

§ 1.381(c)(13)-1

26 CFR Ch. I (4-1-04 Edition)

Taxable year of recovery	M Corporation (transferor)	N Corporation (acquirer)
1959	50 (g) 30 (i)	20 (h) 15 (j)
1960		350 (g) 225 (i) 550 (k) 100 (h) 350 (j) 85 (m)

(2) *M Corporation's 1958 recovery.*  
 Total recovery of section 111 items for 1957 ..... \$25  
 Less: Recovery exclusion for 1957 ..... 400

Amount included in gross income of M Corporation for 1958 ..... 0

(3) *M Corporation's 1959 recoveries.*  
 (i) Total recovery of section 111 items for 1957 ..... \$50  
 Less: Recovery exclusion for 1957 ..... \$400  
 Minus excludable recovery ..... 25

Amount included in gross income of M Corporation for 1959 ..... 0  
 (ii) Total recovery of section 111 items for 1958 ..... 30  
 Less: Recovery exclusion for 1958 ..... 200

Amount included in gross income of M Corporation for 1959 ..... 0

(4) *N Corporation's 1958 recovery.*  
 Total recovery of section 111 items for 1957 ..... \$50  
 Less: Recovery exclusion for 1957 ..... 150

Amount included in gross income of N Corporation for 1958 ..... 0

(5) *N Corporation's 1959 recoveries.*  
 (i) Total recovery of section 111 items for 1957 ..... \$20  
 Less: Recovery exclusion for 1957 ..... \$150  
 Minus excludable recovery in 1958 ..... 50

Amount included in gross income of N Corporation for 1959 ..... 0  
 (ii) Total recovery of section 111 items for 1958 ..... 15  
 Less: Recovery exclusion for 1958 ..... 300

Amount included in gross income of N Corporation for 1959 ..... 0

(6) *N Corporation's 1960 recoveries.*  
 (i) Total recovery of section 111 items of M Corporation for 1957 ..... \$350  
 Less: Recovery exclusion of M Corporation for 1957 ..... \$400

Minus:  
 Excludable recovery in 1959 ..... \$50  
 Excludable recovery in 1958 ..... 25

Amount included in gross income of N Corporation for 1960 ..... 25  
 (ii) Total recovery of section 111 items of M Corporation for 1958 ..... 225

Less: Recovery exclusion of M Corporation for 1958 ..... \$200

Minus excludable recovery in 1959 .... 30  
 Amount included in gross income of N Corporation for 1960 ..... 170  
 (iii) Total recovery of section 111 items of M Corporation for 1959 ..... 550  
 Less: Recovery exclusion of M Corporation for 1959 ..... 500  
 Amount included in gross income of N Corporation for 1960 ..... 50  
 (iv) Total recovery of section 111 items of N Corporation for 1957 ..... 100  
 Less: Recovery exclusion of N Corporation for 1957 ..... \$150  
 Minus:  
 Excludable recovery in 1959 ..... \$20  
 Excludable recovery in 1958 ..... 50

Amount included in gross income of N Corporation for 1960 ..... 20  
 (v) Total recovery of section 111 items of N Corporation for 1958 ..... \$350  
 Less: Recovery exclusion of N Corporation for 1958 ..... \$300  
 Minus excludable recovery in 1959 ..... 15

Amount included in gross income of N Corporation for 1960 ..... 285  
 (vi) Total recovery of section 111 items of N Corporation for 1959 ..... 65  
 Less: Recovery exclusion of N Corporation for 1959 ..... 85

Amount included in gross income of N Corporation for 1960 ..... 10  
 (7) *Summary of recoveries included in gross income of N Corporation for 1960.*

(i) Recovery of M Corporation items for:  
 1957 ..... \$25  
 1958 ..... 55  
 1959 ..... 50  
 \$130

(ii) Recovery of N corporation items for:  
 1957 ..... 20  
 1958 ..... 65  
 1959 ..... 10  
 95

Total amount included in gross income ..... 225

[T.D. 6559, 26 FR 2984, Apr. 7, 1961]

§ 1.381(c)(13)-1 **Involuntary conversions.**

(a) *Carryover requirement*—(1) *General rule.* Section 381(c)(13) requires that after the date of distribution or transfer the acquiring corporation, in a transaction to which section 381(a) applies, shall be treated as the distributor or transferor corporation for

purposes of applying section 1033, relating to involuntary conversions. This rule shall apply even though the property similar or related in service or use to the property converted, or the stock of a corporation owning such similar property, is purchased by the acquiring corporation after the date of distribution or transfer and is not received from the distributor or transferor corporation in the transaction to which section 381(a) applies. Accordingly, if any factor essential to the application of section 1033 occurs on or before the date of distribution or transfer and any other such factor also occurs after that date, then, in accordance with section 381(c)(13) and this section, the provisions of section 1033 shall apply to the acquiring corporation in the same manner that they would have applied to the distributor or transferor corporation in the absence of the distribution or transfer. For purposes of this section, the terms *involuntary conversion* and *disposition of the converted property* shall have the meaning ascribed to them by the regulations under section 1033.

(2) *Application to other transactions.* The provisions of this section shall apply to any transaction which, under provisions of the Internal Revenue Code of 1954, is treated as though it were an involuntary conversion within the meaning of section 1033. See, for example, section 1071, relating to gain from a sale or exchange to effectuate the policies of the Federal Communications Commission; and sections 1332(b)(3) and 1333(3), relating to war loss recoveries.

(b) *Conversion into similar property.* Section 1033(a)(1) provides that no gain shall be recognized if property is involuntarily converted only into property which is similar or related in service or use to the property so converted. If there is a disposition of property of a distributor or transferor corporation and, subsequent to the date of distribution or transfer, property similar or related in service or use to the property disposed of is received by the acquiring corporation as compensation for the property so disposed of, then no gain shall be recognized to the acquiring corporation, provided that no gain would have been recognized under sec-

tion 1033(a)(1) if the similar property had been received directly by the distributor or transferor corporation.

*Example.* Property of S Corporation with an adjusted basis of \$100 is condemned by the local government. Shortly after the property is so condemned, S Corporation liquidates and distributes its assets to P Corporation in a distribution to which section 381(a) applies. Subsequent to the date of distribution, P Corporation receives from the government (in settlement of the condemnation proceedings) property with a market value of \$500 which is similar or related in service or use to the property so condemned. No gain is recognized to either corporation upon P Corporation's receipt of the similar property, and the property so received has a basis of \$100 in the hands of P Corporation on the date of its acquisition.

(c) *Conversion into money or dissimilar property when disposition occurs after December 31, 1950*—(1) *General rule.* Section 1033(a)(3) and §1.1033(a)-2 provide rules for involuntary conversions of property into money or dissimilar property where the disposition of the converted property occurs after December 31, 1950. In such a case, the gain on the conversion, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized on the conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or exceeds the cost of stock purchased by the taxpayer in the acquisition of control of a corporation owning such other property, provided (i) the taxpayer purchases such other property or stock for the purpose of replacing the property so converted and (ii) the purchase occurs during the period of time specified in section 1033(a)(3)(B). The provisions of this paragraph shall apply to involuntary conversions where the disposition of the property occurs after December 31, 1950, and where the election to have section 1033(a)(3) apply to the treatment of the gain upon the conversion is contingent upon activities of both the distributor or transferor corporation and the acquiring corporation. For purposes of section 381(c)(13), the period of time specified in section 1033(a)(3)(B) shall be determined by taking into account taxable years of, and extensions of time granted to, both

the distributor or transferor corporation and the acquiring corporation.

(2) *Replacement period.* The period during which the purchase of similar property or stock must be made in order to prevent the recognition of gain on the involuntary conversion terminates 2 years (or, in the case of a disposition occurring before Dec. 31, 1969, 1 year) after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may be designated pursuant to an application of the taxpayer. See paragraph (c)(3) of § 1.1033(a)-2. Therefore, if, in a case to which this subparagraph applies, the first taxable year in which gain is realized is the taxable year of the distributor or transferor corporation ending with the close of the date of distribution or transfer, the acquiring corporation will have a maximum of only 2 years (or, in the case of a disposition occurring before Dec. 31, 1969, 1 year) after that date in which to purchase the similar property or stock, unless an extension of time has been granted upon application by the distributor, transferor, or acquiring corporation within the time prescribed. See paragraph (a) of § 1.381(b)-1 as to the termination of the taxable year of the distributor or transferor corporation. See paragraph (c)(3) of § 1.1033(a)-2 as to applications to extend the period within which to replace the converted property. In addition to the information otherwise required under paragraph (c)(3) of § 1.1033(a)-2, the application shall contain sufficient detail in connection with the distribution or transfer to establish that section 381(c)(13) applies to the involuntary conversion involved.

(3) *Examples.* The application of this paragraph may be illustrated by the following examples:

*Example (1).* A and B Corporations compute their taxable income on the basis of the calendar year, and both corporations use the cash method of accounting. During 1970 property of A Corporation is destroyed by fire, and in January 1971, A Corporation receives \$15,000 from an insurance company as compensation for its loss of property. The adjusted basis of the property on the date of destruction is \$10,000; as a consequence, A Corporation realizes a gain of \$5,000 on the involuntary conversion. On June 30, 1971, B

Corporation acquires all of the assets of A Corporation in a reorganization to which section 381(a) applies. In accordance with paragraph (c)(2) of § 1.1033(a)-2, A Corporation reports in its return for the short taxable year ending June 30, 1971, all the details in connection with the involuntary conversion but does not include the realized gain in gross income, thereby electing to have the gain recognized only to the extent provided in section 1033(a)(3). On June 15, 1973, B Corporation purchases for \$20,000 property which is similar or related in service or use to the property previously destroyed. In its return for 1973, B Corporation reports all of the details in connection with its replacement of the property, as required by paragraph (c)(2) of § 1.1033(a)-2. As a result of this replacement by B Corporation, none of the gain realized by A Corporation is recognized. The replacement property which is purchased by B Corporation has a basis to that corporation of \$15,000 on the date of its purchase, that is, the cost of such property (\$20,000) decreased by the amount of gain not recognized to A Corporation on the involuntary conversion (\$5,000).

*Example (2).* Assume the same facts as in *Example (1)*, except that B Corporation does not purchase similar property on or before June 30, 1973, and does not apply on or before that date (in accordance with paragraph (c)(3) of § 1.1033(a)-2) for an extension of time in which to make a replacement. In such event, the gain realized by A Corporation is recognized to that corporation for its taxable year ending June 30, 1971. A Corporation's tax liability for such taxable year must be recomputed in accordance with paragraph (c)(2) of § 1.1033(a)-2 in order to reflect this additional income.

*Example (3).* Assume the same facts as in *Example (1)*, except that the property of A Corporation is destroyed in 1968, A Corporation receives the \$15,000 from an insurance company in January 1969, B Corporation acquires all of the assets of A Corporation on June 30, 1969, and A Corporation's return is filed for the short taxable year ending June 30, 1969. B Corporation would have to purchase property which is similar or related in service or use to the property previously destroyed by June 30, 1970, in order to take advantage of the provisions of section 1033.

*Example (4).* M and N Corporations compute their taxable income on the basis of the calendar year, and both corporations use the cash method of accounting. During 1970, property of M Corporation is destroyed by fire. The adjusted basis of the property on the date of destruction is \$10,000. The property is insured against loss by fire, but the insurance claim is not satisfied on or before June 30, 1971, the date on which N Corporation acquires all of the assets (including the insurance claim) of M Corporation in a reorganization to which section 381(a) applies. On

September 1, 1972, N Corporation receives \$15,000 from the insurance company as compensation for the fire loss suffered by M Corporation. Upon receipt of the insurance proceeds, N Corporation realizes a gain of \$5,000 upon the involuntary conversion; however, in its return for 1972, N Corporation elects under the provisions of paragraph (c)(2) of § 1.1033(a)-2 to have the gain recognized only to the extent provided by section 1033(a)(3). On December 30, 1974, N Corporation purchases for \$20,000 property which is similar or related in service or use to the property previously destroyed in the hands of M Corporation. As a result of this replacement by N Corporation, none of the gain realized by N Corporation in 1972 is recognized. The replacement property which is purchased by N Corporation has a basis to that corporation of \$15,000 on the date of its purchase, that is, the cost of such property (\$20,000) decreased by the amount of gain not recognized to N Corporation on the involuntary conversion (\$5,000).

*Example (5).* R and S Corporations compute their taxable income on the basis of the calendar year, and both corporations use the cash method of accounting. During 1970 property of R Corporation is destroyed by fire. The adjusted basis of the property on the date of destruction is \$10,000. In anticipation of taking the benefit of section 1033(a)(3), R Corporation purchases for \$20,000 on June 1, 1971, property which is similar or related in service or use to the destroyed property. In its return for 1971, R Corporation reports all of the details in connection with the replacement of the property, as required by paragraph (c)(2) of § 1.1033(a)-2. The property destroyed in 1970 is insured against loss by fire, but the insurance claim is not satisfied on or before March 1, 1972, the date on which S Corporation acquires all of the assets (including the insurance claim) of R Corporation in a reorganization to which section 381(a) applies. On October 1, 1972, S Corporation receives \$12,000 from the insurance company as compensation for the fire loss suffered by R Corporation. Upon receipt of the insurance proceeds, S Corporation realizes a gain of \$2,000 upon the involuntary conversion; however, in its return for 1972, S Corporation elects under the provisions of paragraph (c)(2) of § 1.1033(a)-2 to have the gain recognized only to the extent provided by section 1033(a)(3). As a result of the replacement by R Corporation, none of the gain realized by S Corporation in 1972 is recognized. Assuming there are no adjustments for depreciation, the replacement property has a basis on October 1, 1972, of \$18,000, that is, the cost of such property (\$20,000) decreased by the amount of gain not recognized to S Corporation on the involuntary conversion (\$2,000).

(d) *Conversion into money when disposition occurs before January 1, 1951.* Section 1033(a)(2) provides that, if property is disposed of in an involuntary conversion before January 1, 1951, and money is received as compensation for the conversion, no gain shall be recognized if such money is forthwith expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund. That section also provides that, if any part of the money is not so expended, the gain, if any, shall be recognized to the extent of the money which is not so expended. For example, if, pursuant to section 381(c)(13) and section 1033(a)(2), property of a distributor or transferor corporation is disposed of before January 1, 1951, in an involuntary conversion, and the proceeds from the conversion are received by the acquiring corporation so that the gain on the conversion is realized by that corporation, the acquiring corporation may avoid recognition of the gain if it complies with the provisions of section 1033(a)(2) for nonrecognition of gain. Thus, the acquiring corporation must forthwith expend the proceeds in the acquisition of similar property or stock, or in the establishment of a replacement fund, in order to avoid recognition of the gain, if the disposition occurred before January 1, 1951. See the provisions of §§ 1.1033(a)-3 and 1.1033(a)-4 relating to involuntary conversions and replacement funds when disposition of the converted property occurred before January 1, 1951.

(e) *Successive acquiring corporations.* An acquiring corporation which, in a transaction to which section 381(a) applies, acquires the assets of a corporation which previously acquired the assets of another corporation in a transaction to which section 381(a) applies, shall be treated as such other corporation for purposes of applying sections 381(c)(13) and 1033 (relating to involuntary conversions). Thus, for example, if any factor essential to the application of section 1033 occurs on or before the date of distribution or transfer in one transaction to which section 381(a) applies, and any other such factor occurs

after the date of distribution or transfer in a subsequent transaction to which section 381(a) applies, then the acquiring corporation in such subsequent transaction shall be treated as the first distributor or transferor corporation subject to the rules and limitations of this section for purposes of sections 381(c)(13) and 1033.

[T.D. 6552, 26 FR 1989, Mar. 8, 1961, as amended by T.D. 7075, 35 FR 17995, Nov. 24, 1970]

**§ 1.381(c)(14)-1 Dividend carryover to personal holding company.**

(a) *Carryover requirement.* Section 381(c)(14) provides that an acquiring corporation shall succeed to and take into account the dividend carryover (described in section 564) of a distributor or transferor corporation in computing its dividends paid deduction under section 561 for taxable years ending after the date of distribution or transfer for which the acquiring corporation is a personal holding company under section 542. To determine the amount of such dividend carryover and to integrate it with the dividend carryover of the acquiring corporation in computing the dividends paid deduction for taxable years ending after the date of distribution or transfer, it is necessary to apply the provisions of section 564 and § 1.564-1 in accordance with this section.

(b) *Manner of computing dividend carryover—(1) Preceding taxable years.* If the acquiring corporation is a personal holding company under section 542 for its first taxable year ending after the date of distribution or transfer, the taxable year of the distributor or transferor corporation ending with such date is a first preceding taxable year for purposes of section 564, and the taxable year of the distributor or transferor corporation immediately preceding such first preceding year is a second preceding taxable year for purposes of section 564. If the acquiring corporation is a personal holding company for its second taxable year ending after the date of distribution or transfer, the taxable year of the distributor or transferor corporation ending with such date is a second preceding taxable year for purposes of section 564.

(2) *Determination of dividends paid deduction and taxable income.* The divi-

dends paid deduction of any distributor or transferor corporation (determined under section 561 but without regard to any dividend carryover) and the taxable income of any such corporation (adjusted as provided in section 545(b)) for any taxable year ending on or before the date of distribution or transfer shall be determined without reference to any dividends paid deduction, or taxable income, of the acquiring corporation or any other distributor or transferor corporation; in like manner, the dividends paid deduction and the taxable income of the acquiring corporation for any such taxable year shall be determined without reference to any dividends paid deduction, or taxable income, of a distributor or transferor corporation.

(3) *Computation of dividend carryover.*

(i) For the purpose of determining the dividend carryover to the first taxable year of the acquiring corporation ending after the date of distribution or transfer, the amount of the dividend carryover from the distributor or transferor corporation shall be determined under section 564 without reference to the dividends paid deduction or taxable income of the acquiring corporation or any other corporation. If two or more transactions to which section 381(a) applies have the same date of distribution or transfer, or if a particular taxable year of the acquiring corporation is the first taxable year ending after the dates of distribution or transfer of two or more such transactions occurring on different dates, the amount of the dividend carryover from each distributor or transferor corporation shall be determined separately as provided in the preceding sentence. Except as provided in subdivision (iii) of this subparagraph, the aggregate of the dividend carryovers from each distributor or transferor corporation and the dividend carryover of the acquiring corporation (computed without regard to this section) shall constitute the dividend carryover under section 561(a)(3) of the acquiring corporation for its first taxable year ending after the date (or dates) of distribution or transfer.

(ii) For the purpose of determining the dividend carryover to the second