

Asset	Original (c)(3) allocation	Redetermined (c)(3) allocation	Increase (decrease)
Investment in T1	402	398	(4)
Goodwill and going concern value	134	354	220
Total	2,500	2,700	200

Example 4. (i) On January 1, 2001, P purchases all of the outstanding T stock and makes a section 338 election for T. P pays \$700 of cash and promises also to pay a maximum \$300 of contingent consideration at various times in the future. Assume that, under general principles of tax law, such later payments are properly taken into account by P when paid. Assume also, however, that the current fair market value of the contingent payments is reasonably ascertainable. The fair market value of T's assets (other than goodwill and going concern value) as of the beginning of the following day is as follows:

Asset class	Assets	Fair market value
V	Equipment	\$200
V	Non-actively traded securities	100
V	Building	500
	Total	800

(ii) T has no liabilities. The AGUB is \$700. In calculating ADSP, assume that, under §1.1001-1, the current amount realized attributable to the contingent consideration is \$200. ADSP is therefore \$900 (\$700 cash plus \$200).

(iii) (A) The AGUB of \$700 is ratably allocated among T's Class V acquisition date assets in proportion to their fair market values as follows:

Asset	Basis
Equipment ($\$700 \times 200/800$)	\$175.00
Non-actively traded securities ($\$700 \times 100/800$) ..	87.50
Building ($\$700 \times 500/800$)	437.50
Total	700.00

(B) No amount is allocated to goodwill or going concern value.

(iv) (A) The ADSP of \$900 is ratably allocated among T's Class V acquisition date assets in proportion to their fair market values as follows:

Asset	Basis
Equipment	\$200
Non-actively traded securities	100
Building	500
Total	800

(B) The remaining ADSP, \$100, is allocated to goodwill and going concern value (Class VII).

(v) P and T file a consolidated return for 2001 and each following year with P as the common parent of the affiliated group.

(vi) In 2004, a contingent amount of \$120 is paid by P. For old T, this payment has no effect on ADSP, because the payment is accounted for as a separate transaction. We have assumed that, under general principles of tax law, the payment is properly taken into account by P at the time made. Therefore, in 2004, there is an increase in new T's AGUB of \$120. The amount of the increase allocated to each acquisition date asset is determined as follows:

Asset	Original AGUB	Redetermined AGUB	Increase
Equipment	\$175.00	\$200.00	\$25.00
Land	87.50	100.00	12.50
Building	437.50	500.00	62.50
Goodwill and going concern value	0.00	20.00	20.00
Total	700.00	820.00	120.00

[T.D. 8940, 66 FR 9929, Feb. 13, 2001]

§ 1.338-8 Asset and stock consistency.

(a) *Introduction*—(1) *Overview.* This section implements the consistency rules of sections 338(e) and (f). Under this section, no election under section 338 is deemed made or required with respect to target or any target affiliate. Instead, the person acquiring an asset may have a carryover basis in the asset.

(2) *General application.* The consistency rules generally apply if the purchasing corporation acquires an asset directly from target during the target consistency period and target is a subsidiary in a consolidated group. In such a case, gain from the sale of the asset is reflected under the investment adjustment provisions of the consolidated return regulations in the basis of target stock and may reduce gain from

the sale of the stock. See § 1.1502-32 (investment adjustment provisions). Under the consistency rules, the purchasing corporation generally takes a carryover basis in the asset, unless a section 338 election is made for target. Similar rules apply if the purchasing corporation acquires an asset directly from a lower-tier target affiliate if gain from the sale is reflected under the investment adjustment provisions in the basis of target stock.

(3) *Extensions of the general rules.* If an arrangement exists, paragraph (f) of this section generally extends the carryover basis rule to certain cases in which the purchasing corporation acquires assets indirectly from target (or a lower-tier target affiliate). To prevent avoidance of the consistency rules, paragraph (j) of this section also may extend the consistency period or the 12-month acquisition period and may disregard the presence of conduits.

(4) *Application where certain dividends are paid.* Paragraph (g) of this section extends the carryover basis rule to certain cases in which dividends are paid to a corporation that is not a member of the same consolidated group as the distributing corporation. Generally, this rule applies where a 100 percent dividends received deduction is used in conjunction with asset dispositions to achieve an effect similar to that available under the investment adjustment provisions of the consolidated return regulations.

(5) *Application to foreign target affiliates.* Paragraph (h) of this section extends the carryover basis rule to certain cases involving target affiliates that are controlled foreign corporations.

(6) *Stock consistency.* This section limits the application of the stock consistency rules to cases in which the rules are necessary to prevent avoidance of the asset consistency rules. Following the general treatment of a section 338(h)(10) election, a sale of a corporation's stock is treated as a sale of the corporation's assets if a section 338(h)(10) election is made. Because gain from this asset sale may be reflected in the basis of the stock of a higher-tier target, the carryover basis rule may apply to the assets.

(b) *Consistency for direct acquisitions—*
(1) *General rule.* The basis rules of paragraph (d) of this section apply to an asset if—

(i) The asset is disposed of during the target consistency period;

(ii) The basis of target stock, as of the target acquisition date, reflects gain from the disposition of the asset (see paragraph (c) of this section); and

(iii) The asset is owned, immediately after its acquisition and on the target acquisition date, by a corporation that acquires stock of target in the qualified stock purchase (or by an affiliate of an acquiring corporation).

(2) *Section 338(h)(10) elections.* For purposes of this section, if a section 338(h)(10) election is made for a corporation acquired in a qualified stock purchase—

(i) The acquisition is treated as an acquisition of the corporation's assets (see § 1.338(h)(10)-1); and

(ii) The corporation is not treated as target.

(c) *Gain from disposition reflected in basis of target stock.* For purposes of this section:

(1) *General rule.* Gain from the disposition of an asset is reflected in the basis of a corporation's stock if the gain is taken into account under § 1.1502-32, directly or indirectly, in determining the basis of the stock, after applying section 1503(e) and other provisions of the Internal Revenue Code.

(2) *Gain not reflected if section 338 election made for target.* Gain from the disposition of an asset that is otherwise reflected in the basis of target stock as of the target acquisition date is not considered reflected in the basis of target stock if a section 338 election is made for target.

(3) *Gain reflected by reason of distributions.* Gain from the disposition of an asset is not considered reflected in the basis of target stock merely by reason of the receipt of a distribution from a target affiliate that is not a member of the same consolidated group as the distributee. See paragraph (g) of this section for the treatment of dividends eligible for a 100 percent dividends received deduction.

(4) *Controlled foreign corporations.* For a limitation applicable to gain of a target affiliate that is a controlled foreign

corporation, see paragraph (h)(2) of this section.

(5) *Gain recognized outside the consolidated group.* Gain from the disposition of an asset by a person other than target or a target affiliate is not reflected in the basis of a corporation's stock unless the person is a conduit, as defined in paragraph (j)(4) of this section.

(d) *Basis of acquired assets—(1) Carryover basis rule.* If this paragraph (d) applies to an asset, the asset's basis immediately after its acquisition is, for all purposes of the Internal Revenue Code, its adjusted basis immediately before its disposition.

(2) *Exceptions to carryover basis rule for certain assets.* The carryover basis rule of paragraph (d)(1) of this section does not apply to the following assets—

(i) Any asset disposed of in the ordinary course of a trade or business (see section 338(e)(2)(A));

(ii) Any asset the basis of which is determined wholly by reference to the adjusted basis of the asset in the hands of the person that disposed of the asset (see section 338(e)(2)(B));

(iii) Any debt or equity instrument issued by target or a target affiliate (see paragraph (h)(3) of this section for an exception relating to the stock of a target affiliate that is a controlled foreign corporation);

(iv) Any asset the basis of which immediately after its acquisition would otherwise be less than its adjusted basis immediately before its disposition; and

(v) Any asset identified by the Internal Revenue Service in a revenue ruling or revenue procedure.

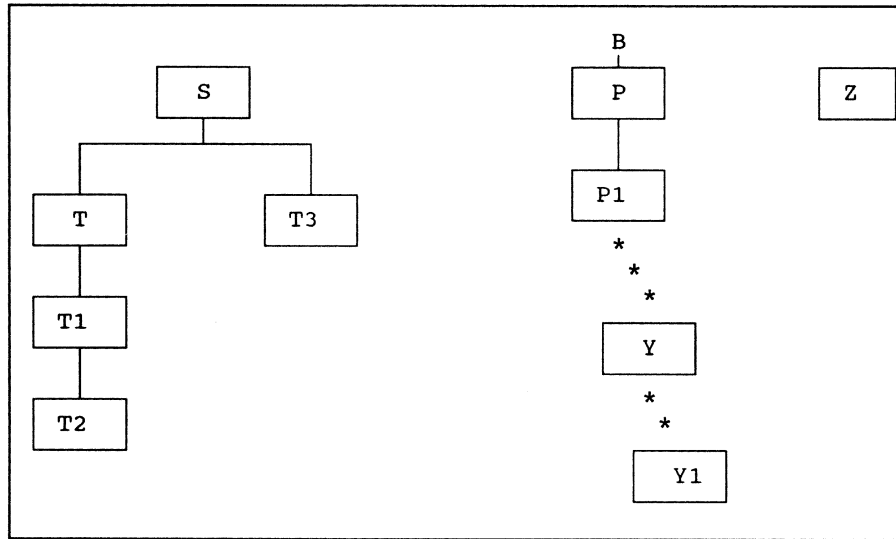
(3) *Exception to carryover basis rule for de minimis assets.* The carryover basis rules of this section do not apply to an asset if the asset is not disposed of as

part of the same arrangement as the acquisition of target and the aggregate amount realized for all assets otherwise subject to the carryover basis rules of this section does not exceed \$250,000.

(4) *Mitigation rule—(i) General rule.* If the carryover basis rules of this section apply to an asset and the asset is transferred to a domestic corporation in a transaction to which section 351 applies or as a contribution to capital and no gain is recognized, the transferor's basis in the stock of the transferee (but not the transferee's basis in the asset) is determined without taking into account the carryover basis rules of this section.

(ii) *Time for transfer.* This paragraph (d)(4) applies only if the asset is transferred before the due date (including extensions) for the transferor's income tax return for the year that includes the last date for which a section 338 election may be made for target.

(e) *Examples—(1) In general.* For purposes of the examples in this section, unless otherwise stated, the basis of each asset is the same for determining earnings and profits and taxable income, the exceptions to paragraph (d)(1) of this section do not apply, the taxable year of all persons is the calendar year, and the following facts apply: S is the common parent of a consolidated group that includes T, T1, T2, and T3; S owns all of the stock of T and T3; and T owns all of the stock of T1, which owns all of the stock of T2. B is unrelated to the S group and owns all of the stock of P, which owns all of the stock of P1. Y and Y1 are partnerships that are unrelated to the S group but may be related to the P group. Z is a corporation that is not related to any of the other parties.



(2) *Direct acquisitions.* Paragraphs (b), (c), and (d) of this section may be illustrated by the following examples:

Example 1. Asset acquired from target by purchasing corporation. (a) On February 1 of Year 1, T sells an asset to P1 and recognizes gain. T's gain from the disposition of the asset is taken into account under §1.1502-32 in determining S's basis in the T stock. On January 1 of Year 2, P1 makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) T disposed of the asset during its consistency period, gain from the asset disposition is reflected in the basis of the T stock as of T's acquisition date (January 1 of Year 2), and the asset is owned both immediately after the asset disposition (February 1 of Year 1) and on T's acquisition date by P1, the corporation that acquired T stock in the qualified stock purchase. Consequently, under paragraph (b) of this section, paragraph (d)(1) of this section applies to the asset and P1's basis in the asset is T's adjusted basis in the asset immediately before the sale to P1.

Example 2. Gain from section 338(h)(10) election reflected in stock basis. (a) On February 1 of Year 1, P1 makes a qualified stock purchase of T2 from T1. A section 338(h)(10) election is made for T2 and T2 recognizes gain on each of its assets. T2's gain is taken into account under §1.1502-32 in determining S's basis in the T stock. On January 1 of Year 2, P1 makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Under paragraph (b)(2) of this section, the acquisition of the T2 stock is treated as an acquisition of T2's assets on February 1 of Year 1, because a section 338(h)(10) election is made for T2. The gain recognized by T2 under section 338(h)(10) is reflected in S's basis in the T stock as of T's acquisition date. Because the other requirements of paragraph (b) of this section are satisfied, paragraph (d)(1) of this section applies to the assets and new T2's basis in its assets is old T2's adjusted basis in the assets immediately before the disposition.

Example 3. Corporation owning asset ceases affiliation with corporation purchasing target before target acquisition date. (a) On February 1 of Year 1, T sells an asset to P1 and recognizes gain. On December 1 of Year 1, P disposes of all of the P1 stock while P1 still owns the asset. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Immediately after T's disposition of the asset, the asset is owned by P1 which is affiliated on that date with P, the corporation that acquired T stock in the qualified stock purchase. However, the asset is owned by a corporation (P1) that is no longer affiliated with P on T's acquisition date. Although the other requirements of paragraph (b) of this section are satisfied, the requirements of paragraph (b)(1)(iii) of this section are not satisfied. Consequently, the basis rules of paragraph (d) of this section do not apply to the asset by reason of P1's acquisition.

(c) If P acquires all of the Z stock and P1 transfers the asset to Z on or before T's acquisition date (January 1 of Year 2), the

asset is owned by an affiliate of P both on February 1 of Year 1 (P1) and on January 1 of Year 2 (Z). Consequently, all of the requirements of paragraph (b) of this section are satisfied and paragraph (d)(1) of this section applies to the asset and P1's basis in the asset is T's adjusted basis in the asset immediately before the sale to P1.

Example 4. Gain reflected in stock basis notwithstanding offsetting loss or distribution. (a) On April 1 of Year 1, T sells an asset to P1 and recognizes gain. In Year 1, T distributes an amount equal to the gain. On March 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Although, as a result of the distribution, there is no adjustment with respect to the T stock under §1.1502-32 for Year 1, T's gain from the disposition of the asset is considered reflected in S's basis in the T stock. The gain is considered to have been taken into account under §1.1502-32 in determining the adjustments to S's basis in the T stock because S's basis in the T stock is different from what it would have been had there been no gain.

(c) If T distributes an amount equal to the gain on February 1 of Year 2, rather than in Year 1, the results would be the same because S's basis in the T stock is different from what it would have been had there been no gain. If the distribution in Year 2 is by reason of an election under §1.1502-32(f)(2), the results would be the same.

(d) If, in Year 1, T does not make a distribution and the S group does not file a consolidated return, but, in Year 2, the S group does file a consolidated return and makes an election under §1.1502-32(f)(2) for T, the results would be the same. S's basis in the T stock is different from what it would have been had there been no gain. Paragraph (c)(3) of this section (gain not considered reflected by reason of distributions) does not apply to the deemed distribution under the election because S and T are members of the same consolidated group. If T distributes an amount equal to the gain in Year 2 and no election is made under §1.1502-32(f)(2), the results would be the same.

(e) If, in Year 1, T incurs an unrelated loss in an amount equal to the gain, rather than distributing an amount equal to the gain, the results would be the same because the gain is taken into account under §1.1502-32 in determining S's basis in the T stock.

Example 5. Gain of a target affiliate reflected in stock basis after corporate reorganization. (a) On February 1 of Year 1, T3 sells an asset to P1 and recognizes gain. On March 1 of Year 1, S contributes the T3 stock to T in a transaction qualifying under section 351. On January 15 of Year 2, P1 makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) T3's gain from the asset sale is taken into account under §1.1502-32 in determining S's basis in the T3 stock. Under section 358, the gain that is taken into account under §1.1502-32 in determining S's basis in the T3 stock is also taken into account in determining S's basis in the T stock following S's contribution of the T3 stock to T. Consequently, under paragraph (b) of this section, paragraph (d)(1) of this section applies to the asset and P1's basis in the asset is T3's adjusted basis in the asset immediately before the sale to P1.

(c) If on March 1 of Year 1, rather than S contributing the T3 stock to T, S causes T3 to merge into T in a transaction qualifying under section 368(a)(1)(D), the results would be the same.

Example 6. Gain not reflected if election under section 338 made. (a) On February 1 of Year 1, T1 sells an asset to P1 and recognizes gain. On January 1 of Year 2, P1 makes a qualified stock purchase of T1 from T. A section 338 election (but not a section 338(h)(10) election) is made for T1.

(b) Under paragraph (c)(2) of this section, because a section 338 election is made for T1, T's basis in the T1 stock is considered not to reflect gain from the disposition. Consequently, the requirement of paragraph (b)(1)(ii) of this section is not satisfied. Thus, P1's basis in the asset is not determined under paragraph (d) of this section. Although the section 338 election for T1 results in a qualified stock purchase of T2, the requirement of paragraph (b)(1)(ii) of this section is not satisfied with respect to T2, whether or not a section 338 election is made for T2.

(c) If, on January 1 of Year 2, P1 makes a qualified stock purchase of T from S and a section 338 election for T, rather than T1, S's basis in the T stock is considered not to reflect gain from T1's disposition of the asset. However, the section 338 election for T results in a qualified stock purchase of T1. Because the gain is reflected in T's basis in the T1 stock, the requirements of paragraph (b) of this section are satisfied. Consequently, P1's basis in the asset is determined under paragraph (d)(1) of this section unless a section 338 election is also made for T1.

(f) *Extension of consistency to indirect acquisitions—(1) Introduction.* If an arrangement exists (see paragraph (j)(5) of this section), this paragraph (f) generally extends the consistency rules to indirect acquisitions that have the same effect as direct acquisitions. For example, this paragraph (f) applies if, pursuant to an arrangement, target sells an asset to an unrelated person who then sells the asset to the purchasing corporation.

(2) *General rule.* This paragraph (f) applies to an asset if, pursuant to an arrangement—

(i) The asset is disposed of during the target consistency period;

(ii) The basis of target stock as of, or at any time before, the target acquisition date reflects gain from the disposition of the asset; and

(iii) The asset ownership requirements of paragraph (b)(1)(iii) of this section are not satisfied, but the asset is owned, at any time during the portion of the target consistency period following the target acquisition date, by—

(A) A corporation—

(1) The basis of whose stock, as of, or at any time before, the target acquisition date, reflects gain from the disposition of the asset; and

(2) That is affiliated, at any time during the target consistency period, with a corporation that acquires stock of target in the qualified stock purchase; or

(B) A corporation that at the time it owns the asset is affiliated with a corporation described in paragraph (f)(2)(iii)(A) of this section.

(3) *Basis of acquired assets.* If this paragraph (f) applies to an asset, the principles of the basis rules of paragraph (d) of this section apply to the asset as of the date, following the disposition with respect to which gain is reflected in the basis of target's stock, that the asset is first owned by a corporation described in paragraph (f)(2)(iii) of this section. If the principles of the carryover basis rule of paragraph (d)(1) of this section apply to an asset, the asset's basis also is reduced (but not below zero) by the amount of any reduction in its basis occurring after the disposition with respect to which gain is reflected in the basis of target's stock.

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

Example 1. Acquisition of asset from unrelated party by purchasing corporation. (a) On February 1 of Year 1, T sells an asset to Z and recognizes gain. On February 15 of Year 1, P1 makes a qualified stock purchase of T from S. No section 338 election is made for T. P1 buys the asset from Z on March 1 of Year 1, before Z has reduced the basis of the asset through depreciation or otherwise.

(b) Paragraph (b) of this section does not apply to the asset because the asset ownership requirements of paragraph (b)(1)(iii) of this section are not satisfied. However, the asset ownership requirements of paragraph (f)(2)(iii) of this section are satisfied because, during the portion of T's consistency period following T's acquisition date, the asset is owned by P1 while it is affiliated with T. Consequently, paragraph (f) of this section applies to the asset if there is an arrangement for T to dispose of the asset during T's consistency period, for the gain to be reflected in S's basis in the T stock as of T's acquisition date, and for P1 to own the asset during the portion of T's consistency period following T's acquisition date. If the arrangement exists, under paragraph (f)(3) of this section, P1's basis in the asset is determined as of March 1 of Year 1, under the principles of paragraph (d) of this section. Consequently, P1's basis in the asset is T's adjusted basis in the asset immediately before the sale to Z.

(c) If P1 acquires the asset from Z on January 15 of Year 2 (rather than on March 1 of Year 1), and Z's basis in the asset has been reduced through depreciation at the time of the acquisition, P1's basis in the asset as of January 15 of Year 2 would be T's adjusted basis in the asset immediately before the sale to Z, reduced (but not below zero) by the amount of the depreciation. Z's basis and depreciation are determined without taking into account the basis rules of paragraph (d) of this section.

(d) If P, rather than P1, acquires the asset from Z, the results would be the same.

(e) If, on March 1 of Year 1, P1 acquires the Z stock, rather than acquiring the asset from Z, paragraph (f) of this section would apply to the asset if an arrangement exists. However, under paragraph (f)(3) of this section, Z's basis in the asset would be determined as of February 1 of Year 1, the date the asset is first owned by a corporation (Z) described in paragraph (f)(2)(iii) of this section. Consequently, Z's basis in the asset as of February 1 of Year 1, determined under the principles of paragraph (d) of this section, would be T's adjusted basis in the asset immediately before the sale to Z.

Example 2. Acquisition of asset from target by target affiliate. (a) On February 1 of Year 1, T contributes an asset to T1 in a transaction qualifying under section 351 and in which T recognizes gain under section 351(b) that is deferred under § 1.1502-13. On March 1 of Year 1, P1 makes a qualified stock purchase of T from S and, pursuant to § 1.1502-13, the deferred gain is taken into account by T immediately before T ceases to be a member of the S group. No section 338 election is made for T.

(b) Paragraph (b) of this section does not apply to the asset because the asset ownership requirements of paragraph (b)(1)(iii) of this section are not satisfied.

(c) T1 is not described in paragraph (f)(2)(iii)(A) of this section because the basis of the T1 stock does not reflect gain from the disposition of the asset. Although, under section 358(a)(1)(B)(ii), T's basis in the T1 stock is increased by the amount of the gain, the gain is not taken into account directly or indirectly under § 1.1502-32 in determining T's basis in the T1 stock.

(d) T1 is described in paragraph (f)(2)(iii)(B) of this section because, during the portion of T's consistency period following T's acquisition date, T1 owns the asset while it is affiliated with T, a corporation described in paragraph (f)(2)(iii)(A) of this section. Consequently, paragraph (f) of this section applies to the asset if there is an arrangement. Under paragraph (j)(5) of this section, the fact that, at the time T1 acquires the asset from T, T1 is related (within the meaning of section 267(b)) to T indicates that an arrangement exists.

Example 3. Acquisition of asset from target and indirect acquisition of target stock. (a) On February 1 of Year 1, T sells an asset to P1 and recognizes gain. On March 1 of Year 1, Z makes a qualified stock purchase of T from S. No section 338 election is made for T. On January 1 of Year 2, P1 acquires the T stock from Z other than in a qualified stock purchase.

(b) The asset ownership requirements of paragraph (b)(1)(iii) of this section are not satisfied because the asset was never owned by Z, the corporation that acquired T stock in the qualified stock purchase (or by a corporation that was affiliated with Z at the time it owned the asset). However, because the asset is owned by P1 while it is affiliated with T during the portion of T's consistency period following T's acquisition date, paragraph (f) of this section applies to the asset if there is an arrangement. If there is an arrangement, the principles of the carryover basis rule of paragraph (d)(1) of this section apply to determine P1's basis in the asset unless Z makes a section 338 election for T. See paragraph (c)(2) of this section.

(c) If P1 also makes a qualified stock purchase of T from Z, the results would be the same. If there is an arrangement, the principles of the carryover basis rule of paragraph (d)(1) of this section apply to determine P1's basis in the asset unless Z makes a section 338 election for T. However, these principles apply to determine P1's basis in the asset if P1, but not Z, makes a section 338 election for T. The basis of the T stock no longer reflects, as of T's acquisition date by P1, the gain from the disposition of the asset.

(d) Assume Z purchases the T stock other than in a qualified stock purchase and P1

makes a qualified stock purchase of T from Z. Paragraph (b) of this section does not apply to the asset because gain from the disposition of the asset is not reflected in the basis of T's stock as of T's acquisition date (January 1 of Year 2). However, because the gain is reflected in S's basis in the T stock before T's acquisition date and the asset is owned by P1 while it is affiliated with T during the portion of T's consistency period following T's acquisition date, paragraph (f) of this section applies to the asset if there is an arrangement. If there is an arrangement, the principles of the carryover basis rule of paragraph (d)(1) of this section apply to determine P1's basis in the asset even if P1 makes a section 338 election for T. The basis of the T stock no longer reflects, as of T's acquisition date, the gain from the disposition of the asset.

Example 4. Asset acquired from target affiliate by corporation that becomes its affiliate. (a) On February 1 of Year 1, T1 sells an asset to P1 and recognizes gain. On February 15 of Year 1, Z makes a qualified stock purchase of T from S. No section 338 election is made for T. On June 1 of Year 1, P1 acquires the T1 stock from T, other than in a qualified stock purchase.

(b) The asset ownership requirements of paragraph (b)(1)(iii) of this section are not satisfied because the asset was never owned by Z, the corporation that acquired T stock in the qualified stock purchase (or by a corporation that was affiliated with Z at the time it owned the asset).

(c) P1 is not described in paragraph (f)(2)(iii)(A) of this section because gain from the disposition of the asset is not reflected in the basis of the P1 stock.

(d) P1 is described in paragraph (f)(2)(iii)(B) of this section because the asset is owned by P1 while P1 is affiliated with T1 during the portion of T's consistency period following T's acquisition date. T1 becomes affiliated with Z, the corporation that acquired T stock in the qualified stock purchase, during T's consistency period, and, as of T's acquisition date, the basis of T1's stock reflects gain from the disposition of the asset. Consequently, paragraph (f) of this section applies to the asset if there is an arrangement.

Example 5. De minimis rules. (a) On February 1 of Year 1, T sells an asset to P and recognizes gain. On February 15 of Year 1, T1 sells an asset to Z and recognizes gain. The aggregate amount realized by T and T1 on their respective sales of assets is not more than \$250,000. On March 1 of Year 1, T3 sells an asset to P and recognizes gain. On April 1 of Year 1, P makes a qualified stock purchase of T from S. No section 338 election is made for T. On June 1 of Year 1, P1 buys from Z the asset sold by T1.

(b) Under paragraph (b) of this section, the basis rules of paragraph (d) of this section

apply to the asset sold by T. Under paragraph (f) of this section, the principles of the basis rules of paragraph (d) of this section apply to the asset sold by T1 if there is an arrangement. Because T3's gain is not reflected in the basis of the T stock, the basis rules of this section do not apply to the asset sold by T3.

(c) The de minimis rule of paragraph (d)(3) of this section applies to an asset if the asset is not disposed of as part of the same arrangement as the acquisition of T and the aggregate amount realized for all assets otherwise subject to the carryover basis rules does not exceed \$250,000. The aggregate amount realized by T and T1 does not exceed \$250,000. (The asset sold by T3 is not taken into account for purposes of the de minimis rule.) Thus, the de minimis rule applies to the asset sold by T if the asset is not disposed of as part of the same arrangement as the acquisition of T.

(d) If, under paragraph (f) of this section, the principles of the carryover basis rules of paragraph (d)(1) of this section otherwise apply to the asset sold by T1 because of an arrangement, the de minimis rules of this section do not apply to the asset because of the arrangement.

(e) Assume on June 1 of Year 1, Z acquires the T1 stock from T, other than in a qualified stock purchase, rather than P1 buying the T1 asset, and paragraph (f) of this section applies because there is an arrangement. Because the asset was disposed of and the T1 stock was acquired as part of the arrangement, the de minimis rules of this section do not apply to the asset.

(g) *Extension of consistency if dividends qualifying for 100 percent dividends received deduction are paid*—(1) *General rule for direct acquisitions from target.* Unless a section 338 election is made for target, the basis rules of paragraph (d) of this section apply to an asset if—

(i) Target recognizes gain (whether or not deferred) on disposition of the asset during the portion of the target consistency period that ends on the target acquisition date;

(ii) The asset is owned, immediately after the asset disposition and on the target acquisition date, by a corporation that acquires stock of target in the qualified stock purchase (or by an affiliate of an acquiring corporation); and

(iii) During the portion of the target consistency period that ends on the target acquisition date, the aggregate amount of dividends paid by target, to which section 243(a)(3) applies, exceeds the greater of—

(A) \$250,000; or

(B) 125 percent of the yearly average amount of dividends paid by target, to which section 243(a)(3) applies, during the three calendar years immediately preceding the year in which the target consistency period begins (or, if shorter, the period target was in existence).

(2) *Other direct acquisitions having same effect.* The basis rules of paragraph (d) of this section also apply to an asset if the effect of a transaction described in paragraph (g)(1) of this section is achieved through any combination of disposition of assets and payment of dividends to which section 243(a)(3) applies (or any other dividends eligible for a 100 percent dividends received deduction). See paragraph (h)(4) of this section for additional rules relating to target affiliates that are controlled foreign corporations.

(3) *Indirect acquisitions.* The principles of paragraph (f) of this section also apply for purposes of this paragraph (g).

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

Example 1. Asset acquired from target paying dividends to which section 243(a)(3) applies. (a) The S group does not file a consolidated return. In Year 1, Year 2, and Year 3, T pays dividends to S to which section 243(a)(3) applies of \$200,000, \$250,000, and \$300,000, respectively. On February 1 of Year 4, T sells an asset to P and recognizes gain. On January 1 of Year 5, P makes a qualified stock purchase of T from S. No section 338 election is made for T. During the portion of T's consistency period that ends on T's acquisition date, T pays S dividends to which section 243(a)(3) applies of \$1,000,000.

(b) Under paragraph (g)(1) of this section, paragraph (d) of this section applies to the asset. T recognizes gain on disposition of the asset during the portion of T's consistency period that ends on T's acquisition date, the asset is owned by P immediately after the disposition and on T's acquisition date, and T pays dividends described in paragraph (g)(1)(iii) of this section. Consequently, under paragraph (d)(1) of this section, P's basis in the asset is T's adjusted basis in the asset immediately before the sale to P.

(c) If T is a controlled foreign corporation, the results would be the same if T pays dividends in the amount described in paragraph (g)(1)(iii) of this section that qualify for a 100 percent dividends received deduction. See sections 243(e) and 245.

(d) If S and T3 file a consolidated return in which T, T1, and T2 do not join, the results

would be the same because the dividends paid by T are still described in paragraph (g)(1)(iii) of this section.

(e) If T, T1, and T2 file a consolidated return in which S and T3 do not join, the results would be the same because the dividends paid by T are still described in paragraph (g)(1)(iii) of this section.

Example 2. Asset disposition by target affiliate achieving same effect. (a) The S group does not file a consolidated return. On February 1 of Year 1, T2 sells an asset to P and recognizes gain. T pays dividends to S described in paragraph (g)(1)(iii) of this section. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Paragraph (g)(1) of this section does not apply to the asset because T did not recognize gain on the disposition of the asset. However, under paragraph (g)(2) of this section, because the asset disposition by T2 and the dividends paid by T achieve the effect of a transaction described in paragraph (g)(1) of this section, the carryover basis rule of paragraph (d)(1) of this section applies to the asset. The effect was achieved because T2 is a lower-tier affiliate of T and the dividends paid by T to S reduce the value to S of T and its lower-tier affiliates.

(c) If T2 is a controlled foreign corporation, the results would be the same because T2 is a lower-tier affiliate of T and the dividends paid by T to S reduce the value to S of T and its lower-tier affiliates.

(d) If P buys an asset from T3, rather than T2, the asset disposition and the dividends do not achieve the effect of a transaction described in paragraph (g)(1) of this section because T3 is not a lower-tier affiliate of T. Thus, the basis rules of paragraph (d) of this section do not apply to the asset. The results would be the same whether or not P also acquires the T3 stock (whether or not in a qualified stock purchase).

Example 3. Dividends by target affiliate achieving same effect. (a) The S group does not file a consolidated return. On February 1 of Year 1, T1 sells an asset to P and recognizes gain. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T. T does not pay dividends to S described in paragraph (g)(1)(iii) of this section. However, T1 pays dividends to T that would be described in paragraph (g)(1)(iii) of this section if T1 were a target.

(b) Paragraph (g)(1) of this section does not apply to the asset because T did not recognize gain on the disposition of the asset and did not pay dividends described in paragraph (g)(1)(iii) of this section. Further, paragraph (g)(2) of this section does not apply because the dividends paid by T1 to T do not reduce the value to S of T and its lower-tier affiliates.

(c) If both S and T own T1 stock and T1 pays dividends to S that would be described in paragraph (g)(1)(iii) of this section if T1 were a target, paragraph (g)(2) of this section would apply because the dividends paid by T1 to S reduce the value to S of T and its lower-tier affiliates. If T, rather than T1, sold the asset to P, the results would be the same. Further, if T and T1 pay dividends to S that, only when aggregated, would be described in paragraph (g)(1)(iii) of this section (if they were all paid by T), the results would be the same.

Example 4. Gain reflected by reason of dividends. (a) S and T file a consolidated return in which T1 and T2 do not join. On February 1 of Year 1, T1 sells an asset to P and recognizes gain. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T. T1 pays dividends to T that would be described in paragraph (g)(1)(iii) of this section if T1 were a target.

(b) The requirements of paragraph (b) of this section are not satisfied because, under paragraph (c)(3) of this section, gain from T1's sale is not reflected in S's basis in the T stock by reason of the dividends paid by T1 to T.

(c) Although the dividends paid by T1 to T do not reduce the value to S of T and its lower-tier affiliates, paragraph (g)(2) of this section applies because the dividends paid by T1 to T are taken into account under §1.1502-32 in determining S's basis in the T stock. Consequently, the carryover basis rule of paragraph (d)(1) of this section applies to the asset.

(h) *Consistency for target affiliates that are controlled foreign corporations—(1) In general.* This paragraph (h) applies only if target is a domestic corporation. For additional rules that may apply with respect to controlled foreign corporations, see paragraph (g) of this section. The definitions and nomenclature of §1.338-2(b) and (c) and paragraph (e) of this section apply for purposes of this section.

(2) *Income or gain resulting from asset dispositions—(i) General rule.* Income or gain of a target affiliate that is a controlled foreign corporation from the disposition of an asset is not reflected in the basis of target stock under paragraph (c) of this section unless the income or gain results in an inclusion under section 951(a)(1)(A), 951(a)(1)(C), 1291 or 1293.

(ii) *Basis of controlled foreign corporation stock.* If, by reason of paragraph (h)(2)(i) of this section, the carryover basis rules of this section apply to an

asset, no increase in basis in the stock of a controlled foreign corporation under section 961(a) or 1293(d)(1), or under regulations issued pursuant to section 1297(b)(5), is allowed to target or a target affiliate to the extent the increase is attributable to income or gain described in paragraph (h)(2)(i) of this section. A similar rule applies to the basis of any property by reason of which the stock of the controlled foreign corporation is considered owned under section 958(a)(2) or 1297(a).

(iii) *Operating rule.* For purposes of this paragraph (h)(2)—

(A) If there is an income inclusion under section 951 (a)(1)(A) or (C), the shareholder's income inclusion is first attributed to the income or gain of the controlled foreign corporation from the disposition of the asset to the extent of the shareholder's pro rata share of such income or gain; and

(B) Any income or gain under section 1293 is first attributed to the income or gain from the disposition of the asset to the extent of the shareholder's pro rata share of the income or gain.

(iv) *Increase in asset or stock basis—*(A) If the carryover basis rules under paragraph (h)(2)(i) of this section apply to an asset, and the purchasing corporation disposes of the asset to an unrelated party in a taxable transaction and recognizes and includes in its U.S. gross income or the U.S. gross income of its shareholders the greater of the income or gain from the disposition of the asset by the selling controlled foreign corporation that was reflected in the basis of the target stock under paragraph (c) of this section, or the gain recognized on the asset by the purchasing corporation on the disposition of the asset, then the purchasing corporation or the target or a target affiliate, as appropriate, shall increase the basis of the selling controlled foreign corporation stock subject to paragraph (h)(2)(ii) of this section, as of the date of the disposition of the asset by the purchasing corporation, by the amount of the basis increase that was denied under paragraph (h)(2)(ii) of this section. The preceding sentence shall apply only to the extent that the controlled foreign corporation stock is owned (within the meaning of section

958(a)) by a member of the purchasing corporation's affiliated group.

(B) If the carryover basis rules under paragraph (h)(2)(i) of this section apply to an asset, and the purchasing corporation or the target or a target affiliate, as appropriate, disposes of the stock of the selling controlled foreign corporation to an unrelated party in a taxable transaction and recognizes and includes in its U.S. gross income or the U.S. gross income of its shareholders the greater of the gain equal to the basis increase that was denied under paragraph (h)(2)(ii) of this section, or the gain recognized in the stock by the purchasing corporation or by the target or a target affiliate, as appropriate, on the disposition of the stock, then the purchasing corporation shall increase the basis of the asset, as of the date of the disposition of the stock of the selling controlled foreign corporation by the purchasing corporation or by the target or a target affiliate, as appropriate, by the amount of the basis increase that was denied pursuant to paragraph (h)(2)(i) of this section. The preceding sentence shall apply only to the extent that the asset is owned (within the meaning of section 958(a)) by a member of the purchasing corporation's affiliated group.

(3) *Stock issued by target affiliate that is a controlled foreign corporation.* The exception to the carryover basis rules of this section provided in paragraph (d)(2)(iii) of this section does not apply to stock issued by a target affiliate that is a controlled foreign corporation. After applying the carryover basis rules of this section to the stock, the basis in the stock is increased by the amount treated as a dividend under section 1248 on the disposition of the stock (or that would have been so treated but for section 1291), except to the extent the basis increase is attributable to the disposition of an asset in which a carryover basis is taken under this section.

(4) *Certain distributions—*(i) *General rule.* In the case of a target affiliate that is a controlled foreign corporation, paragraph (g) of this section applies with respect to the target affiliate by treating any reference to a dividend to which section 243(a)(3) applies as a reference to any amount taken

into account under §1.1502-32 in determining the basis of target stock that is—

(A) A dividend;

(B) An amount treated as a dividend under section 1248 (or that would have been so treated but for section 1291); or

(C) An amount included in income under section 951(a)(1)(B).

(ii) *Basis of controlled foreign corporation stock.* If the carryover basis rules of this section apply to an asset, the basis in the stock of the controlled foreign corporation (or any property by reason of which the stock is considered owned under section 958(a)(2)) is reduced (but not below zero) by the sum of any amounts that are treated, solely by reason of the disposition of the asset, as a dividend, amount treated as a dividend under section 1248 (or that would have been so treated but for section 1291), or amount included in income under section 951(a)(1)(B). For this purpose, any dividend, amount treated as a dividend under section 1248 (or that would have been so treated but for section 1291), or amount included in income under section 951(a)(1)(B) is considered attributable first to earnings and profits resulting from the disposition of the asset.

(iii) *Increase in asset or stock basis—*

(A) If the carryover basis rules under paragraphs (g) and (h)(4)(i) of this section apply to an asset, and the purchasing corporation disposes of the asset to an unrelated party in a taxable transaction and recognizes and includes in its U.S. gross income or the U.S. gross income of its shareholders the greater of the gain equal to the basis increase denied in the asset pursuant to paragraphs (g) and (h)(4)(i) of this section, or the gain recognized on the asset by the purchasing corporation on the disposition of the asset, then the purchasing corporation or the target or a target affiliate, as appropriate, shall increase the basis of the selling controlled foreign corporation stock subject to paragraph (h)(4)(ii) of this section, as of the date of the disposition of the asset by the purchasing corporation, by the amount of the basis reduction under paragraph (h)(4)(ii) of this section. The preceding sentence shall apply only to the extent that the controlled foreign corporation stock is

owned (within the meaning of section 958(a)) by a member of the purchasing corporation's affiliated group.

(B) If the carryover basis rules under paragraphs (g) and (h)(4)(i) of this section apply to an asset, and the purchasing corporation or the target or a target affiliate, as appropriate, disposes of the stock of the selling controlled foreign corporation to an unrelated party in a taxable transaction and recognizes and includes in its U.S. gross income or the U.S. gross income of its shareholders the greater of the amount of the basis reduction under paragraph (h)(4)(ii) of this section, or the gain recognized in the stock by the purchasing corporation or by the target or a target affiliate, as appropriate, on the disposition of the stock, then the purchasing corporation shall increase the basis of the asset, as of the date of the disposition of the stock of the selling controlled foreign corporation by the purchasing corporation or by the target or a target affiliate, as appropriate, by the amount of the basis increase that was denied pursuant to paragraphs (g) and (h)(4)(i) of this section. The preceding sentence shall apply only to the extent that the asset is owned (within the meaning of section 958(a)) by a member of the purchasing corporation's affiliated group.

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

Example 1. Stock of target affiliate that is a CFC. (a) The S group files a consolidated return; however, T2 is a controlled foreign corporation. On December 1 of Year 1, T1 sells the T2 stock to P and recognizes gain. On January 2 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Under paragraph (b)(1) of this section, paragraph (d) of this section applies to the T2 stock. Under paragraph (h)(3) of this section, paragraph (d)(2)(iii) of this section does not apply to the T2 stock. Consequently, paragraph (d)(1) of this section applies to the T2 stock. However, after applying paragraph (d)(1) of this section, P's basis in the T2 stock is increased by the amount of T1's gain on the sale of the T2 stock that is treated as a dividend under section 1248. Because P has a carryover basis in the T2 stock, the T2 stock is not considered purchased within the meaning of section 338(h)(3) and no section 338 election may be made for T2.

Example 2. Stock of target affiliate CFC; inclusion under subpart F. (a) The S group files a consolidated return; however, T2 is a controlled foreign corporation. On December 1 of Year 1, T2 sells an asset to P and recognizes subpart F income that results in an inclusion in T1's gross income under section 951(a)(1)(A). On January 2 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Because gain from the disposition of the asset results in an inclusion under section 951(a)(1)(A), the gain is reflected in the basis of the T stock as of T's acquisition date. See paragraph (h)(2)(i) of this section. Consequently, under paragraph (b)(1) of this section, paragraph (d)(1) of this section applies to the asset. In addition, under paragraph (h)(2)(ii) of this section, T1's basis in the T2 stock is not increased under section 961(a) by the amount of the inclusion that is attributable to the sale of the asset.

(c) If, in addition to making a qualified stock purchase of T, P acquires the T2 stock from T1 on January 1 of Year 2, the results are the same for the asset sold by T2. In addition, under paragraph (h)(2)(ii) of this section, T1's basis in the T2 stock is not increased by the amount of the inclusion that is attributable to the gain on the sale of the asset. Further, under paragraph (h)(3) of this section, paragraph (d)(1) of this section applies to the T2 stock. However, after applying paragraph (d)(1) of this section, P's basis in the T2 stock is increased by the amount of T1's gain on the sale of the T2 stock that is treated as a dividend under section 1248. Finally, because P has a carryover basis in the T2 stock, the T2 stock is not considered purchased within the meaning of section 338(h)(3) and no section 338 election may be made for T2.

(d) If P makes a qualified stock purchase of T2 from T1, rather than of T from S, and T1's gain on the sale of T2 is treated as a dividend under section 1248, under paragraph (h)(1) of this section, paragraphs (h)(2) and (3) of this section do not apply because there is no target that is a domestic corporation. Consequently, the carryover basis rules of paragraph do not apply to the asset sold by T2 or the T2 stock.

Example 3. Gain reflected by reason of section 1248 dividend; gain from non-subpart F asset.

(a) The S group files a consolidated return; however, T2 is a controlled foreign corporation. In Years 1 through 4, T2 does not pay any dividends to T1 and no amount is included in T1's income under section 951(a)(1)(B). On December 1 of Year 4, T2 sells an asset with a basis of \$400,000 to P for \$900,000. T2's gain of \$500,000 is not subpart F income. On December 15 of Year 4, T1 sells T2, in which it has a basis of \$600,000, to P for \$1,600,000. Under section 1248, \$800,000 of T1's gain of \$1,000,000 is treated as a dividend. However, in the absence of the sale of the

asset by T2 to P, only \$300,000 would have been treated as a dividend under section 1248. On December 30 of Year 4, P makes a qualified stock purchase of T1 from T. No section 338 election is made for T1.

(b) Under paragraph (h)(4) of this section, paragraph (g)(2) of this section applies by reference to the amount treated as a dividend under section 1248 on the disposition of the T2 stock. Because the amount treated as a dividend is taken into account in determining T's basis in the T1 stock under § 1.1502-32, the sale of the T2 stock and the deemed dividend have the effect of a transaction described in paragraph (g)(1) of this section. Consequently, paragraph (d)(1) of this section applies to the asset sold by T2 to P and P's basis in the asset is \$400,000 as of December 1 of Year 4.

(c) Under paragraph (h)(3) of this section, paragraph (d)(1) of this section applies to the T2 stock and P's basis in the T2 stock is \$600,000 as of December 15 of Year 4. Under paragraphs (h)(3) and (4)(ii) of this section, however, P's basis in the T2 stock is increased by \$300,000 (the amount of T1's gain treated as a dividend under section 1248 (\$800,000), other than the amount treated as a dividend solely as a result of the sale of the asset by T2 to P (\$500,000)) to \$900,000.

(i) [Reserved]

(j) *Anti-avoidance rules.* For purposes of this section—

(1) *Extension of consistency period.* The target consistency period is extended to include any continuous period that ends on, or begins on, any day of the consistency period during which a purchasing corporation, or any person related, within the meaning of section 267(b) or 707(b)(1), to a purchasing corporation, has an arrangement—

(i) To purchase stock of target; or

(ii) To own an asset to which the carryover basis rules of this section apply, taking into account the extension.

(2) *Qualified stock purchase and 12-month acquisition period.* The 12-month acquisition period is extended if, pursuant to an arrangement, a corporation acquires by purchase stock of another corporation satisfying the requirements of section 1504(a)(2) over a period of more than 12 months.

(3) *Acquisitions by conduits—(i) Asset ownership—(A) General rule.* A corporation is treated as owning any portion of an asset attributed to the corporation from a conduit under section 318(a) (treating any asset as stock for this purpose), for purposes of—

(I) The asset ownership requirements of this section; and

(2) Determining whether a controlled foreign corporation is a target affiliate for purposes of paragraph (h) of this section.

(B) *Application of carryover basis rule.* If the basis rules of this section apply to the asset, the basis rules of this section apply to the entire asset (not just the portion for which ownership is attributed).

(ii) *Stock acquisitions—(A) Purchase by conduit.* A corporation is treated as purchasing stock of another corporation attributed to the corporation from a conduit under section 318(a) on the day the stock is purchased by the conduit. The corporation is not treated as purchasing the stock, however, if the conduit purchased the stock more than two years before the date the stock is first attributed to the corporation.

(B) *Purchase of conduit by corporation.* If a corporation purchases an interest in a conduit (treating the interest as stock for this purpose), the corporation is treated as purchasing on that date any stock owned by a conduit on that date and attributed to the corporation under section 318(a) with respect to the interest in the conduit that was purchased.

(C) *Purchase of conduit by conduit.* If a conduit (the *first* conduit) purchases an interest in a second conduit (treating the interest as stock for this purpose), the first conduit is treated as purchasing on that date any stock owned by a conduit on that date and attributed to the first conduit under section 318(a) with respect to the interest in the second conduit that was purchased.

(4) *Conduit.* A person (other than a corporation) is a conduit as to a corporation if—

(i) The corporation would be treated under section 318(a)(2)(A) and (B) (attribution from partnerships, estates, and trusts) as owning any stock owned by the person; and

(ii) The corporation, together with its affiliates, would be treated as owning an aggregate of at least 50 percent of the stock owned by the person.

(5) *Existence of arrangement.* The existence of an arrangement is determined under all the facts and circumstances. For an arrangement to exist, there need not be an enforceable, written, or unconditional agreement,

and all the parties to the transaction need not have participated in each step of the transaction. One factor indicating the existence of an arrangement is the participation of a related party. For this purpose, persons are related if they are related within the meaning of section 267(b) or 707(b)(1).

(6) *Predecessor and successor—(i) Persons.* A reference to a person (including target, target affiliate, and purchasing corporation) includes, as the context may require, a reference to a predecessor or successor. For this purpose, a predecessor is a transferor or distributor of assets to a person (the successor) in a transaction—

(A) To which section 381(a) applies; or

(B) In which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the transferor or distributor.

(ii) *Assets.* A reference to an asset (the first asset) includes, as the context may require, a reference to any asset the basis of which is determined, directly or indirectly, in whole or in part, by reference to the first asset.

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

Example 1. Asset owned by conduit treated as owned by purchaser of target stock. (a) P owns a 60-percent interest in Y. On March 1 of Year 1, T sells an asset to Y and recognizes gain. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Under paragraph (j)(4) of this section, Y is a conduit with respect to P. Consequently, under paragraph (j)(3)(i)(A) of this section, P is treated as owning 60% of the asset on March 1 of Year 1 and January 1 of Year 2. Because P is treated as owning part or all of the asset both immediately after the asset disposition and on T's acquisition date, paragraph (b) of this section applies to the asset. Consequently, paragraph (d)(1) of this section applies to the asset and Y's basis in the asset is T's adjusted basis in the asset immediately before the sale to Y.

Example 2. Corporation whose stock is owned by conduit treated as affiliate. (a) P owns an 80-percent interest in Y. Y owns all of the stock of Z. On March 1 of Year 1, T sells an asset to Z and recognizes gain. On January 1 of Year 2, P makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) Under paragraph (j)(4) of this section, Y is a conduit with respect to P. Consequently,

under paragraph (j)(3)(i)(A) of this section, P is treated as owning 80% of the Z stock and Z is therefore treated as an affiliate of P for purposes of applying the asset ownership requirements of paragraph (b)(1)(iii) of this section. Because Z, an affiliate of P, owns the asset both immediately after the asset disposition and on T's acquisition date, paragraph (b) of this section applies to the asset, and the asset's basis is determined under paragraph (d) of this section.

(c) If, instead of owning an 80-percent interest in Y, P owned a 79-percent interest in Y, Z would not be treated as an affiliate of P and paragraph (b) of this section would not apply to the asset.

Example 3. Qualified stock purchase by reason of stock purchase by conduit. (a) P owns a 90-percent interest in Y. Y owns a 60-percent interest in Y1. On February 1 of Year 2, T sells an asset to P and recognizes gain. On January 1 of Year 3, P purchases 70% of the T stock from S and Y1 purchases the remaining 30% of the T stock from S.

(b) Under paragraph (j)(3)(ii)(A) of this section, P is treated as purchasing on January 1 of Year 3, the 16.2% of the T stock that is attributed to P from Y and Y1 under section 318(a). Thus, for purposes of this section, P is treated as making a qualified stock purchase of T on January 1 of Year 3, paragraph (b) of this section applies to the asset, and the asset's basis is determined under paragraph (d) of this section. However, because P is not treated as having made a qualified stock purchase of T for purposes of making an election under section 338, no election can be made for T.

(c) If Y1 purchases 20% of the T stock from S on December 1 of Year 1, rather than 30% on January 1 of Year 3, P would be treated as purchasing 10.8% of the T stock on December 1 of Year 1. Thus, if paragraph (j)(2) of this section (relating to extension of the 12-month acquisition period) does not apply, P would not be treated as making a qualified stock purchase of T, because P is not treated as purchasing T stock satisfying the requirements of section 1504(a)(2) within a 12-month period.

Example 4. Successor asset. (a) On February 1 of Year 1, T sells stock of X to P1 and recognizes gain. On December 1 of Year 1, P1 exchanges its X stock for stock in new X in a reorganization qualifying under section 368(a)(1)(F). On January 1 of Year 2, P1 makes a qualified stock purchase of T from S. No section 338 election is made for T.

(b) The asset ownership requirements of paragraph (b)(1)(iii) of this section are satisfied because, under paragraph (j)(6)(ii) of this section, P1 is treated as owning the X stock on T's acquisition date. P1 is treated as owning the X stock on that date because P1 owns the new X stock and P1's basis in the new X stock is determined by reference to P1's basis in the X stock. Consequently, under

paragraph (d)(1) of this section, P1's basis in the X stock on February 1 of Year 1 is T's adjusted basis in the X stock immediately before the sale to P1.

[T.D. 8515, 59 FR 2972, Jan. 20, 1994, as amended by T.D. 8597, 60 FR 36679, July 18, 1995; T.D. 8710, 62 FR 3459, Jan. 23, 1997. Redesignated by T.D. 8858, 65 FR 1246, Jan. 7, 2000, as amended by T.D. 8940, 66 FR 9929, Feb. 13, 2001; 66 FR 17466, Mar. 30, 2001]

§ 1.338-9 International aspects of section 338.

(a) *Scope.* This section provides guidance regarding international aspects of section 338. As provided in § 1.338-2(c)(18), a foreign corporation, a DISC, or a corporation for which a section 936 election has been made is considered a target affiliate for all purposes of section 338. In addition, stock described in section 338(h)(6)(B)(ii) held by a target affiliate is not excluded from the operation of section 338.

(b) *Application of section 338 to foreign targets—(1) In general.* For purposes of subtitle A, the deemed sale tax consequences, as defined in § 1.338-2(c)(7), of a foreign target for which a section 338 election is made (FT), and the corresponding earnings and profits, are taken into account in determining the taxation of FT and FT's direct and indirect shareholders. See, however, section 338(h)(16). For example, the income and earnings and profits of FT are determined, for purposes of sections 551, 951, 1248, and 1293, by taking into account the deemed sale tax sentence consequences.

(2) *Ownership of FT stock on the acquisition date.* A person who transfers FT stock to the purchasing corporation on FT's acquisition date is considered to own the transferred stock at the close of FT's acquisition date. See, e.g., § 1.951-1(f) (relating to determination of holding period for purposes of sections 951 through 964). If on the acquisition date the purchasing corporation owns a block of FT stock that was acquired before FT's acquisition date, the purchasing corporation is considered to own such block of stock at the close of the acquisition date.

(3) *Carryover FT stock—(i) Definition.* FT stock is carryover FT stock if—

(A) FT was a controlled foreign corporation within the meaning of section 957 (taking into account section 953(c))