

distribution is within the provisions of section 1081 (d)(1) and also may be considered to be within some other provisions of section 1081, it shall be considered that only the provisions of section 1081 (d)(1) apply and that the nonrecognition of gain or loss upon such exchange or distribution is by virtue of that section.

§ 1.1081-7 Sale of stock or securities received upon exchange by members of system group.

(a) Section 1081(d)(2) provides that to the extent that property received upon an exchange by corporations which are members of the same system group consists of stock or securities issued by the corporation from which such property was received, such stock or securities may, under certain specifically described circumstances, be sold to a party not a member of the system group, without the recognition of gain or loss to the selling corporation. The nonrecognition of gain or loss is limited, in the case of stock, to a sale of stock which is preferred as to both dividends and assets. The stock or securities must have been received upon an exchange with respect to which section 1081(d)(1) operated to prevent recognition of gain or loss to any party to the exchange. Nonrecognition of gain or loss upon the sale of such stock or securities is permitted only if the proceeds derived from the sale are applied in retirement or cancellation of stock or securities of the selling corporation which were outstanding at the time the exchange was made. It is also essential to nonrecognition of gain or loss upon the sale that both the sale of the stock or securities and the application of the proceeds derived therefrom be made in obedience to an order of the Securities and Exchange Commission. If any part of the proceeds derived from the sale is not applied in making the required retirement or cancellation of stock or securities and if the sale is otherwise within the provisions of section 1081 (d)(2), the gain resulting from the sale shall be recognized, but in an amount not in excess of the proceeds which are not so applied. In any event, if the proceeds derived from the sale of the stock or securities exceed the fair market value of such stock or securities at the

time of the exchange through which they were acquired by the selling corporation, the gain resulting from the sale is to be recognized to the extent of such excess. Section 1081 (d)(2) does not provide for the nonrecognition of any gain resulting from the retirement of bonds, notes, or other evidences of indebtedness for a consideration less than the issuing price thereof. Also, that section does not provide for the nonrecognition of gain or loss upon the sale of any stock or securities received upon a distribution or otherwise than upon an exchange.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example: The X Corporation and the Y Corporation, both of which make their income tax returns on a calendar year basis, are members of the same system group. As part of an exchange to which section 1081 (d)(1) is applicable the Y Corporation on June 1, 1954, issued to the X Corporation 1,000 shares of class A stock, preferred as to both dividends and assets. The fair market value of such stock at the time of issuance was \$90,000 and its basis to the X Corporation was \$75,000. On December 1, 1954, in obedience to an appropriate order of the Securities and Exchange Commission, the X Corporation sells all of such stock to the public for \$100,000 and applies \$95,000 of this amount to the retirement of its own bonds, which were outstanding on June 1, 1954. The remaining \$5,000 is not used to retire any of the X Corporation's stock or securities. Of the total gain of \$25,000 realized on the disposition of the Y Corporation stock, only \$10,000 is recognized (the difference between the fair market value of the stock when acquired and the amount for which it was sold), since such amount is greater than the portion (\$5,000) of the proceeds not applied to the retirement of the X Corporation's stock or securities. If in this example the stock acquired by the X Corporation had not been stock of the Y Corporation issued to the X Corporation or if it had been stock not preferred as to both dividends and assets, the full amount of the gain (\$25,000) realized upon its disposition would have been recognized, regardless of what was done with the proceeds.

§ 1.1081-8 Exchanges in which money or other nonexempt property is received.

(a) Under section 1081(e)(1), if in any exchange (not within any of the provisions of section 1081(d)) in which stock or securities in a corporation which is