginning after December 31, 1965, a member's portion of the tax liability of the group under the method of allocation provided by subdivision (i) of this subparagraph is an amount equal to the tax liability of the group multiplied by a fraction, the numerator of which is the taxable income of such member, and the denominator of which is the sum of the taxable incomes of all the members. For purposes of this subdivision the taxable income of a member shall be the separate taxable income determined under § 1.1502-12, adjusted for the following items taken into account in the computation of consolidated taxable income:

(a) The portion of the consolidated net operating loss deduction, the consolidated charitable contributions deduction, the consolidated dividends received deduction, the consolidated section 247 deduction, the consolidated section 582(c) net loss, and the consolidated section 922 deduction, attributable to such member;

(b) Such member's capital gain net income (net capital gain for taxable years beginning before January 1, 1977) (determined without regard to any net

capital loss carryover attributable to such member);

(c) Such member's net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such member; and

(d) The portion of any consolidated net capital loss carryover attributable to such member which is absorbed in the taxable year.

If the computation of the taxable income of a member under this subdivision results in an excess of deductions over gross income, then for purposes of this subdivision such member's taxable income shall be zero.

(2)(i) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.

(ii) For consolidated return years beginning after December 31, 1965, a member's portion of the tax liability of the group under the method of allocation provided by subdivision (i) of this subparagraph is an amount equal to the tax liability of the group multiplied by a fraction, the numerator of which is the separate return tax liability of such member, and the denominator of which is the sum of the separate return tax liabilities of all the members. For purposes of this subdivision the separate return tax liability of a member is its tax liability computed as if it has filed a separate return for the year except that:

(a) Gains and losses on intercompany transactions shall be taken into account as provided in § 1.1502-13 as if a consolidated return had been filed for the year;

(b) Gains and losses relating to inventory adjustments shall be taken into account as provided in § 1.1502-18 as if a consolidated return had been filed for the year;

(c) Transactions with respect to stock, bonds, or other obligations of members shall be reflected as provided in § 1.1502-13 (f) and (g) as if a consolidated return had been filed for the year;