

(ii) Since A received a distribution and realized a gain attributable to the building constructed by the corporation, since, at the time of such distribution, the corporation has not realized a substantial part of the taxable income to be derived from such building, and since the construction of the building was a substantial activity of the corporation, the W Corporation is considered a collapsible corporation under paragraph (b) of § 1.341-5. The provisions of section 341(d) do not prohibit the application of section 341(a). Therefore, the distribution, if and to the extent that it may be considered long-term capital gain rather than ordinary income without regard to section 341, will be considered ordinary income under section 341(a).

(iii) In the event of the existence of additional facts and circumstances in the above case, the corporation, notwithstanding the above facts, might not be considered a collapsible corporation. See § 1.342-2 and paragraph (a) of § 1.341-5.

*Example (2).* (i) On January 2, 1954, B formed X Corporation and became its sole shareholder. In August 1954, the corporation completed construction of an office building. It immediately sold this building at a gain of \$50,000, included this entire gain in its return for 1954, and distributed this entire gain (less taxes) to B. In June 1955, the corporation completed construction of a second office building. In August 1955, B sold the entire stock of X Corporation at a gain of \$12,000, which gain is attributable to the second building.

(ii) X Corporation is a collapsible corporation under section 341(b) for the following reasons: The gain realized through the sale of the stock of X Corporation was attributable to the second office building; the construction of that building was a substantial activity of X Corporation during the time of construction and, at the time of sale, the corporation had not realized a substantial part of the taxable income to be derived from such building. Since the provisions of section 341(d) do not prohibit the application of section 341(a) to B, the gain of \$12,000 to B is, accordingly, considered ordinary income.

*Example (3).* The facts are the same as in *Example (2)*, except that the following facts are shown: B was the president of the X Corporation and active in the conduct of its business. The second building was constructed as the first step in a project of the X Corporation for the development for rental purposes of a large suburban center involving the construction of several buildings by the corporation. The sale of the stock by B was caused by his retiring from all business activity as a result of illness arising after the second building was constructed. Under these additional facts, the corporation is not considered a collapsible corporation. See § 1.341-2 and paragraph (a) of § 1.341-5.

*Example (4).* (i) On January 2, 1948, C formed the Y Corporation and became the sole shareholder thereof. The Y Corporation has been engaged solely in the business of producing motion pictures and licensing their exhibition. On January 2, 1955, C sold all of the stock of the Y Corporation at a gain. The Y Corporation has produced one motion picture each year since its organization and before January 2, 1955, it has realized a substantial part of the taxable income to be derived from each of its motion pictures except the last one made in 1954. This last motion picture was completed September 1, 1954. As of January 2, 1955, no license had been made for its exhibition. The fair market value on January 2, 1955, of this last motion picture exceeds the cost of its production by \$50,000. A material part of the production of this last picture was completed on January 1, 1954, and between that date and January 2, 1955, the corporation had realized taxable income of \$500,000 from other motion pictures produced by it. The corporation has consistently distributed to its shareholder its taxable income when received (after adjustment for taxes).

(ii) Although the corporation is within paragraph (b) of this section with respect to the production of property, the amount of the unrealized income from such property (\$50,000) is not substantial in relation to the amount of the income realized, after the completion of a material part of the production of such property and prior to sale of the stock, from such property and other property produced by the corporation (\$500,000). Accordingly, the Y Corporation is within paragraph (c)(2) of this section, and is not considered a collapsible corporation.

*Example (5).* The facts are the same as in *Example (4)* except that C sold all of his stock to D on February 1, 1954. On January 2, 1955, D sold all of the Y Corporation stock at a gain, the gain being attributable to the picture completed September 1, 1954, and not released by the corporation for exhibition. In view of the change of control of the corporation, the provisions of paragraph (c)(2) of this section are not significant at the time of the sale by D, and the Y Corporation would be considered a collapsible corporation on January 2, 1955. See § 1.341-2 and paragraph (a) of § 1.341-5.

#### § 1.341-6 Exceptions to application of section.

(a) *In general*—(1) *Transactions excepted.* Section 341(e) excepts 4 types of transactions from the application of the collapsible corporation provisions. These exceptions, where applicable, eliminate the necessity of determining whether a corporation is a collapsible

corporation within the meaning of section 341(b) or whether any of the limitations of section 341(d) are applicable. Under section 341(e)(1) and (2), there are 2 exceptions which are designed to allow the shareholders of a corporation either to sell or exchange their stock or to receive distributions in certain complete liquidations without having any gain considered under section 341(a)(1) or (2) as gain from the sale or exchange of property which is not a capital asset. Under section 341(e)(3), a third exception is designed to permit the shareholders of a corporation to make use of section 333, relating to elections as to recognition of gain in certain complete liquidations occurring within one calendar month. Under section 341(e)(4), the fourth exception permits a corporation to make use of section 337, relating to nonrecognition of gain or loss on sales or exchanges of property by a corporation following the adoption of a plan of complete liquidation. Section 341(e) does not apply to distributions in partial liquidation or in redemption of stock (other than any such distribution pursuant to a plan of complete liquidation), or to distributions described in section 301(c)(3)(A).

(2) *Effective date.* The exceptions in section 341(e)(1), (2), and (3) apply only with respect to taxable years of shareholders beginning after December 31, 1957, and only with respect to sales or exchanges of stock and distributions of property occurring after September 2, 1958. The exception in section 341(e)(4) applies only with respect to taxable years of corporations beginning after December 31, 1957, and only if all sales or exchanges of property, and all liquidating distributions, made by the corporation under the plan of complete liquidation occur after September 2, 1958.

(3) *Definition of constructive shareholder and attribution rules.* (i) For purposes of this section, the term *constructive shareholder* means a person who does not actually own any stock but who is considered to own stock by reason of the application of subdivision (ii) of this subparagraph.

(ii) For purposes of this section (other than paragraph (k), relating to definition of related person) a person shall be considered to own the stock he

actually owns plus any stock which is attributed to him by reason of applying the rules prescribed in paragraph (b)(2) and (3) of §1.341-4. See section 341(e)(10).

(iii) As an example of this subparagraph, if a husband does not actually own any stock in a corporation but his wife is the actual owner of 5 shares in the corporation, then the husband is a constructive shareholder who is considered to own 5 shares in the corporation.

(4) *General corporate test.* No exception provided in section 341(e) applies unless a general corporate test and, where applicable, a specific shareholder test are satisfied. Under the general corporate test no taxpayer may utilize the provisions of section 341(e) unless the net increase in value (called "net unrealized appreciation") in the corporation's "subsection (e) assets" does not exceed 15 percent of the corporation's net worth. Subsection (e) assets are, in general, those assets of the corporation which, if sold at a gain by the corporation or by any actual or constructive shareholder who is considered to own more than 20 percent in value of the outstanding stock, would result in the realization of ordinary income. See paragraph (b) of this section for the definition of subsection (e) assets, and paragraph (h) of this section for definition of net unrealized appreciation. This subparagraph may be illustrated by the following examples:

*Example (1).* X Corporation is in the business of selling whiskey. The net unrealized appreciation in its whiskey is \$20,000 and the net worth of the corporation is \$100,000. Since the corporation's whiskey is a subsection (e) asset and since the net unrealized appreciation in subsection (e) assets (\$20,000) exceeds 15 percent of net worth (\$15,000), the general corporate test is not satisfied and section 341(e) is inapplicable to the corporation or its shareholders.

*Example (2).* Assume the same facts as in *Example (1)* except that X Corporation is not in the business of selling whiskey. Assume further that an actual shareholder who owns more than 20 percent in value of the outstanding X stock (or a person who is considered to own such actual shareholder's stock, such as his spouse) is in the business of selling whiskey. The result is the same as in *Example (1)*.

(5) *Specific shareholder test.* Even if the general corporate test is met, a shareholder selling or exchanging his

stock or receiving a distribution with respect to his stock (referred to as a “specific shareholder”) who is considered to own more than 5 percent in value of the outstanding stock of the corporation may not utilize the benefits of the exception in section 341(e)(1) (or the exception in section 341(e)(2)) unless he satisfies the applicable specific shareholder test. In general, the specific shareholder test is satisfied if the net unrealized appreciation in subsection (e) assets of the corporation, plus the net unrealized appreciation in certain other assets of the corporation which would be subsection (e) assets in respect of the specific shareholder under the following circumstances, does not exceed 15 percent of the corporation’s net worth:

(i) If the specific shareholder is considered to own more than 5 percent but not more than 20 percent in value of the outstanding stock, he must take into account the net unrealized appreciation in assets of the corporation which would be subsection (e) assets if he was considered to own more than 20 percent in value of the outstanding stock (see paragraph (c)(3)(i) of this section);

(ii) In addition, if the specific shareholder is considered to own more than 20 percent in value of the outstanding stock, he must also take into account the net unrealized appreciation in assets of the corporation which would be subsection (e) assets under section 341(e)(5)(A)(i) and (iii) if his ownership within the preceding 3 years of stock in certain “related” corporations were taken into account in the manner prescribed in paragraphs (c)(3)(ii) and (d) of this section.

(b) *Subsection (e) asset defined*—(1) *General.* The benefits of section 341(e) are unavailable if the net unrealized appreciation (as defined in paragraph (h) of this section) in certain assets of the corporation (hereinafter called “subsection (e) assets”) exceeds 15 percent of the corporation’s net worth. In determining whether property is a subsection (e) asset, it is immaterial whether the property is described in section 341(b), and there shall not be taken into account sections 617(d) (relating to gain from dispositions of certain mining property), 1245 and 1250 (re-

lating to gain from dispositions of certain depreciable property), 1251 (relating to gain from disposition of farm property where farm losses offset non-farm income), 1252 (relating to gain from disposition of farm land), and 1254 (relating to gain from disposition of natural resource recapture property).

(2) *Categories of subsection (e) assets.* The term *subsection (e) assets*, as defined in section 341(e)(5)(A)(i), (ii), (iii), and (iv), means the following categories of property held by a corporation:

(i) The first category is property (except property described in section 1231(b), without regard to any holding period prescribed therein) which in the hands of the corporation is, or in the hands of any actual or constructive shareholder who is considered to own more than 20 percent in value of the outstanding stock of the corporation would be, property gain from the sale or exchange of which would under any provision of chapter 1 of the Code (other than section 617(d), 1245, 1250, 1251, 1252, or 1254) be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b). For example, included in this category is property held by a corporation which in its hands is stock in trade, inventory, or property held by it primarily for sale to customers in the ordinary course of its trade or business regardless of whether such property is appreciated or depreciated in value. Also included in this category is property held by a corporation which is a capital asset in its hands but which, in the hands of any actual or constructive shareholder who is considered to own more than 20 percent in value of the outstanding stock, would be stock in trade, inventory, or property held by such actual or constructive shareholder primarily for sale to customers in the ordinary course of his trade or business. For additional rules relating to whether property is a subsection (e) asset under this subdivision, see subparagraphs (3), (4), and (5) of this paragraph.

(ii) The second category of subsection (e) assets is property which in the hands of the corporation is property

described in section 1231(b) (without regard to any holding period prescribed therein), but only if there is net unrealized depreciation (within the meaning of paragraph (h)(2) of this section) on all such property. This subdivision may be illustrated by the following example:

*Example.* X Corporation owns only the following section 1231(b) property (determined without regard to holding period).

Oil leaseholds	Adjusted basis	Fair market value	Unrealized appreciation (depreciation)
No. 1 .....	\$16,000	\$10,000	(\$6,000)
No. 2 .....	8,000	5,000	(3,000)
No. 3 .....	5,000	5,000	0
No. 4 .....	3,000	5,000	2,000
Totals .....	32,000	25,000	(7,000)

Since with respect to such property the unrealized depreciation in property on which there is unrealized depreciation (\$9,000) exceeds the unrealized appreciation in property on which there is unrealized appreciation (\$2,000), all such property is included in subsection (e) assets under clause (ii) of section 341(e)(5)(A).

(iii) The third category of subsection (e) assets exists only if there is net unrealized appreciation on all property which in the hands of the corporation is property described in section 1231(b) (without regard to any holding period prescribed therein). In such case, any such section 1231(b) property (whether appreciated or depreciated) is a subsection (e) asset of the third category if, in the hands of an actual or constructive shareholder who is considered to own more than 20 percent in value of the outstanding stock of the corporation, such property would be property gain from the sale or exchange of which would under any provision of chapter 1 of the Code (other than section 617(d), 1245, 1250, 1251, 1252, or 1254) be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b). Included in this category, for example, is property which in the hands of the corporation is property described in section 1231(b) (without regard to any holding period prescribed therein), but which in the hands of an actual or constructive more-than-20-

percent shareholder would be property used in his trade or business held for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), stock in trade, inventory, or property held by such shareholder primarily for sale to customers in the ordinary course of his trade or business. For additional rules relating to whether property is a subsection (e) asset under this subdivision, see subparagraphs (3) and (4) of this paragraph. This subdivision may be further illustrated by the following example:

*Example.* Assume the same facts as stated in the example under subdivision (ii) of this subparagraph, except that in addition to the oil leaseholds the corporation also owns land which has a fair market value of \$30,000 and an adjusted basis of \$20,000 and which in the hands of the corporation is property described in section 1231(b) (without regard to any holding period prescribed therein). Assume further that A is a constructive shareholder of the corporation who is considered to own 25 percent in value of its outstanding stock and that A holds land primarily for sale to customers in the ordinary course of his trade or business, and that no actual or constructive shareholder who is considered to own more than 20 percent in value of the stock of corporation X so holds oil leases. Since with respect to the corporation's section 1231(b) property the unrealized appreciation in such property on which there is unrealized appreciation (\$12,000) exceeds the unrealized depreciation in such property on which there is unrealized depreciation (\$9,000), then clause (iii), and not clause (ii), of section 341(e)(5)(A) is applicable. Therefore, no oil lease of the corporation is a subsection (e) asset. However, since in the hands of A, a more-than-20-percent constructive shareholder, the land would be property gain from the sale or exchange of which would be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b), the land is a subsection (e) asset. Consequently, the net unrealized appreciation on subsection (e) assets of the corporation is \$10,000 since the net unrealized depreciation on the oil leases is not taken into account.

(iv) The fourth category of subsection (e) assets is property (unless included under subdivision (i), (ii), or (iii) of this subparagraph) which consists of a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, or any interest in any such property, if the property was created in whole or in

part by the personal efforts of, or, in the case of a letter, memorandum, or property similar to a letter or memorandum, was prepared, or produced in whole or in part, for, any individual actual or constructive shareholder who is considered to own more than 5 percent in value of the outstanding stock of the corporation. For items included in the phrase "similar property" see paragraph (c) of § 1.1221-1. In general, property is created in whole or in part by the personal efforts of an individual if such individual performs literary, theatrical, musical, artistic, or other creative or productive work which affirmatively contributes to the creation of the property, or if such individual directs and guides others in the performance of such work. An individual, such as a corporate executive, who merely has administrative control of writers, actors, artists, or personnel and who does not substantially engage in the direction and guidance of such persons in the performance of their work, does not create property by his personal efforts. However, a letter or memorandum, or property similar to a letter or memorandum, which is prepared by personnel who are under the administrative control of an individual, such as a corporate executive, shall be deemed to have been prepared or produced for him whether or not such letter, memorandum, or similar property is reviewed by him. In addition, a letter, memorandum, or property similar to a letter or memorandum, addressed to an individual shall be considered as prepared or produced for him. In the case of a letter, memorandum, or property similar to a letter or memorandum, this subdivision applies only to sales and other dispositions occurring after July 25, 1969.

(3) *Manner of determination.* For purposes of determining whether property is a subsection (e) asset under subparagraph (2)(i) or (iii) of this paragraph, the determination as to whether property of a corporation in the hands of the corporation is, or in the hands of an actual or constructive shareholder of the corporation would be, property gain from the sale or exchange of which would under any provision of chapter 1 of the Code (other than section 617(d), 1245, 1250, 1251, 1252, or 1254)

be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b) shall be made as if all property of the corporation had been sold or exchanged to one person in one transaction. For example, if a corporation whose sole asset is an interest in a gas well has entered into a long-term contract for the future delivery of gas from the well, the ownership of which will pass to the buyer only after extraction or severance from the well, the determination as to whether such contract is a subsection (e) asset shall be made as if the contract were sold or exchanged to one person in one transaction together with such corporation's interest in the well. An assumed sale under this subparagraph does not affect the character of property which is held for sale to customers in the ordinary course of a person's trade or business or the character of a transaction which would be an anticipatory assignment of income. Thus, for example, if a corporation holds subdivided lots for sale to customers in the ordinary course of its trade or business, this subparagraph shall not be applied to change the manner in which the lots are held.

(4) *Shareholder reference test.* For purposes of subparagraph (2)(i) and (iii) of this paragraph, in determining whether any property of the corporation would, in the hands of a particular actual or constructive shareholder, be property gain from the sale or exchange of which would be considered in whole or in part as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b), all the facts and circumstances of the direct and indirect activities of the shareholder must be taken into account. If the particular shareholder holds property primarily for sale to customers in the ordinary course of his trade or business and if similar property is held by the corporation, then in the hands of the shareholder such corporate property will be treated as held primarily for sale to customers in the ordinary course of his trade or business. Moreover, even if the shareholder does not presently so hold property which is similar to property

held by the corporation, it may be determined under the particular facts and circumstances (taking into account an assumed sale of such corporate property by the shareholder, all his other direct and indirect activities, and, if applicable, the fact that he previously so held similar property) that he would hold the corporate property primarily for sale to customers in the ordinary course of his trade or business. See also paragraph (d) of this section, pertaining to effect of stock in related corporations.

(5) *Special rule for stock in shareholder's investment account.* If—

(i) A dealer in stock or securities is an actual shareholder (considered to own more than 20 percent of the outstanding stock of a corporation) and holds such stock which he actually owns in his investment account pursuant to section 1236(a), or

(ii) A dealer in stock or securities is a constructive shareholder who is considered to own more than 20 percent of the outstanding stock of a corporation, then stock or securities held by such corporation shall not be considered subsection (e) assets under subparagraph (2)(i) of this paragraph solely because such actual or constructive shareholder is a dealer in stock or securities. However, stock held by such corporation shall be considered as a subsection (e) asset if, in the hands of any more-than-20-percent actual or constructive shareholder of the corporation, the gain (or any portion thereof) upon a sale of such stock would (if it were held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), constitute, by reason of the application of section 341, gain from the sale of property which is not a capital asset. This subparagraph may be illustrated by the following example:

*Example.* Jones, a more-than-20-percent actual shareholder in corporation X holds his X stock in an investment account in the manner prescribed in section 1236(a). Jones is a dealer in stock and securities and holds land for sale to customers in the ordinary course of his trade or business. No other actual or constructive shareholder is a dealer in stock and securities or so holds land. X holds all of the stock in corporation Y, a collapsible corporation within the meaning of section

341(b). Y's sole asset is land on which unrealized appreciation exceeds 15 percent of Y's net worth. Since Jones holds his X stock in an investment account pursuant to section 1236(a), the Y stock cannot be considered a subsection (e) asset of the X Corporation merely because Jones is a dealer in stock and securities. Nevertheless, the Y stock is a subsection (e) asset of the X Corporation because if Jones were treated as having sold the Y stock, his gain would be treated as gain from the sale of property which is not a capital asset by reason of the application of section 341. If, however, the net unrealized appreciation on Y's land did not exceed 15 percent of Y's net worth the Y stock would not be a subsection (e) asset since section 341(e)(1) would except such sale from the application of section 341.

(c) *Sales or exchanges of stock—(1) General.* Section 341(e)(1) provides that, if certain requirements are satisfied, the provisions of section 341(a)(1) shall in no event apply to certain sales or exchanges of stock by a shareholder. See subparagraph (5) of this paragraph for sales or exchanges of stock which do not qualify under section 341(e)(1). Section 341(e)(1) applies to a sale or exchange of stock by a shareholder only if, at the time of such sale or exchange, the general corporate test and, if applicable, the specific shareholder test are satisfied.

(2) *General corporate test.* The general corporate test is satisfied if the net unrealized appreciation in subsection (e) assets of the corporation does not exceed an amount equal to 15 percent of the net worth of the corporation. See paragraphs (h), (b), and (j) of this section for the definition of "net unrealized appreciation," "subsection (e) assets," and "net worth."

(3) *Specific shareholder test.* The specific shareholder test (if applicable) is satisfied if the following conditions are met:

(i) If the shareholder selling or exchanging the stock is considered to own more than 5 percent but not more than 20 percent in value of the outstanding stock, the sum of the net unrealized appreciation in the following assets of the corporation must not exceed an amount equal to 15 percent of the net worth of the corporation:

(a) The subsection (e) assets of the corporation, plus

(b) The other assets of the corporation which would be subsection (e) assets under section 341(e)(5)(A)(i) and (iii) if such shareholder were considered to own more than 20 percent in value of the outstanding stock.

(ii) If the shareholder selling or exchanging the stock is considered to own more than 20 percent in value of the outstanding stock, the sum of the net unrealized appreciation in the following assets of the corporation must not exceed an amount equal to 15 percent of the net worth of the corporation:

(a) The subsection (e) assets of the corporation, plus

(b) The other assets of the corporation which would be subsection (e) assets under section 341(e)(5)(A)(i) and (iii) if the shareholder's ownership of stock in certain related corporations were taken into account in the manner prescribed in paragraph (d) of this section.

(4) *Example.* Subparagraph (3) of this paragraph may be illustrated by the following example:

*Example.* Assume an individual, A, and his grandfather, G, each actually owns 3 percent in value of the stock of corporation X, a corporation holding apartment houses used in its trade or business on which net unrealized appreciation exceeds 15 percent of X's net worth. A, but not G, holds apartment houses primarily for sale to customers in the ordinary course of trade or business. Assume that X satisfies the general corporate test. A and G desire to sell their stock and to take advantage of section 341(e)(1). Since a grandfather and grandson are each considered to own the other's stock under paragraph (a)(3)(ii) of this section, A and G are each considered to own 6 percent in value of corporation X's outstanding stock. Therefore, A cannot avail himself of section 341(e)(1) since he does not satisfy the specific shareholder test prescribed in subparagraph (3)(i) of this paragraph. G, however, who is considered to own 6 percent in value of the stock, does not hold apartment houses for sale to customers in the ordinary course of trade or business. Therefore, G satisfies the specific shareholder test and may benefit from section 341(e)(1).

(5) *Nonqualifying sales or exchanges.* Section 341(e)(1) does not apply to any sale or exchange of stock to the issuing corporation. Thus, stock redemptions (including distributions in complete or partial liquidation) cannot qualify

under section 341(e)(1). In addition, section 341(e)(1) does not apply in any case where a shareholder who is considered to own more than 20 percent in value of the outstanding stock sells or exchanges stock to any person related (within the meaning of paragraph (k) of this section) to such shareholder. A sale or exchange of stock of the corporation by a shareholder to which section 341(e)(1) does not apply because of this subparagraph shall have no effect on the application of this section to other sales or exchanges of stock of the corporation.

(6) *Example.* For an illustration of the application of this paragraph, see *Example (2)* in paragraph (o) of this section.

(d) *Stock in related corporations—(1) General.* This paragraph provides rules for applying the specific shareholder test prescribed in paragraph (c)(3)(ii) of this section for purposes of determining whether section 341(e)(1) (relating to sales or exchanges of stock of a corporation) or section 341(e)(2) (relating to distributions in complete liquidation of a corporation) applies to an actual shareholder who is considered as owning more than 20 percent in value of the corporation's outstanding stock. In general, if such a more-than-20-percent shareholder of such corporation (referred to as a "first" corporation) owns, or at any time during the preceding 3 years has owned, more than 20 percent in value of the outstanding stock of a "related" corporation (see subparagraph (2) of this paragraph), then certain transactions in respect of the stock of the related corporation are taken into account in the manner prescribed in subparagraph (3) of this paragraph. By taking such transactions into account, such shareholder of the first corporation may be deemed to hold primarily for sale to customers in the ordinary course of trade or business property similar or related in service or use to property owned by the first corporation where his other activities, direct and indirect, are insufficient to treat him as so holding such property. See section 341(e)(1)(C) and (2)(C). The transactions in respect of stock in a related corporation are taken into account solely for the purpose of determining the extent to

which assets (other than subsection (e) assets) of the first corporation are treated as subsection (e) assets under the shareholder reference tests of section 341(e)(5)(A)(i) and (iii). For purposes of this paragraph, the term “similar or related in service or use” shall have the same meaning as such term has in section 1033 (relating to involuntary conversions), without regard to subsection (g) thereof.

(2) *Related corporation defined.* (i) A corporation (referred to as a “second” corporation) is “related” to another corporation (referred to as a “first” corporation) if the stock ownership test specified in subdivision (ii) of this subparagraph and the more-than-70-percent-asset comparison test specified in subdivision (iii) of this subparagraph are met.

(ii) The stock ownership test specified in this subdivision is met—

(a) In the case of a sale or exchange referred to in paragraph (c)(1) of this section, if the shareholder in the first corporation is considered to own on the date of such sale or exchange more than 20 percent in value of the outstanding stock of the first corporation, and if on such date (or at any time during the 3-year period preceding such date) such shareholder in the first corporation is an actual or constructive shareholder in the second corporation who was considered to own more than 20 percent in value of the outstanding stock of the second corporation, or

(b) In the case of a distribution pursuant to the adoption by the first corporation of a plan of complete liquidation referred to in paragraph (e) of this section, if the shareholder in the first corporation is considered to own on any date after the adoption of such plan more than 20 percent in value of the outstanding stock of the first corporation, and if on such date (or at any time during the 3-year period preceding such date) such shareholder in the first corporation was an actual or constructive shareholder in the second corporation who was considered to own more than 20 percent in value of the outstanding stock of the second corporation.

(iii) The more-than-70-percent-asset comparison test specified in this subdivision is met if more than 70 percent

in value of the assets of the second corporation (at any of the applicable times determined under subdivision (ii) of this subparagraph during which the shareholder of the first corporation is or was considered to own more than 20 percent in value of the outstanding stock of the second corporation) are, or were, assets similar or related in service or use to assets comprising more than 70 percent in value of the assets of the first corporation (at any of the times determined under subdivision (ii) of this subparagraph during which the shareholder of the first corporation is or was considered to own more than 20 percent in value of the outstanding stock of the first corporation).

(iv) This subparagraph may be illustrated by the following example:

*Example.* X is a first corporation and Y is a second corporation. On January 15, 1960, Jones purchased 21 percent in value of the outstanding stock of X, which he sold on January 1, 1961. On January 15, 1955, Jones had purchased 21 percent in value of the outstanding stock of Y which he sold on December 15, 1959. Since Jones owned 21 percent of the outstanding X stock on January 1, 1961 (the date he sold his X stock) and also owned 21 percent of the outstanding Y stock at some time during the 3-year period preceding January 1, 1961, the stock ownership test specified in subdivision (ii)(a) of this subparagraph is met. Assume that more than 70 percent in value of the assets of Y were apartment houses held for rental purposes at some time between January 1, 1958, and December 15, 1959 (the portion of the 3-year period preceding the date Jones sold his X stock during which he was a more-than-20-percent shareholder in Y) and that more than 70 percent in value of the assets of X were apartment houses held for rental purposes at some time during the period January 15, 1960, to January 1, 1961, inclusive (the portion of the 3-year period preceding the date he sold his X stock during which he was a more-than-20-percent shareholder in X). Thus, the more-than-70-percent-asset comparison test specified in subdivision (iii) of this subparagraph is met. Accordingly, corporation Y is related to corporation X within the meaning of this subparagraph.

(3) *Manner of taking into account.* If an actual shareholder in a first corporation who is considered to own more than 20 percent of the first corporation's stock, owns or has owned stock in a related corporation, then—



(i) Any sale or exchange by such shareholder, during the applicable period specified in subparagraph (2)(ii) of this paragraph, of stock in the related corporation shall be treated as a sale or exchange by him of his proportionate share of the assets of the related corporation, if immediately before such sale or exchange he was an actual shareholder of the related corporation who was considered to own more than 20 percent in value of the outstanding stock of the related corporation. A shareholder's proportionate share of the assets of a related corporation shall be that percent of each asset of the related corporation as the fair market value of the stock of the related corporation which he actually sold or exchanged bears, immediately before such sale or exchange, to the total fair market value of the outstanding stock of such related corporation; and

(ii) Any sale or exchange of property by the related corporation during the applicable period specified in subparagraph (2)(ii) of this paragraph, gain or loss on which was not recognized to the related corporation by reason of the application of section 337(a), shall be treated as a sale or exchange by him of his proportionate share of the related corporation's property sold or exchanged, if at the time of such sale or exchange he was an actual or constructive shareholder of the related corporation who was considered to own more than 20 percent in value of the outstanding stock of such related corporation. A shareholder's proportionate share of such related corporation's property sold or exchanged shall be that percent of each such property sold or exchanged as the fair market value of the stock which he was considered to own in the related corporation immediately before such sale or exchange bears to the total fair market value of the outstanding stock of such related corporation at such time.

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

*Example.* (i) A owns 25 percent in value of the outstanding stock of Z Corporation. On December 31, 1959, he sells all his stock in the corporation and desires to take advantage of section 341(e)(1). The only asset of Z Corporation is an appreciated apartment

house held for rental purposes but which is not a subsection (e) asset. However, during the preceding 3-year period A sold 25 percent in value of the outstanding stock of each of 3 related corporations. More than 70 percent in value of the assets of each related corporation consisted of an apartment house.

(ii) In determining whether the apartment house owned by Z Corporation would be a subsection (e) asset under the shareholder reference test of section 341(e)(5)(A)(iii), A is treated as having sold a one-fourth interest in each of 3 apartment houses during the preceding 3-year period and these sales must be taken into account, together with all other facts and circumstances, in determining whether the apartment house owned by Z Corporation would be, in the hands of A, property gain from the sale or exchange of which would under any provision of chapter 1 of the Code (other than section 1245 or 1250) be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b). However, A's sales of related corporation stock are not taken into account in determining whether section 341(e)(1) or (2) would be applicable to sales or exchanges of stock by (or liquidating distributions to) other shareholders of Z Corporation.

(e) *Distributions in certain liquidations pursuant to section 337—(1) In general.* Section 341(e)(2) provides that, if certain requirements are met, the provisions of section 341(a)(2) shall in no event apply to certain distributions in complete liquidation of a corporation. Section 341(e)(2) applies with respect to any distribution to a shareholder pursuant to a plan of complete liquidation if the following 3 requirements are satisfied:

(i) By reason of the application of section 341(e)(4) and paragraph (g) of this section, section 337(a) applies to sales or exchanges of property by the corporation within the 12-month period beginning on the date of the adoption of such plan. Thus, for example, section 341(e)(2) is not applicable in any case where depreciable, amortizable, or depletable property is distributed after the date of adoption of the plan or if the corporation does not sell substantially all of the properties held by it on such date within such 12-month period, since such a distribution, or the failure to make such a sale, makes section 337(a) inapplicable under section 341(e)(4).

(ii) At all times within such 12-month period the general corporate test of

paragraph (c)(2) of this section is satisfied.

(iii) In respect of the shareholder who receives the distribution—

(a) At all times within such 12-month period while such shareholder is considered to own more than 5 percent but not more than 20 percent in value of the outstanding stock of the corporation, the shareholder must satisfy the specific shareholder test of paragraph (c)(3)(i) of this section, and

(b) At all times within such 12-month period while such shareholder is considered to own more than 20 percent in value of the outstanding stock of the corporation, the shareholder must satisfy the specific shareholder test of paragraph (c)(3)(ii) of this section.

(2) *Illustration.* For an illustration of this paragraph, see *Example (4)* in paragraph (o) of this section.

(f) *Recognition of gain in certain liquidations under section 333.* Section 341(e)(3) provides that, for purposes of section 333 (relating to elections as to recognition of gain in certain complete liquidations occurring within one calendar month), a corporation is considered not to be a collapsible corporation if, at all times after the adoption of the plan of complete liquidation, the net unrealized appreciation in subsection (e) assets of the corporation does not exceed an amount equal to 15 percent of the net worth of the corporation. For purposes of the preceding sentence, the determination of subsection (e) assets shall be made in accordance with paragraph (b) of this section except that subparagraph (2)(i) and (iii) of such paragraph (b) shall apply in respect of any actual or constructive shareholder who is considered to own more than 5 percent in value of the outstanding stock (in lieu of any actual or constructive shareholder who is considered to own more than 20 percent in value of such stock). Thus, no shareholder of the corporation can qualify under paragraph (3) of section 341(e) for use of section 333 if, because of any actual or constructive shareholder who is considered to own more than 5 percent in value of the stock, this modified general corporate test is not satisfied. On the other hand, once this modified general corporate test is satisfied, all the shareholders can use section 333

(assuming that the requirements of that section are satisfied) since there is no specific shareholder test. For an illustration of this paragraph, see *Example (3)* in paragraph (o) of this section.

(g) *Gain or loss on sales or exchanges in connection with certain liquidations, pursuant to section 337—(1) General.* Section 341(e)(4) provides that solely for purposes of section 337, a corporation is considered not to be a collapsible corporation if (i) at all times within the 12-month period beginning on the date of the adoption of a plan of complete liquidation, the net unrealized appreciation in subsection (e) assets of the corporation does not exceed an amount equal to 15 percent of the net worth of the corporation; (ii) within the 12-month period beginning on the date of the adoption of such plan, the corporation sells substantially all of the properties held by it on such date; and (iii) following the adoption of such plan, no distribution is made of any property which in the hands of the corporation or in the hands of the distributee is property in respect of which a deduction for exhaustion, wear and tear, obsolescence, amortization, or depletion is allowable. Thus, if at the time of the adoption of the plan of liquidation the corporation is a collapsible corporation within the meaning of section 341(b) and if the preceding requirements are satisfied, then except as provided in subparagraph (2) of this paragraph section 337(a) will apply to such corporation but the corporation will continue to be a collapsible corporation within the meaning of section 341(b) (including for purposes of section 341(e)(2)) with the result that each shareholder must still satisfy all the tests in paragraph (e) of this section before he can utilize the benefits of section 341(e)(2).

(2) *Exception to section 337 treatment.* Section 341(e)(4) shall not apply with respect to any sale or exchange of property by the corporation to any actual or constructive shareholder who is considered to own more than 20 percent in value of the outstanding stock of the corporation or to any person related (within the meaning of paragraph (k) of this section) to such actual or constructive shareholder if such property in the hands of the corporation, or in the hands of such shareholder or such

related person, is property in respect of which a deduction for exhaustion, wear and tear, obsolescence, amortization, or depletion is allowable. Thus, gain or loss will be recognized on such sales or exchanges.

(3) *Cross references.* For effective date of section 341(e)(4) and this paragraph, see paragraph (a)(2) of this section. For an illustration of this paragraph, see *Example (4)* in paragraph (o) of this section.

(h) *Net unrealized appreciation and depreciation defined*—(1) *Net unrealized appreciation.* For purposes of this section, the term *net unrealized appreciation* means, with respect to the assets of a corporation, the amount by which—

(i) The unrealized appreciation in such assets on which there is unrealized appreciation, exceeds

(ii) The unrealized depreciation in such assets on which there is unrealized depreciation.

(2) *Net unrealized depreciation.* For purposes of paragraph (b)(2)(ii) of this section, there is net unrealized depreciation on all property of a corporation which in its hands is property described in section 1231(b) (without regard to any holding period prescribed therein) if—

(i) The unrealized depreciation in such property on which there is unrealized depreciation, exceeds

(ii) The unrealized appreciation in such property on which there is unrealized appreciation.

(3) *Unrealized appreciation or depreciation.* For purposes of this paragraph—

(i) The term *unrealized appreciation* means (except as provided in subparagraph (4) of this paragraph), with respect to any asset, the amount by which (a) the fair market value of such asset, exceeds (b) the adjusted basis for determining gain from the sale or other disposition of such asset; and

(ii) The term *unrealized depreciation* means, with respect to any asset, the amount by which (a) the adjusted basis for determining gain from the sale or other disposition of such asset, exceeds (b) the fair market value of such asset.

(4) *Special rule.* For purposes of determining whether the net unrealized appreciation in subsection (e) assets of a corporation exceeds an amount equal to 15 percent of the corporation's net

worth under the tests of section 341(e)(1), (2), (3), and (4), in the case of any asset on the sale or exchange of which only a portion of the gain would under any provision of chapter 1 of the Code (other than section 617(d), 1245, 1250, 1251, 1252, or 1254) be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b), there shall be taken into account only an amount equal to the unrealized appreciation in such asset which is equal to such portion of the gain. This subparagraph shall have no effect on whether paragraph (b)(2)(ii) or (iii) of this section applies for purposes of identifying the subsection (e) assets of the corporation.

(i) [Reserved]

(j) *Net worth defined.* For purposes of this section, the net worth of a corporation, as of any day, is the amount by which—

(1) The fair market value of all its assets at the close of such day, plus the amount of any distribution (taken into account at fair market value on the date of such distribution) in complete liquidation made by it on or before such day, exceeds

(2) All its liabilities at the close of such day.

In computing the fair market value of all the assets of a corporation at the close of such day, there shall be excluded any amount attributable to money or property received by it during the one-year period ending on such day for stock, or as a contribution to capital or as paid-in surplus, if it appears that there was not a bona fide business purpose for the transaction in respect of which such money or property was received.

(k) *Related person defined*—(1) *General.* For purposes of paragraphs (c)(5) and (g)(2) of this section, the following persons are considered to be related to a shareholder:

(i) If the shareholder is an individual—

(a) His spouse, ancestors, and lineal descendants, and

(b) Any corporation which is controlled by him.

(ii) If the shareholder is a corporation—

(a) A corporation which controls, or is controlled by, such shareholder, and

(b) If more than 50 percent in value of the outstanding stock of such shareholder is owned by any person, any corporation more than 50 percent in value of the outstanding stock of which is owned by the same person.

(2) *Control.* For purposes of this paragraph, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(3) *Constructive ownership rules.* In determining the ownership of stock for purposes of this paragraph, the constructive ownership rules of section 267(c) shall apply, except that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(l) [Reserved]

(m) *Corporations and shareholders not meeting requirements.* In determining whether the provisions of section 341 (a) through (d) apply with respect to any corporation, or such corporation with respect to any of its shareholders, does not meet the requirements of section 341(e)(1), (2), (3), or (4) shall not be taken into account, and such determination shall be made as if section 341(e) had not been enacted.

(n) *Determinations without regard to sections 617(d), 1245, 1250, 1251, 1252, and 1254.* For purposes of this section, the determination of whether gain from the sale or exchange of property would under any provision of chapter 1 of the Code be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b) shall be made without regard to the application of sections 617(d)(1) (relating to gain from dispositions of certain mining property), 1245(a) and 1250(a) (relating to gain from dispositions of certain depreciable property), 1251(c) (relating to gain from the disposition of farm property where farm losses offset nonfarm income), 1252(a) (relating to gain from disposition of farm land), and 1254(a) (relating to gain from disposition of in-

terest in natural resource recapture property).

(o) *Illustrations.* The operation of section 341(e) may be illustrated by the following examples:

*Example (1).* (i) The outstanding stock of X Corporation is actually owned, on the basis of value, 75 percent by A, 15 percent by B, and 10 percent by C. None of the stock actually owned by one is attributed to another under the constructive ownership rules of paragraph (a)(3) of this section. The corporation owns no property which, in its hands, is property gain from the sale or exchange of which would be considered (without regard to section 617(d), 1245 or 1250, 1251, or 1252) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b). The corporation owns no property described in section 1231(b) except an apartment house on which the unrealized appreciation is \$20,000 and which in the hands of A would be property held primarily for sale to customers in the ordinary course of trade or business. The corporation owns no property of the type described in clause (iv) of section 341(e)(5)(A). The net worth of the corporation is \$100,000.

(ii) Although the apartment house in the hands of the corporation is section 1231(b) property, in the hands of A, a more-than-20-percent shareholder, the apartment house would be ordinary-income type property. Therefore, the apartment house is a subsection (e) asset under clause (iii) of section 341(e)(5)(A). Accordingly, since the net unrealized appreciation in subsection (e) assets (\$20,000) exceeds 15 percent of net worth (\$15,000), the general corporate test is not satisfied and section 341(e) is unavailable to the corporation or its shareholders.

*Example (2).* (i) Assume the same facts as in *Example (1)*, except that in the hands of B, but not in the hands of A or C, the apartment house would be property held primarily for sale to customers in the ordinary course of trade or business.

(ii) Since B does not own more than 20 percent in value of the outstanding stock, the fact that the apartment house owned by the corporation would, in his hands, be property held primarily for sale to customers in the ordinary course of trade or business does not make the apartment house owned by the corporation a subsection (e) asset. Therefore, since the net unrealized appreciation in subsection (e) assets (zero) does not exceed 15 percent of net worth, the general corporate test is satisfied. C may sell his stock to anyone (other than X Corporation) and will qualify under section 341(e)(1). However, a sale by A of his stock to persons related to A within the meaning of paragraph (k) of this section will not so qualify.

(iii) B, however, since he owns more than 5 percent but not more than 20 percent in

value of the outstanding stock, must take into account not only the net unrealized appreciation in subsection (e) assets but also the net unrealized appreciation in any other assets of the corporation which would be subsection (e) assets under section 341(e)(5)(A) if he owned more than 20 percent in value of the outstanding stock. Therefore, since the apartment house owned by the corporation would be, in B's hands, property held primarily for sale to customers in the ordinary course of trade or business, and since the net unrealized appreciation in such property (\$20,000) exceeds 15 percent of net worth (\$15,000), B does not satisfy the specific shareholder test and therefore cannot avail himself of section 341(e)(1).

*Example (3).* (i) Assume the same facts as in *Example (1)*, except that in the hands of B, but not in the hands of A or C, the apartment house of the corporation would be property held primarily for sale to customers in the ordinary course of trade or business. Assume further that the shareholders of X Corporation wish to avail themselves of section 333.

(ii) For purposes of section 341(e)(3), section 341(e)(5)(A)(iii) applies in respect of any shareholder who owns more than 5 percent (instead of more than 20 percent) in value of the outstanding stock. Since in the hands of B, a more-than-5-percent shareholder, the apartment house would be held primarily for sale to customers in the ordinary course of trade or business, the corporation's apartment house is a subsection (e) asset. Therefore, since the net unrealized appreciation in subsection (e) assets (\$20,000) exceeds 15 percent of net worth (\$15,000), no shareholder of the corporation may qualify under section 341(e)(3) for use of section 333. However, if B were not a more-than-5-percent shareholder of the corporation, or if, in his hands, the apartment house would not be held primarily for sale to customers in the ordinary course of trade or business, then all shareholders of the corporation could qualify under section 341(e)(3) for use of section 333 since the apartment house would not be a subsection (e) asset.

*Example (4).* (i) Assume the same facts as in *Example (1)*, except that in the hands of no shareholder of the corporation would the apartment house be deemed property held primarily for sale to customers in the ordinary course of trade or business (such determination, however, having been made without regard to A's ownership of stock of related corporations). Assume further that (a) X Corporation adopts a plan of complete liquidation, (b) within the 12-month period beginning on the date of such adoption X Corporation sells substantially all the property held by it on such date and distributes all its assets in complete liquidation, (c) following the adoption of such plan, no distribution is made of any property which in the hands of

the corporation or in the hands of the distributee is property in respect of which a deduction for exhaustion, wear and tear, obsolescence, amortization, or depletion is allowable, and (d) following the adoption of such plan no property is sold or exchanged to A, to a constructive owner of A's stock, or to a person "related" (within the meaning of paragraph (k) of this section) to A or such constructive owner.

(ii) Since, under the above-stated facts, the requirements of section 341(e)(4) are satisfied, section 337(a) will apply to sales or exchanges of property by the corporation within the 12-month period beginning on the date of the adoption of the plan of liquidation.

(iii) Any distribution in complete liquidation to B and C, who own 15 and 10 percent, respectively, in value of the outstanding stock, will qualify under section 341(e)(2) because (a) by reason of the application of section 341(e)(4), section 337(a) applies to sales or exchanges of property by the corporation, and (b) at all times within the 12-month period beginning on the date of the adoption of the plan of complete liquidation the general corporate test is satisfied and B and C each satisfy the specific shareholder test of paragraph (e)(1)(iii)(a) of this section.

(iv) Any distribution in complete liquidation to A, who owns 75 percent in value of the outstanding stock, will qualify under section 341(e)(2) if, at all times within the 12-month period beginning on the date of the adoption of the plan of complete liquidation, and after taking into account A's ownership of stock in related corporations in the manner prescribed in paragraph (d) of this section, A satisfies the specific shareholder test of paragraph (e)(1)(iii)(b) of this section.

[T.D. 6806, 30 FR 2845, Mar. 5, 1965, as amended by T.D. 7369, 40 FR 29840, July 16, 1975; T.D. 7418, 41 FR 18811, May 7, 1976; T.D. 7728, 45 FR 72650, Nov. 3, 1980; T.D. 8586, 60 FR 2500, Jan. 10, 1995]

#### § 1.341-7 Certain sales of stock of consenting corporations.

(a) *In general.* (1) Under section 341(f)(1), if a corporation consents (in the manner provided in paragraph (b) of this section) to the application of section 341(f)(2) with respect to dispositions by it of its subsection (f) assets (as defined in paragraph (g) of this section), then section 341(a)(1) does not apply to any sales of stock of such consenting corporation (other than sale to such corporation) made by any of its shareholders within the 6-month period beginning on the date on which such consent is filed.

(2) For purposes of section 341(f)(1) and (5)—(i) The term *sale* means a sale