

gain, and the remaining half shall be treated as long-term capital gain.

Example (2). If half of the assets (ascertained by reference to their fair market value at the time of the transfer) transferred are capital assets and half are assets other than capital assets, then half of the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as capital gain, and the remaining half shall be treated as gain from the sale or exchange of assets other than capital assets.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.358-1 Basis to distributees.

(a) In the case of an exchange or distribution to which section 354, 355, or 371(b) applies in which, under the law applicable to the year in which the exchange is made, only nonrecognition property is received, the sum of the basis of all of the stock and securities in the corporation whose stock and securities are exchanged or with respect to which the distribution is made, held immediately after the transaction, plus the basis of all stock and securities received in the transaction shall be the same as the basis of all the stock and securities in such corporation held immediately before the transaction allocated in the manner described in § 1.358-2. In the case of an exchange to which section 351, 361, or 374 applies in which, under the law applicable to the year in which the exchange was made, only nonrecognition property is received, the basis of all the stock and securities received in the exchange shall be the same as the basis of all property exchange therefor. If in an exchange or distribution to which section 351, 356, 361, 371(b), or 374 applies both nonrecognition property and “other property” are received, the basis of all the property except “other property” held after the transaction shall be determined as described in the preceding two sentences decreased by the sum of the money and the fair market value of the “other property” (as of the date of the transaction) and increased by the sum of the amount treated as a dividend (if any) and the amount of the gain recognized on the exchange, but the term *gain* as here used does not include any portion of the recognized

gain that was treated as a dividend. In any case in which a taxpayer transfers property with respect to which loss is recognized, such loss shall be reflected in determining the basis of the property received in the exchange. The basis of the “other property” is its fair market value as of the date of the transaction. See § 1.460-4(k)(3)(iv)(A) for rules relating to stock basis adjustments required where a contract accounted for using a long-term contract method of accounting is transferred in a transaction described in section 351 or a reorganization described in section 368(a)(1)(D) with respect to which the requirements of section 355 (or so much of section 356 as relates to section 355) are met.

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

Example. A purchased a share of stock in Corporation X in 1935 for \$150. Since that date he has received distributions out of other than earnings and profits (as defined in section 316) totalling \$60, so that his adjusted basis for the stock is \$90. In a transaction qualifying under section 356, A exchanged this share for one share in Corporation Y, worth \$100, cash in the amount of \$10, and other property with a fair market value of \$30. The exchanging had the effect of the distribution of a dividend. A's ratable share of the earnings and profits of Corporation X accumulated after February 28, 1913, was \$5. A realized a gain of \$50 on the exchange, but the amount recognized is limited to \$40, the sum of the cash received and the fair market value of the other property. Of the gain recognized, \$5 is taxable as a dividend, and \$35 as a gain from the exchange of property. The basis to A of the one share of stock of Corporation Y is \$90. That is, the adjusted basis of the one share of stock Corporation X (\$90), decreased by the sum of the cash received (\$10) and the fair market value of the other property received (\$30) and increased by the sum of the amount treated as a dividend (\$5) and the amount treated as a gain from the exchange of property (\$35). The basis of the other property received is \$30.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6533, 26 FR 404, Jan. 19, 1965; T.D. 7616, 44 FR 26869, May 8, 1979; T.D. 8995, 67 FR 34605, May 15, 2002]

§ 1.358-2 Allocation of basis among nonrecognition property.

(a)(1) As used in this paragraph the term *stock* means stock which is not “other property” under section 356 or

371(b), stock with respect to which a distribution is made, and, in the case of a surrender of part of the stock of a particular class, the retained part of such stock. The term *securities* means securities (including, where appropriate, fractional parts of securities) which are not “other property” under section 356 or 371(b) and in the case of a surrender of part of the securities of a particular class, the retained part of such securities. Stock, or securities, as the case may be, which differ either because they are in different corporations or because the rights attributable to them differ (although they are in the same corporation) are considered different classes of stock or securities, as the case may be, for purposes of this section.

(2) If as the result of an exchange or distribution under the terms of section 354, 355, 356 or 371(b) a shareholder who owned stock of only one class before the transaction owns stock of two or more classes after the transaction, then the basis of all the stock held before the transaction (as adjusted under § 1.358-1) shall be allocated among the stock of all classes (whether or not such stock was received in the transaction) held immediately after the transaction in proportion to the fair market values of the stock of each class.

(3) If as the result of an exchange under the terms of section 354, 355, 356 or 371(b) a security holder who owned only securities, all of one class, before the transaction, owns securities or stock of more than one class, or owns both stock and securities, then the basis of all the securities held before the transaction (as adjusted under § 1.358-1) shall be allocated among all the stock and securities (whether or not received in the transaction) held immediately after the transaction in proportion to the fair market values of the stock of each class and the securities of each class.

(4) In every case in which, before the transactions, a person owned stock of more than one class or securities of more than one class or owned both stock and securities, a determination must be made, upon the basis of all the facts, of the stock or securities received with respect to stock and securi-

ties of each class held (whether or not surrendered). The allocation described in subparagraph (2) of this paragraph shall be separately made as to the stock of each class with respect to which there is an exchange or distribution and the allocation described in subparagraph (3) of this paragraph shall be separately made with respect to the securities of each class, part or all of which are surrendered in the exchange.

(5) Notwithstanding the provisions of subparagraphs (2), (3), and (4) of this paragraph, in any case in which a plan of recapitalization under section 368(a)(1)(E) provides that each holder of stock or securities of a particular class shall have an option to surrender some or none of such stock or securities in exchange for stock or securities, and a shareholder or security holder exchanges an identifiable part of his stock or securities, the basis of the part of the stock or securities retained shall remain unchanged and shall not be taken into account in determining the basis of the stock or securities received.

(b)(1) As used in this paragraph the term *stock* refers only to stock which is not “other property” under section 351, 361, or 374 and the term *securities* refers only to securities which are not “other property” under section 351, 361, or 374.

(2) If in an exchange to which section 351 or 361 applies property is transferred to a corporation and the transferor receives stock or securities of more than one class or receives both stock and securities, then the basis of the property transferred (as adjusted under § 1.358-1) shall be allocated among all of the stock and securities received in proportion to the fair market values of the stock of each class and the securities of each class.

(c) The application of paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1). A, an individual, owns stock in Corporation X with an adjusted basis of \$1,000. In a transaction qualifying under section 356 (so far as such section relates to section 354), he exchanged this stock for 20 shares of stock of Corporation Y worth \$1,200 and securities of Corporation Y worth \$400. A realizes a gain of \$600 of which \$400 is recognized. The adjusted basis in A's hands of each share of the stock of Corporation Y is

\$50 determined by allocating the basis of the stock of Corporation X ratably to the stock of Corporation Y received in the exchange. The securities of Corporation Y have a basis in the hands of A of \$400.

Example (2). B, an individual, owns a security in the principal amount of \$10,000 with a basis of \$5,000. In a transaction to which section 354 is applicable, he exchanges this security for four securities in the principal amount of \$750 each, worth \$800 each, four securities in the principal amount of \$750 each, worth \$600 each, class A common stock worth \$1,000, and class B common stock worth \$400. B realizes a gain of \$2,000, none of which is recognized. The basis of his original security, \$5,000, will be allocated 32/70ths to the four securities worth \$800, 24/70ths to the four securities worth \$600, 10/70ths to the class A common stock, and 4/70ths to the class B common stock.

Example (3). C, an individual, owns stock of Corporation Y with a basis of \$5,000 and owns a security issued by Corporation Y in the principal amount of \$5,000 with a basis of \$5,000. In a transaction to which section 354 is applicable, he exchanges the stock of Corporation Y for stock of Corporation Z with a value of \$6,000, and he exchanges the security of Corporation Y for stock of Corporation Z worth \$1,500 and a security of Corporation Z in the principal amount of \$4,500 worth \$4,500. No gain is recognized to C on either exchange. The basis of the stock of Corporation Z received for the stock of Corporation Y is \$5,000. The bases of the stock and security of Corporation Z received in exchange for the security of Corporation Y are \$1,250 and \$3,750, respectively.

Example (4). D, an individual, owns stock in Corporation M with a basis of \$15,000, worth \$40,000, and owns a security issued by Corporation M in the principal amount of \$5,000 with a basis of \$4,000. In a transaction qualifying under section 356 (so far as such section relates to section 355), he exchanges the security of Corporation M for a security of Corporation O (a controlled corporation) in the principal amount of \$5,000, worth \$5,000, and exchanges one-half of his stock of Corporation M for stock of Corporation O worth \$15,000 and a security of Corporation O in the principal amount of \$5,000, worth \$5,000. All of the stock and securities of Corporation O are distributed pursuant to the transaction. D realizes a gain of \$12,500 on the exchange of the stock of Corporation M for the stock and security of Corporation O of which \$5,000 is recognized. D also realizes a gain of \$1,000 on the exchange of a security of Corporation M for a security of Corporation O, none of which is recognized. The basis of his stock of Corporation M held before the transaction is allocated 20/35ths to the stock of Corporation M held after the transaction and 15/35ths to the stock of Corporation O. The basis of the security of Corporation O received in ex-

change for his security of Corporation M is \$4,000, the basis of the security of Corporation M exchanged. The basis of the security of Corporation O received with respect to D's stock of Corporation M is \$5,000, its fair market value.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 7616, 44 FR 26869, May 8, 1979; T.D. 8648, 60 FR 66079, Dec. 21, 1995]

§ 1.358-3 Treatment of assumption of liabilities.

(a) For purposes of section 358, where a party to the exchange assumes a liability of a distributee or acquires from him property subject to a liability, the amount of such liability is to be treated as money received by the distributee upon the exchange, whether or not the assumption of liabilities resulted in a recognition of gain or loss to the taxpayer under the law applicable to the year in which the exchange was made.

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

Example (1). A, an individual, owns property with an adjusted basis of \$100,000 on which there is a purchase money mortgage of \$25,000. On December 1, 1945, A organizes Corporation X to which he transfers the property in exchange for all the stock of Corporation X and the assumption by Corporation X of the mortgage. The capital stock of the Corporation X has a fair market value of \$150,000. Under sections 351 and 357, no gain or loss is recognized to A. The basis in A's hands of the stock of Corporation X is \$75,000, computed as follows:

Adjusted basis of property transferred	\$100,000
Less: Amount of money received (amount of liabilities assumed)	—25,000
Basis of Corporation X stock to A	75,000

Example (2). A, an individual, owns property with an adjusted basis of \$25,000 on which there is a mortgage of \$50,000. On December 1, 1954, A organizes Corporation X to which he transfers the property in exchange for all the stock of Corporation X and the assumption by Corporation X of the mortgage. The stock of Corporation X has a fair market value of \$50,000. Under sections 351 and 357, gain is recognized to A in the amount of \$25,000. The basis in A's hands of the stock of Corporation X is zero, computed as follows:

Adjusted basis of property transferred	\$25,000
Less: Amount of money received (amount of liabilities)	—50,000
Plus: Amount of gain recognized to taxpayer	25,000
Basis of Corporation X stock to A	0