

§ 1.355-4

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Y both satisfy the requirements of section 355(b). See paragraph (b)(3)(i) and (ii) of this section.

Example (8). For the past six years, corporation X has owned and operated hardware stores in several states. Two years ago, X purchased all of the assets of a hardware store in State M, where X had not previously conducted business. X transfers the State M store and related business assets to new subsidiary Y and distributes the stock of Y to X's shareholders. After the distribution, the State M store has its own manager and is operated independently of the other stores. X and Y both satisfy the requirements of section 355(b). See paragraph (b)(3)(i) and (ii) of this section.

Example (9). For the past eight years, corporation X has engaged in the manufacture and sale of household products. Throughout this period, X has maintained a research department for use in connection with its manufacturing activities. The research department has 30 employees actively engaged in the development of new products. X transfers the research department to new subsidiary Y and distributes the stock of Y to X's shareholders. After the distribution, Y continues its research operations on a contractual basis with several corporations, including X. X and Y both satisfy the requirements of section 355(b). See paragraph (b)(3)(i) of this section. The result in this example is the same if, after the distribution, Y continues its research operations but furnishes its services only to X. See paragraph (b)(3)(i) of this section. However, see § 1.355-2 (d)(2)(iv)(C) (related function device factor) for possible evidence of device.

Example (10). For the past six years, corporation X has processed and sold meat products. X derives income from no other source. X separates the sales function from the processing function by transferring the business assets related to the sales function and cash for working capital to new subsidiary Y. X then distributes the stock of Y to X's shareholders. After the distribution, Y purchases for resale the meat products processed by X. X and Y both satisfy the requirements of section 355(b). See paragraph (b)(3)(i) of this section. However, see § 1.355-2(d)(2)(iv)(C) (related function device factor) for possible evidence of device.

Example (11). For the past eight years, corporation X has been engaged in the manufacture and sale of steel and steel products. X owns all of the stock of corporation Y, which, for the past six years, has owned and operated a coal mine for the sole purpose of supplying X's coal requirements in the manufacture of steel. X distributes the stock of Y to X's shareholders. X and Y both satisfy the requirements of section 355 (b). See paragraph (b)(3)(i) of this section. However, see § 1.355-2 (d)(2)(iv)(C) (related function device factor) for possible evidence of device.

Example (12). For the past seven years, corporation X, a bank, has owned an eleven-story office building, the ground floor of which X has occupied in the conduct of its banking business. The remaining ten floors are rented to various tenants. Throughout this seven-year period, the building has been managed and maintained by employees of the bank. X transfers the building to new subsidiary Y and distributes the stock of Y to X's shareholders. Henceforth, Y will manage the building, negotiate leases, seek new tenants, and repair and maintain the building. X and Y both satisfy the requirements of section 355 (b). See paragraph (b)(3) of this section.

Example (13). For the past nine years, corporation X, a bank, has owned a two-story building, the ground floor and one half of the second floor of which X has occupied in the conduct of its banking business. The other half of the second floor has been rented as storage space to a neighboring retail merchant. X transfers the building to new subsidiary Y and distributes the stock of Y to X's shareholders. After the distribution, X leases from Y the space in the building that it formerly occupied. Under the lease, X will repair and maintain its portion of the building and pay property taxes and insurance. Y does not satisfy the requirements of section 355 (b) because it is not engaged in the active conduct of a trade or business immediately after the distribution. See paragraph (b)(2)(iv)(A) of this section. This example does not address the question of whether the activities of X with respect to the building prior to the separation would constitute the active conduct of a trade or business.

[T.D. 8238, 54 FR 294, Jan. 5, 1989]

§ 1.355-4 Non pro rata distributions, etc.

Section 355 provides for nonrecognition of gain or loss with respect to a distribution whether or not (a) the distribution is pro rata with respect to all of the shareholders of the distributing corporation, (b) the distribution is pursuant to a plan of reorganization within the meaning of section 368 (a) (1)(D), or (c) the shareholder surrenders stock in the distributing corporation. Under section 355, the stock of a controlled corporation may consist of common stock or preferred stock. (See, however, section 306 and the regulations thereunder.) Section 355 does not apply, however, if the substance of a transaction is merely an exchange between shareholders or security holders of stock or securities in one corporation

for stock or securities in another corporation. For example, if two individuals, A and B, each own directly 50 percent of the stock of corporation X and 50 percent of the stock of corporation Y, section 355 would not apply to a transaction in which A and B transfer all of their stock of X and Y to a new corporation Z, for all of the stock of Z, and Z then distributes the stock of X to A and the stock of Y to B.

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§ 1.355-5 Records to be kept and information to be filed.

(a) Every corporation that makes a distribution of stock or securities of a controlled corporation, as described in section 355, shall attach to its return for the year of the distribution a detailed statement setting forth such data as may be appropriate in order to show compliance with the provisions of such section.

(b) Every taxpayer who receives a distribution of stock or securities of a corporation that was controlled by a corporation in which he holds stock or securities shall attach to his return for the year in which such distribution is received a detailed statement setting forth such data as may be appropriate in order to show the applicability of section 355. Such statement shall include, but shall not be limited to, a description of the stock and securities surrendered (if any) and received, and the names and addresses of all of the corporations involved in the transaction.

§ 1.355-6 Recognition of gain on certain distributions of stock or securities in controlled corporation.

(a) *Conventions*—(1) *Examples*. For purposes of the examples in this section, unless otherwise stated, assume that P, S, T, X, Y, N, HC, D, D1, D2, D3, and C are corporations, A and B are individuals, shareholders are not treated as one person under section 355(d)(7), stock has been owned for more than five years and section 355(d)(6) and paragraph (e)(4) of this section do not apply, no election under section 338 (if available) is made, and all transactions described are respected under general tax principles, including the step transaction doctrine. No inference should be

drawn from any example as to whether any requirements of section 355 other than those of section 355(d), as specified, are satisfied.

(2) *Five-year period*. For purposes of this section, the term five-year period means the five-year period (determined after applying section 355(d)(6) and paragraph (e)(4) of this section) ending on the date of the distribution, but in no event beginning earlier than October 10, 1990.

(3) *Distributing securities*. For purposes of determining if stock of any controlled corporation received in the distribution is disqualified stock described in section 355(d)(3)(B)(ii)(II) (relating to a distribution of controlled corporation stock on any securities in the distributing corporation acquired by purchase during the five-year period), references in this section to stock of a corporation that is or becomes a distributing corporation includes securities of the corporation. Similarly, a reference to stock in paragraph (c)(4) of this section (relating to a plan or arrangement) includes securities.

(4) *Marketable securities*. Unless otherwise stated, any reference in this section to marketable stock includes marketable securities.

(b) *General rules and purposes of section 355(d)*—(1) *Disqualified distributions in general*. In the case of a disqualified distribution, any stock or securities in the controlled corporation shall not be treated as qualified property for purposes of section 355(c)(2) or 361(c)(2). In general, a disqualified distribution is any distribution to which section 355 (or so much of section 356 as relates thereto) applies if, immediately after the distribution—

(i) Any person holds disqualified stock in the distributing corporation that constitutes a 50 percent or greater interest in such corporation; or

(ii) Any person holds disqualified stock in the controlled corporation (or, if stock of more than one controlled corporation is distributed, in any controlled corporation) that constitutes a 50 percent or greater interest in such corporation.

(2) *Disqualified stock*—(i) *In general*. *Disqualified stock* is—