

year as its taxable year and the stated facts are assumed to exist on each day of 1970 (unless otherwise provided in the example):

Example (1). Jones owns all the stock of corporation X and has an option to purchase from Smith all the outstanding stock of corporation Y. Smith owns all the outstanding stock of corporation Z. Since the Y stock is considered as owned by two or more persons, under subparagraph (2)(ii) of this paragraph the Y stock is treated as owned only by Smith since he has direct ownership of such stock. Therefore, on December 31, 1970, Y and Z are component members of the same brother-sister controlled group. If, however, Smith had owned his stock in corporation Z for less than one-half of the number of days of Z's 1970 taxable year, then under subparagraph (1) of this paragraph the Y stock would be treated as owned only by Jones since his ownership results in Y being a component member of a controlled group on December 31, 1970.

Example (2). Individual H owns directly all the outstanding stock of corporation M. W (the wife of H) owns directly all the outstanding stock of corporation N. Neither spouse is considered as owning the stock directly owned by the other because each of the conditions prescribed in paragraph (b)(5)(ii) of this section is satisfied with respect to each corporation's 1970 taxable year. H owns directly 60 percent of the only class of stock of corporation P and W owns the remaining 40 percent of the P stock. Under subparagraph (2)(iii) of this paragraph, the stock of P is treated as owned only by H since H owns (directly and with the application of the rules contained in paragraph (b)(1), (2), (3), and (4) of this section) the stock possessing the greatest percentage of the total value of shares of all classes of stock of P. Accordingly, on December 31, 1970, P is treated as a component member of a brother-sister group consisting of M and P.

Example (3). Unrelated individuals A and B each own 49 percent of all the outstanding stock of corporation R, which in turn owns 70 percent of the only class of outstanding stock of corporation S. The remaining 30 percent of the stock of corporation S is owned by unrelated individual C. C also owns the remaining 2 percent of the stock of corporation R. Under the attribution rule of paragraph (b)(4) of this section A and B are each considered to own 34.3 percent of the stock of corporation S. Accordingly, since five or fewer persons own at least 80 percent of the stock of corporations R and S and also own more than 50 percent identically (A's and B's identical ownership each is 34.3 percent, C's identical ownership is 2 percent), on December 31, 1970, corporations R and S are treated

as component members of the same brother-sister controlled group.

[T.D. 6845, 30 FR 9755, Aug. 5, 1965, as amended by T.D. 7181, 37 FR 8070, Apr. 25, 1972; T.D. 7779, 46 FR 29474, June 2, 1981; T.D. 8179, 53 FR 6613, Mar. 2, 1988]

§ 1.1563-4 Franchised corporations.

(a) *In general.* For purposes of paragraph (b)(2)(ii)(d) of § 1.1563-1, a member of a controlled group of corporations shall be considered to be a franchised corporation for a taxable year if each of the following conditions is satisfied for one-half (or more) of the number of days preceding the December 31 included within such taxable year (or, if such taxable year does not include a December 31, for one-half or more of the number of days in such taxable year preceding the last day of such year):

(1) Such member is franchised to sell the products of another member, or the common owner, of such controlled group.

(2) More than 50 percent (determined on the basis of cost) of all the goods held by such member primarily for sale to its customers are acquired from members or the common owner of the controlled group, or both.

(3) The stock of such member is to be sold to an employee (or employees) of such member pursuant to a bona fide plan designed to eliminate the stock ownership of the parent corporation (as defined in paragraph (b)(1) of § 1.1563-2) or of the common owner (as defined in paragraph (b)(3) of § 1.1563-2) in such member.

(4) Such employee owns (or such employees in the aggregate own) directly more than 20 percent of the total value of shares of all classes of stock of such member. For purposes of this subparagraph, the determination of whether an employee (or employees) owns the requisite percentage of the total value of the stock of the member shall be made without regard to paragraph (b) of § 1.1563-2, relating to certain stock treated as excluded stock. Furthermore, if the corporation has more than one class of stock outstanding, the relative voting rights as between each such class of stock shall be disregarded in making such determination.

§ 1.1564-1

(b) *Plan for elimination of stock ownership.* (1) A plan referred to in paragraph (a)(3) of this section must:

(i) Provide a reasonable selling price for the stock of the member, and

(ii) Require that a portion of the employee's compensation or dividends, or both, from such member be applied to the purchase of such stock (or to the purchase of notes, bonds, debentures, or similar evidences of indebtedness of such member held by the parent corporation or the common owner).

It is not necessary, in order to satisfy the requirements of subdivision (ii) of this subparagraph, that the plan require that a percentage of every dollar of the compensation and dividends be applied to the purchase of the stock (or the indebtedness). The requirements of such subdivision are satisfied if an otherwise qualified plan provides that under certain specified conditions (such as a requirement that the member earn a specified profit) no portion of the compensation and/or dividends need be applied to the purchase of the stock (or indebtedness), provided such conditions are reasonable.

(2) A plan for the elimination of the stock ownership of the parent corporation or of the common owner will satisfy the requirements of paragraph (a)(3) of this section and subparagraph (1) of this paragraph even though it does not require that the stock of the member be sold to an employee (or employees) if it provides for the redemption of the stock of the member held by the parent or common owner and under the plan the amount of such stock to be redeemed during any period is calculated by reference to the profits of such member during such period.

[T.D. 6845, 30 FR 9757, Aug. 5, 1965]

§ 1.1564-1 Limitations on additional benefits for members of controlled groups.

(a) *In general.* Section 1564(a)(1) provides that, with respect to any December 31 after 1969 and before 1975, only one component member of a controlled group of corporations (as defined in section 1563(a)) shall be allowed the full amount of:

(1) The \$25,000 surtax exemption under section 1562 (relating to election of multiple surtax exemptions),

(2) The \$100,000 amount under section 535(c) (2) and (3) (relating to the accumulated earnings credit), and

(3) The \$25,000 limitation on the small business deduction of life insurance companies under sections 804(a)(4) and 809(d)(10).

The amounts otherwise allowed to the other component members of such controlled group for their taxable years which include such December 31 shall be reduced to the amounts set forth in the following schedule:

Taxable years including—	Surtax exemption	Amount under sec. 535(c) (2) and (3)	Small business deduction limitation
Dec. 31, 1970	\$20,833	\$83,333	\$20,833
Dec. 31, 1971	16,667	66,667	16,667
Dec. 31, 1972	12,500	50,000	12,500
Dec. 31, 1973	8,333	33,333	8,333
Dec. 31, 1974	4,167	16,667	4,167

(b) *Election.* (1) Section 1564(a)(2) provides that, with respect to any December 31 after 1969 and before 1975, the component members of a controlled group of corporations shall elect which component member or members of such group shall be allowed for their taxable years which includes such December 31 the full amounts described in paragraph (a) (1), (2), and (3) of this section. In making such election, the members may allocate such full amounts among themselves in any manner they choose. For example, the group may select one of its members to receive the full amount of the \$25,000 surtax exemption under section 1562 and another of its members to receive the full \$100,000 amount under section 535(c)(2), or it may select one of its members to claim both, such full amounts.

(2) The election shall be made with respect to a particular December 31 and shall be valid only if each corporation which is a component member of the controlled group on such December 31 gives its consent. The consents shall be made by means of a statement, signed by persons duly authorized to act on behalf of each of the component members (other than wholly owned subsidiaries), stating which member has been selected to receive the amount which is not reduced under paragraph (a) of this section. The member so selected shall attach the statement to its income tax