

by Y when the stock vests. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing X's stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

Example 7. (i) Assume the same facts as in *Example 6*, except that Y (rather than X) retains a reversionary interest in the X stock in the event that B forfeits the right to the stock. Several years after X's transfer of the X shares, the stock vests.

(ii) In this *Example 7*, this section does not apply to Y's deemed disposition of the X shares because Y is not deemed to have transferred the X stock to B immediately after receiving the stock from X. For the tax consequences to Y on the deemed disposition of the X stock, see § 1.83-6(b).

Example 8. (i) X, a corporation, owns all of the outstanding stock of Y corporation. In Year 1, X issues to Y's employee, B, a non-statutory stock option to purchase 10 shares of X stock as compensation for services provided to Y. The option is exercisable against X and does not have a readily ascertainable fair market value (determined under § 1.83-7(b)) at the time the option is granted. In Year 2, B exercises the option by paying X the strike price of \$80 for the X stock, which then has a fair market value of \$100.

(ii) In this *Example 8*, because, under section 83(e)(3), section 83(a) does not apply to the grant of the option, paragraph (d) of this section also does not apply to the grant of the option. Section 83 and § 1.1032-3 apply in Year 2 when the option is exercised; thus, no gain or loss is recognized on the deemed disposition of X stock by Y in Year 2. Immediately before Y's deemed disposition of the X stock in Year 2, Y is treated as purchasing the X stock from X for \$100, \$80 of which Y is deemed to have received from B and the remaining \$20 of which is deemed to have been contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$20.

Example 9. (i) A, an individual, owns a majority of the stock of X. X owns stock of Y constituting control of Y within the meaning of section 368(c). A transfers 10 shares of its X stock to B, a key employee of Y. The fair market value of the 10 shares on the date of transfer was \$100.

(ii) In this *Example 9*, A is treated as making a nondeductible contribution of the 10 shares of X to the capital of X, and no gain or loss is recognized by A as a result of this transfer. See *Commissioner v. Fink*, 483 U.S. 89 (1987). A must allocate his basis in the transferred shares to his remaining shares of X stock. No gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by

X. Under section 358, X's basis in its Y stock is increased by \$100.

Example 10. (i) In Year 1, X, a corporation, forms a trust which will be used to satisfy deferred compensation obligations owed by Y, X's wholly owned subsidiary, to Y's employees. X funds the trust with X stock, which would revert to X upon termination of the trust, subject to the employees' rights to be paid the deferred compensation due to them. The creditors of X can reach all the trust assets upon the insolvency of X. Similarly, Y's creditors can reach all the trust assets upon the insolvency of Y. In Year 5, the trust transfers X stock to the employees of Y in satisfaction of the deferred compensation obligation.

(ii) In this *Example 10*, X is considered to be the grantor of the trust, and, under section 677, X is also the owner of the trust. Any income earned by the trust would be reflected on X's income tax return. Y is not considered a grantor or owner of the trust corpus at the time X transfers X stock to the trust. In Year 5, when employees of Y receive X stock in satisfaction of the deferred compensation obligation, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for fair market value using cash contributed to Y by X. Under section 358, X's basis in its Y stock increases by the amount of cash deemed contributed.

(f) *Effective date.* This section applies to transfers of stock or stock options of the issuing corporation occurring on or after May 16, 2000.

[T.D. 8883, 65 FR 31076, May 16, 2000; T.D. 8883, 65 FR 37482, June 15, 2000]

§ 1.1033(a)-1 Involuntary conversions; nonrecognition of gain.

(a) *In general.* Section 1033 applies to cases where property is compulsorily or involuntarily converted. An *involuntary conversion* may be the result of the destruction of property in whole or in part, the theft of property, the seizure of property, the requisition or condemnation of property, or the threat or imminence of requisition or condemnation of property. An *involuntary conversion* may be a conversion into similar property or into money or into dissimilar property. Section 1033 provides that, under certain specified circumstances, any gain which is realized from an involuntary conversion shall not be recognized. In cases where property is converted into other property similar or related in service or use to

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the converted property, no gain shall be recognized regardless of when the disposition of the converted property occurred and regardless of whether or not the taxpayer elects to have the gain not recognized. In other types of involuntary conversion cases, however, the proceeds arising from the disposition of the converted property must (within the time limits specified) be reinvested in similar property in order to avoid recognition of any gain realized. Section 1033 applies only with respect to gains; losses from involuntary conversions are recognized or not recognized without regard to this section.

(b) *Special rules.* For rules relating to the application of section 1033 to involuntary conversions of a principal residence with respect to which an election has been made under section 121 (relating to gain from sale or exchange of residence of individual who has attained age 65), see paragraph (g) of § 1.121-5. For rules applicable to involuntary conversions of a principal residence occurring before January 1, 1951, see § 1.1033(a)-3. For rules applicable to involuntary conversions of a principal residence occurring after December 31, 1950, and before January 1, 1954, see paragraph (h)(1) of § 1.1034-1. For rules applicable to involuntary conversions of a personal residence occurring after December 31, 1953, see § 1.1033(a)-3. For special rules relating to the election to have section 1034 apply to certain involuntary conversions of a principal residence occurring after December 31, 1957, see paragraph (h)(2) of § 1.1034-1. For special rules relating to certain involuntary conversions of real property held either for productive use in trade or business or for investment and occurring after December 31, 1957, see § 1.1033(g)-1. See also special rules applicable to involuntary conversions of property sold pursuant to reclamation laws, livestock destroyed by disease, and livestock sold on account of drought provided in §§ 1.1033(c)-1, 1.1033(d)-1, and 1.1033(e)-1, respectively. For rules relating to basis of property acquired through involuntary conversions, see § 1.1033(b)-1. For determination of the period for which the taxpayer has held property acquired as a result of certain involuntary conversions, see section 1223 and regulations

issued thereunder. For treatment of gains from involuntary conversions as capital gains in certain cases, see section 1231(a) and regulations issued thereunder. For portion of war loss recoveries treated as gain on involuntary conversion, see section 1332(b)(3) and regulations issued thereunder.

(Secs. 1033 (90 Stat. 1920, 26 U.S.C. 1033), and 7805 (68A Stat. 917, 26 U.S.C. 7805))

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6856, 30 FR 13318, Oct. 20, 1965; T.D. 7625, 44 FR 31013, May 30, 1979; T.D. 7758, 46 FR 6925, Jan. 22, 1981]

§ 1.1033(a)-2 Involuntary conversion into similar property, into money or into dissimilar property.

(a) *In general.* The term *disposition of the converted property* means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b) *Conversion into similar property.* If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such non-recognition of gain is mandatory.

(c) *Conversion into money or into dissimilar property.* (1) If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such 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 the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period