

(B) The transfer of an option described in §1.382-4(d)(11)(i) or (ii) (relating to transfers between persons who are not 5-percent shareholders or between members of certain public groups).

(5) *Successor corporation.* A successor corporation is a distributee or transferee corporation that succeeds to and takes into account items described in section 381(c) from a corporation as the result of an acquisition of assets described in section 381(a). A successor corporation also includes, as the context may require, a corporation which receives an asset or assets from another corporation if the corporation's basis for the asset(s) is determined, directly or indirectly, in whole or in part, by reference to the other corporation's basis and the amount by which basis differs from value is, in the aggregate, material. The previous sentence of this paragraph (a)(5) applies to any testing date occurring on or after January 1, 1997.

(6) *Predecessor corporation.* A predecessor corporation is a distributor or transferor corporation that distributes or transfers its assets to an acquiring corporation in a transaction described in section 381(a). A predecessor corporation also includes, as the context may require, a corporation which transfers an asset or assets to another corporation if the transferee's basis for the asset(s) is determined, directly or indirectly, in whole or in part, by reference to the corporation's basis and the amount by which basis differs from value is, in the aggregate, material. The previous sentence of this paragraph (a)(6) applies to any testing date occurring on or after January 1, 1997.

(b) *Effective dates—(1) In general.* [Reserved]

(2) *Rules provided in paragraph (a)(3)(ii) of this section—(i) In general.* Except as provided in paragraph (b)(2)(ii) of this section, the rules provided in paragraph (a)(3)(ii) of this section apply with respect to any convertible stock.

(ii) *Certain convertible preferred stock.* Convertible stock that, when issued, would be described in section 1504(a)(4) by disregarding subparagraph (D) thereof and by ignoring the potential participation in corporate growth that

the conversion feature may offer is treated as stock described in that section (and thus is not treated as stock for the purpose of determining whether an ownership change occurs, but is taken into account for the purpose of determining the value of the loss corporation immediately before an ownership change; see sections 382(e)(1) and 382(k)(6)(A)) if—

(A) The stock was issued on or after July 20, 1988, and prior to November 5, 1992; or

(B) The stock was issued prior to July 20, 1988, and the loss corporation makes the election described in Notice 88-67, 1988-1 C.B. 555, (see §601.601(d)(2)(ii)(b) of this chapter for availability of Cumulative Bulletins (C.B.)) on or before the earlier of the date prescribed in the Notice or December 7, 1992.

(3) *Rules provided in paragraph (a)(4) of this section.* The rules provided in paragraph (a)(4) of this section apply to determine whether dates on or after November 5, 1992, are testing dates.

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**§ 1.382-2T Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).**

(a) *Ownership change—(1) In general.* A corporation is a new loss corporation and thus subject to limitation under section 382 only if an ownership change has occurred with respect to such corporation. An ownership change occurs with respect to a corporation if it is a loss corporation on a testing date and, immediately after the close of the testing date, the percentage of stock of the corporation owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of such corporation owned by such shareholders at any time during the testing period. See paragraph (a)(2)(i) of this section for the definition of testing date. See paragraph (d) of this section for the definition of testing period. See §1.382-2(a)(1) and paragraph (f)(3) of

this section for the respective definition of loss corporation and new loss corporation. See paragraph (g) of this section for the definition of 5-percent shareholder. See section 383 and § 1.383-1 for rules relating to loss corporations that have an ownership change and have capital loss carryovers, excess foreign taxes carried over under section 904(c), carryovers of general business credits under section 39, or unused minimum tax credits under section 53.

(2) *Events requiring a determination of whether an ownership change has occurred—(i) Testing dates prior to November 5, 1992.* Except as otherwise provided in this paragraph (a)(2)(i), a loss corporation is required to determine whether an ownership change has occurred immediately after any owner shift, any equity structure shift, or any transaction in which an option with respect to stock of the loss corporation is—

(A) Transferred to (or by) a 5-percent shareholder (or a person who would be 5-percent shareholder if the option were treated as exercised), or

(B) Issued by the loss corporation, a first tier entity, or a higher tier entity that owns five percent or more of the loss corporation (determined without regard to the application of paragraph (h)(2)(i)(A) of this section). Notwithstanding the preceding sentence, any transfer of stock of the loss corporation (or an option with respect to such stock) in any of the circumstances described in section 382(l)(3)(B), or any equity structure shift that is not also an owner shift, is not an event that requires the loss corporation to make a determination of whether an ownership change has occurred. For purposes of this section, each date on which a loss corporation is required to make a determination of whether an ownership change has occurred is referred to as a testing date, all computations of increases in percentage ownership are to be made as of the close of the testing date, and any transactions described in this paragraph (a)(2)(i) that occur on that date are treated as occurring simultaneously at the close of the testing date. See paragraphs (e)(1) and (2) of this section for the respective definitions of owner shift and equity structure shift. See paragraphs (f)(9) and (14)

of this section for the respective definitions of first tier entity and higher tier entity. See paragraph (m)(4)(vii) of this section for special rules regarding the effective date of the provisions of this paragraph (a)(2)(i).

(ii) *Information statement required.* A loss corporation must file a statement with its income tax return for each taxable year that it is a loss corporation in which an owner shift, equity structure shift or other transaction described in paragraph (a)(2)(i) of this section occurs. The statement must—

(A) Indicate whether any testing dates occurred during the taxable year;

(B) Identify each testing date, if any, on which an ownership change occurred;

(C) Identify the testing date, if any, that occurred during and closest to the end of each of the three month periods ending on March 31, June 30, September 30 and December 31 during the taxable year, regardless of whether an ownership change occurred on the testing date.

(D) Identify each 5-percent shareholder on each such testing date;

(E) State the percentage ownership of the stock of the loss corporation for each 5-percent shareholder as of each such testing date and the increase, if any, in such ownership during the testing period; and

(F) Disclose the extent to which the loss corporation relied upon the presumptions regarding stock ownership under paragraph (k)(i) of this section to determine whether an ownership change occurred on any identified testing date.

See § 1.383-1(k) and paragraph (m)(4)(v) of this section for transitional rules regarding the filing of information statements.

(iii) *Records to be maintained by loss corporation.* A loss corporation shall keep such records as are necessary to determine: (A) The identity of its 5-percent shareholders, (B) the percentage of its stock owned by each such 5-percent shareholder, and (C) whether the section 382 limitation is applicable. Such records shall be retained so long as they may be material in the administration of any internal revenue law.

(b) *Nomenclature and assumptions.* For purposes of the example in this section—

(1) L is a loss corporation, and, if there is more than one loss corporation, they are designated as L<sub>1</sub>, L<sub>2</sub>, L<sub>3</sub>, etc.

(2) P is a corporation that is not a loss corporation, and, if there is more than one such corporation, they are designated as P<sub>1</sub>, P<sub>2</sub>, P<sub>3</sub>, etc.

(3) HC is a corporation whose assets consist solely of the stock of other corporations.

(4) E is an entity other than a corporation (e.g., a partnership), and, if there is more than one such entity, they are designated as E<sub>1</sub>, E<sub>2</sub>, E<sub>3</sub>, etc.

(5) Unless otherwise stated—

(i) A, B, C, D, AA, BB, CC, and DD are unrelated individuals who own interests in corporations or other entities only to the extent expressly stated,

(ii) All corporations have one class of stock outstanding and each share of stock has the same fair market value as each other share,

(iii) The capital structure of the loss corporation and its business do not change over time, and

(iv) The rules of paragraphs (k)(2) and (4) of this section are not applicable.

(6) Public L represents a group of unrelated individuals and entities that own direct (and not indirect) stock ownership interests in loss corporation L, each of whom owns less than five percent of the stock of the loss corporation, and, if there is more than one loss corporation, such groups are designated as Public L<sub>1</sub>, Public L<sub>2</sub>, Public L<sub>3</sub>, etc.

(7) Public P represents a group of unrelated individuals and entities that own direct (and not indirect) stock ownership interests in corporation P, each of whom owns less than five percent of the stock of the corporation, and, if there is more than one corporation, such groups are designated as Public P<sub>1</sub>, P<sub>2</sub>, P<sub>3</sub>, etc.

(8) Public E represents a group of unrelated individuals and entities that own direct (and not indirect) ownership interests in entity E, each of whom owns less than five percent of the entity, and, if there is more than one entity, such groups are designated as Public E<sub>1</sub>, Public E<sub>2</sub>, Public E<sub>3</sub>, etc.

(c) *Computing the amount of increases in percentage ownership—*(1) *In general.*

In order to determine whether an ownership change has occurred on a testing date, the loss corporation must identify each 5-percent shareholder whose percentage of stock ownership in the loss corporation immediately after the close of the testing date has increased, compared to such shareholder's lowest percentage of stock ownership in such corporation at any time during the testing period. The amount of the increase in the percentage of stock ownership in the loss corporation of each 5-percent shareholder must be computed separately by comparing the percentage ownership of each such 5-percent shareholder immediately after the close of the testing date to such shareholder's lowest percentage ownership at any time during the testing period. Each such increase in the percentage ownership of a 5-percent shareholder is then added together with any other such increases of other 5-percent shareholders to determine whether an ownership change has occurred. Because only those 5-percent shareholders whose percentages of stock ownership have increased are taken into account, a 5-percent shareholder is disregarded if his percentage of stock ownership, immediately after the close of the testing date, has decreased (or has remained the same), compared to his lowest percentage ownership interest on any previous date during the testing period.

(2) *Example.*

*Example.* (i) A and B each own 40 percent of the outstanding L stock. The remaining 20 percent of the L stock is owned by 100 unrelated individuals, none of whom own as much as five percent of L stock ("Public L"). C negotiates with A and B to purchase all their stock in L.

(ii) The acquisitions from both A and B are completed on September 13, 1990. C's acquisition of 80 percent of L stock results in an ownership change because C's percentage ownership has increased by 80 percentage points as of the testing date, compared to his lowest percentage ownership in L at any time during the testing period (0 percent).

(3) *Related and unrelated increases in percentage stock ownership.* The determination whether an ownership change has occurred is made without regard to

whether the changes in stock ownership of the loss corporation (by one or more 5-percent shareholders) result from related or unrelated events.

(4) *Example.*

*Example.* (i) L has outstanding 200 shares of common stock. A, B and C respectively own 100, 50 and 50 shares of the L stock. On January 2, 1988, A sells 60 shares of L stock to B. Thus, B's percentage ownership interest in L increases by 30 percentage points, from 50 shares to 110 shares. On January 1, 1989, A purchases C's entire interest in L. Thus, A's percentage ownership interest in L increases by 25 percentage points, compared to his lowest percentage ownership interest in L, from 40 shares immediately following the January 2, 1988 sale to B to 90 shares. Even though A's ownership interest in L as of January 1, 1989 has decreased, compared to his 50 percent ownership interest at the beginning of the testing period, A is a 5-percent shareholder who must be taken into account for purposes of the computation required under paragraph (c)(1) of this section because his interest in L on that testing date (45 percent) has increased, compared to his lowest percentage ownership interest in L at any time during the testing period (20 percent following the sale to B).

(ii) Accordingly, although A and B jointly have increased their aggregate total ownership interest in L between January 2, 1988 and January 1, 1989 by only 25 percentage points (*i.e.*, the total ownership interest in L held by A and B at all times is not less than a 75 percent interest), the total of their separate increases in the percentage stock ownership of L, compared to their respective lowest percentage ownership interests at any time during the testing period, is 55 percentage points. Thus, an ownership change occurs as a result of A's acquisition of L stock on January 1, 1989.

(d) *Testing period*—(1) *In general.* Except as otherwise provided in paragraphs (d) and (m) of this section, the testing period for any testing date is the three-year period ending on the testing date. See paragraph (a)(2)(i) of this section for the definition of testing date.

(2) *Effect of a prior ownership change.* Following an ownership change, the testing period for determining whether a subsequent ownership change has occurred shall begin no earlier than the first day following the change date of the most recent ownership change. See paragraph (f)(19) of this section for the definition of change date.

(3) *Commencement of the testing period*—(i) *In general.* Except as otherwise

provided in paragraph (d)(3)(ii) of this section, the testing period for any loss corporation shall not begin before the earlier of the first day of either—

(A) The first taxable year from which there is a loss or excess credit carryforward to the first taxable year ending after the testing date, or

(B) The taxable year in which the testing date occurs.

(ii) *Exception for corporations with net unrealized built-in loss.* Paragraph (d)(3)(i) of this section shall not apply if the corporation has a net unrealized built-in loss (determined after application of section 382(h)(3)(B)) on the testing date, unless the loss corporation establishes the taxable year in which the net unrealized built-in loss first accrued.

In that event, the testing period shall not begin before the earlier of—

(A) The first day of the taxable year in which the net unrealized built-in loss first accrued, or

(B) The day described in paragraph (d)(3)(i) of this section. See section 382(h) for the definition of net unrealized built-in loss.

(4) *Disregarding testing dates.* Any testing date that occurs before the beginning of the testing period shall be disregarded for purposes of this section.

(5) *Example.*

*Example.* (i) A owns all 100 outstanding shares of L stock. A sells 40 shares to B on January 1, 1988. C purchases 20 shares of L stock from A on July 1, 1991. In determining if an ownership change occurs on the July 1, 1991 testing date, B's acquisition of L stock is disregarded because it occurred before the testing period that ends on such testing date. Thus, B's ownership interest in L does not increase during the testing period, and no ownership change results from C's acquisition.

(ii) The facts are the same as in (i), except that throughout the period during which B negotiated his stock purchase transaction with A, B knew that C intended to attempt to acquire a significant stock interest in L. Also, B and C have been partners in a number of significant business ventures. The result is the same as in (i).

(e) *Owner shift and equity structure shift*—(1) *Owner shift*—(i) *Defined.* For purposes of this section, an owner shift is any change in the ownership of the stock of a loss corporation that affects

the percentage of such stock owned by any 5-percent shareholder. See paragraph (g) of this section for the definition of a 5-percent shareholder. An owner shift includes, but is not limited to, the following transactions:

(A) A purchase or disposition of loss corporation stock by a 5-percent shareholder,

(B) A section 351 exchange that affects the percentage of stock owned by a 5-percent shareholder,

(C) A redemption or a recapitalization that affects the percentage of stock owned by a 5-percent shareholder,

(D) An issuance of loss corporation stock that affects the percentage of stock owned by a 5-percent shareholder, and

(E) An equity structure shift that affects the percentage of stock owned by a 5-percent shareholder.

(ii) *Transactions between persons who are not 5-percent shareholders disregarded.* Transfers of loss corporation stock between persons who are not 5-percent shareholders of such corporation (and between members of separate public groups resulting from the application of the segregation rules of paragraphs (j)(2) and (3)(iii) of this section) are not owner shifts and thus are not taken into account. See paragraph (h)(4)(xi) of this section for a similar rule applicable to transfers of options.

(iii) *Examples.*

*Example (1).* A has owned all 1000 shares of outstanding L stock for more than three years. On June 15, 1988, A sells 300 of his L shares to B. This transaction is an owner shift. No other 5-percent shareholder has increased his percentage ownership of L stock during the testing period. Thus, the owner shift resulting from B's acquisition does not result in an ownership change, because B has increased his stock ownership in L by only 30 percentage points.

*Example (2).* The facts are the same as in *Example (1)*. In addition, on June 15, 1989, L issues 100 shares to each of C, D and AA. The stock issuance is an owner shift. The transaction, however, does not result in an ownership change, because B, C, D and AA (the 5-percent shareholders whose stock ownership has increased as of the testing date, compared to any other time during the testing period) have increased their percentage of stock ownership in L by a total of only 46.2 percentage points during the testing period (by 23.1 percentage points [300 shares/1300

shares] for B, and 7.7 percentage points [100 shares/1300 shares] for each of C, D and AA).

*Example (3).* All 1000 shares of L stock are owned by a group of 100 unrelated individuals, none of whom own as much as five percent of L stock ("Public L"). Several of the members of Public L sell their L stock, amounting to a 30 percent ownership interest in L, to B on June 15, 1988. The sale of stock to B is an owner shift. Between June 16, 1988 and June 15, 1989, each of the remaining individuals in Public L sells his stock to another person who is not a 5-percent shareholder. Under paragraph (e)(1)(ii) of this section, trading activity among the members of Public L is disregarded and does not result in an owner shift. On June 15, 1989, L issues 100 shares to each of C, D and AA. The only sale transactions by members of Public L that are taken into account in determining whether an ownership change occurs on June 15, 1989 are the sales to B on June 15, 1988. Because B, C, D and AA together have increased their percentage ownership of L stock as a result of B's purchase and the stock issuance by an amount not in excess of 50 percentage points during the testing period ending on June 15, 1988, an ownership change does not occur on that date.

*Example (4).* The facts are the same as in *Example (2)*. In addition, on December 15, 1989, L redeems 200 of the L shares from A. The redemption is an owner shift that results in an ownership change, because B, C, D and AA are 5-percent shareholders whose percentage ownership of L increase by a total of 54.6 percentage points during the testing period (by 27.3 percentage points [300 shares/1100 shares] for B and 9.1 percentage points [100 shares/1100 shares] for each of C, D and AA).

*Example (5).* L is owned entirely by 10,000 unrelated shareholders, none of whom owns as much as five percent of the stock of L ("Public L"). Accordingly, Public L is L's only 5-percent shareholder. See paragraph (j)(1) of this section. There are one million shares of common stock outstanding. On December 1, 1988, L issues two million new shares of its common stock to members of the public, none of whom owned any L stock prior to the issuance. Following the public offering, no shareholder of L owns, directly or indirectly, five percent or more of L stock. Under paragraph (j)(2) of this section, however, all of the newly issued stock is treated as acquired by a 5-percent shareholder ("Public NL") that is unrelated to Public L. Therefore, the public offering constitutes an owner shift that results in an ownership change because Public NL's percentage of stock ownership in L increased by 66⅔ percentage points (two million shares acquired in the public offering/three million shares outstanding following the offering) over its lowest percentage ownership during

the testing period (0 percent prior to the offering).

*Example (6).* The facts are the same as in *Example (5)*, except that L issues only 500,000 new shares of L stock on December 1, 1988, and Public NL's percentage ownership interest in L increases by only 33⅓ percentage points (500,000 shares acquired in the public offering/1.5 million shares outstanding following the offering). During the two years following December 2, 1988, 14 percent of the stock outstanding on that date is sold over a public stock exchange. On December 3, 1990, A purchases five percent of L stock (75,000 shares) over a public stock exchange. The purchase of five percent of L stock by A is an owner shift and is presumed to have been made proportionately from Public L and Public NL under paragraph (j)(1)(vi) of this section. Under paragraph (e)(1)(ii) of this section, transfers of L stock in transactions not involving A (*i.e.*, in transactions among or between members of separate public groups resulting from the application of paragraphs (j)(2) and (3) of this section) are not taken into account, and do not constitute owner shifts. (Transfers between members of Public NL and Public L, which are treated as separate 5-percent shareholders solely by virtue of paragraph (j)(2) of this section, are disregarded even if L has actual knowledge of any such transfers.) A and Public NL, the only 5-percent shareholders whose interests in L have increased during the testing period, have increased their respective stock ownership by only 36⅔ percentage points—five percentage points for A [75,000 shares/1.5 million shares outstanding] and 31⅔ percentage points for Public NL [(500,000 shares issued in the public offering)—(5 percent × 500,000 shares presumed to have been acquired by A)] /1.5 million shares outstanding]. Accordingly, there is no ownership change with respect to L notwithstanding that, taking into account the public trading, a change of more than 50 percentage points in the ultimate beneficial ownership of L stock occurred during the three-year period ending on the December 3, 1990 testing date.

*Example 7.* The facts are the same as in *Example 6*, except that five percent of the L stock has always been owned by P which, in turn, has always been owned by Public P. On December 6, 1990, P sells all of its L stock over a public stock exchange. Although the trading of P stock among persons that are not 5-percent shareholders (without regard to the segregation rules of paragraph (j) of this section) are disregarded under paragraph (e)(1)(ii) of this section, the disposition of the L stock by P is not disregarded because the L stock is transferred in a transaction that is subject to paragraph (j)(3)(i) of this section.

(2) *Equity structure shift*—(i) *Tax-free reorganizations.* An equity structure shift is any reorganization within the meaning of section 368 with respect to which the loss corporation is a party to the reorganization, except that such term does not include a reorganization described in—

(A) Section 368(a)(1)(D) or (G) unless the requirements of section 354(b)(1) are met, or

(B) Section 368(a)(1)(F).

(ii) *Transactions designated under section 382(g)(3)(B) treated as equity structure shifts.* [Reserved]

(iii) *Overlap of owner shift and equity structure shift.* Any equity structure shift that affects the percentage of loss corporation stock owned by a 5-percent shareholder also constitutes an owner shift. See paragraph (e)(i)(E) of this section

(iv) *Examples.*

*Example (1).* A owns all of the stock of L and B owns all of the stock of P. On October 13, 1988, L merges into P in a reorganization described in section 368a(1)(A). As a result of the merger, A and B own 25 and 75 percent, respectively, of the stock of P. The merger is an equity structure shift (and, because it affects the percentage of L stock owned by 5-percent shareholders, it also constitutes an owner shift). On the October 13, 1988 testing date, B is a 5-percent shareholder whose stock ownership in the loss corporation following the merger has increased by 75 percentage points over his lowest percentage of stock ownership in L at any time during the testing period (0 percent prior to the merger). Accordingly, an ownership change occurs as a result of the merger. P is thus a new loss corporation and L's pre-change losses are subject to limitation under section 382.

*Example (2).* (i) A owns 100 percent of L<sub>1</sub> stock and B owns 100 percent of L<sub>2</sub> stock. On January 1, 1988, L<sub>1</sub> merges into L<sub>2</sub> in a reorganization described in section 368(a)(1)(A). Immediately after the merger, A and B own 40 percent and 60 percent, respectively, of the L<sub>2</sub> stock. There is an equity structure shift (as well as an owner shift) with respect to both L<sub>1</sub> and L<sub>2</sub> on January 1, 1988.

(ii) Because the percentage of L<sub>2</sub> stock owned by B immediately after the merger (60 percent) increases by more than 50 percentage points over the lowest percentage of the stock of L<sub>1</sub> owned by B during the testing period (0 percent prior to the merger), there is an ownership change with respect to L<sub>1</sub>. L<sub>2</sub> is a new loss corporation and thus, under §1.382-2(a)(1)(iii) of this section, the pre-change losses of L<sub>1</sub> must be accounted for

separately by L<sub>2</sub> from the losses of L<sub>2</sub> (immediately before the ownership change) and are subject to limitation under section 382. See §1.382-2(a)(1)(iv) of this section for rules that end separate accounting for L<sub>1</sub>'s pre-change losses on any testing date occurring on or after January 29, 1991.

(iii) L<sub>2</sub> is a new loss corporation because it is a successor corporation to L<sub>1</sub>. There is no ownership change with respect to L<sub>2</sub>, however, because A's stock ownership in L<sub>2</sub> increased by only 40 percentage points (to 40 percent) over the amount owned by A prior to the merger (0 percent). Therefore, the pre-change losses of L<sub>2</sub> are not limited under section 382 as a result of the merger.

*Example (3).* The result in *Example (2)* would be the same if L<sub>1</sub> had survived the merger (i.e., L<sub>2</sub> merged into L<sub>1</sub>) with A and B owning 40 and 60 percent, respectively, of L<sub>1</sub> stock. L<sub>1</sub>'s pre-change losses would be accounted for separately and limited under section 382 and the pre-change losses of <sup>2</sup> would be accounted for separately under §1.382-2(a)(1)(iii) of this section, but would not be limited under section 382. See §1.382-2(a)(1)(ii) for the treatment of <sup>2</sup> following the transaction.

*Example (4).* The facts are the same as *Example (2)*, except, instead of acquiring <sup>1</sup> in a merger, <sup>2</sup> acquires all of the <sup>1</sup> stock from A on January 1, 1988, solely in exchange for stock representing a 40 percent interest in <sup>2</sup>, in a reorganization described in section 368(a)(1)(B). The acquisition of stock by <sup>2</sup> is an equity structure shift (as well as an owner shift) with respect to <sup>1</sup> that results in an ownership change with respect to <sup>1</sup> because the percentage of <sup>1</sup> stock owned by B immediately after the reorganization (60 percent, by virtue of B's ownership of <sup>2</sup>, through the operation of the constructive ownership rules of paragraph (h) of this section) increases by more than 50 percentage points over the lowest percentage of <sup>1</sup> stock owned by B at any time during the testing period (0 percent prior to the reorganization). The acquisition also results in an equity structure shift and an owner shift with respect to <sup>2</sup>, but <sup>2</sup> incurs no ownership change, because A's stock ownership in <sup>2</sup> increased by only 40 percentage points over the percentage of <sup>2</sup> stock owned by A prior to the reorganization (0 percent).

(f) *Definitions.* For purposes of this section—

(1) *Loss corporation.* See section 382 and §1.382-2(a)(1) for the definition of a loss corporation.

(2) *Old loss corporation.* The term *old loss corporation* means any corporation with respect to which there is an ownership change and that was a loss corporation immediately before the ownership change.

(3) *New loss corporation.* The term *new loss corporation* means a corporation with respect to which there is an ownership change if, immediately after such change, it is a loss corporation. A successor corporation to the corporation described in the preceding sentence also is a new loss corporation.

(4) *Successor corporation.* See §1.382-2(a)(5) for the definition of *successor corporation*.

(5) *Predecessor corporation.* See §1.382-2(a)(6) for the definitions of *predecessor corporation*.

(6) *Shift.* As the context may require, a shift means an equity structure shift, an owner shift or both.

(7) *Entity.* See §1.382-3(a)(1) for the definition of an entity.

(8) *Direct ownership interest.* A *direct ownership interest* means the interest a person owns in an entity, including a loss corporation, without regard to the constructive ownership rules of paragraph (h) of this section.

(9) *First tier entity.* A first tier entity is an entity that, at any time during the testing period, owns a five percent or more direct ownership interest in the loss corporation.

(10) *5-percent owner.* A 5-percent owner is any individual that, at any time during the testing period, owns a five percent or more direct ownership interest in a first tier entity or a higher tier entity. See paragraph (g) of this section for rules to determine whether, as a result of the constructive ownership rules of paragraph (h) of this section, a 5-percent owner is a 5-percent shareholder.

(11) *Public shareholder.* A public shareholder is any individual, entity, or other person with a direct ownership interest in a loss corporation of less than five percent at all times during the testing period.

(12) *Public owner.* A public owner is any individual, entity, or other person that, at all times during the testing period, owns less than a five percent direct ownership interest in a first tier entity or any higher tier entity.

(13) *Public group.* A public group is a group of individuals, entities, or other persons each of whom owns, directly or constructively, less than five percent of the loss corporation. See paragraphs (g) and (j) of this section for the rules

applicable to identify public groups and to determine whether a public group is a 5-percent shareholder.

(14) *Higher tier entity.* A higher tier entity is any entity that, at any time during the testing period, owns a five percent or more direct ownership interest in a first tier entity or in any higher tier entity.

(15) *Indirect ownership interest.* An indirect ownership is an interest a person owns in an entity determined solely as a result of the application of the constructive ownership rules of paragraph (h) of this section and without regard to any direct ownership interest (or other beneficial ownership interest) in the entity.

(16) *Highest tier entity.* A highest tier entity is a first tier entity or a higher tier entity that is not owned, in whole or in part, at any time during the testing period by a higher tier entity.

(17) *Next lower tier entity.* The next lower tier entity with respect to a first tier entity is the loss corporation. The next lower tier entity with respect to a higher tier entity is any first tier entity or other higher tier entity in which the higher tier entity owns, at any time during the testing period, a five percent or more direct ownership interest.

(18) *Stock*—(i) *In general.* For further guidance, see § 1.382-2(a)(3)(i).

(ii) *Treating stock as not stock.* Any ownership interest that otherwise would be treated as stock under paragraph (f)(18)(i) of this section shall not be treated as stock if—

(A) As of the time of its issuance or transfer to (or by) a 5-percent shareholder, the likely participation of such interest in future corporate growth is disproportionately small when compared to the value of such stock as a proportion of the total value of the outstanding stock of the corporation,

(B) Treating the interest as not constituting stock would result in an ownership change, and

(C) The amount of the pre-change loss (determined as if the testing date were the change and treating the amount of any net unrealized built-in loss as a pre-change loss) is more than twice the amount determined by multiplying

(1) the value of the loss corporation (as determined under section 382(e)) on the testing date, by

(2) the long-term tax exempt rate (as defined in section 382(f)) for the calendar month in which the testing date occurs.

Stock that is not treated as stock under this paragraph (f)(18)(ii), however, is taken into account for purposes of determining the value of the loss corporation under section 382(e).

(iii) *Treating interests not constituting stock as stock.* Any ownership interest that would not be treated as stock under paragraph (f)(18)(i) of this section (other than an option that is subject to paragraph (h)(4) of this section) shall be treated as constituting stock if—

(A) As of the time of its issuance or transfer to (or by) a 5-percent shareholder (or a person who would be a 5-percent shareholder if the interest not constituting stock were treated as stock), such interest offers a potential significant participation in the growth of the corporation,

(B) Treating the interest as constituting stock would result in an ownership change, and

(C) The amount of the pre-change losses (determined as if the testing date were the change date and treating the amount of any net unrealized built-in loss as a pre-change loss) is more than twice the amount determined by multiplying

(1) The value of the loss corporation (as determined under section 382(e)) on the testing date, by

(2) The long-term tax exempt rate (as defined in section 382(f)) for the calendar month in which the testing date occurs.

An ownership interest is that treated as stock under this paragraph (f)(18)(iii) is taken into account for purposes of determining the value of the loss corporation under section 382(e). See § 1.382-4(d)(12) for rules that apply with respect to options and this paragraph (f)(18)(iii).

(iv) *Stock of the loss corporation.* The *stock of the loss corporation* means stock of such corporation within the meaning of this paragraph (f)(18) and, as the



context may require, includes any indirect ownership interest in the loss corporation.

(19) *Change date.* The *change date* means the date on which a shift (or any other transaction described in paragraph (a)(2)(i) of this section) that is the last component of an ownership change occurs.

(20) *Year.* A *year*, or any multiple thereof, means a 365-day period (or a 366-day period in the case of a leap year), or any multiple thereof, unless the year is specifically identified as a taxable year.

(21) *Old section 382.* “Old section 382” means section 382, as in effect prior to the effective date of section 382 in the Tax Reform Act of 1986 (the “Act”), but taking into account section 621(f)(2) of the Act.

(22) *Pre-change loss.* See section 382 and § 1.382-2(a)(2) for the definition of pre-change loss.

(23) *Unrelated.* Any two persons are unrelated if the constructive ownership rules of paragraph (h) of this section do not apply to treat either person as owning stock that is owned, directly or constructively, by the other person.

(24) *Percentage ownership interest.* A person’s percentage ownership interest in—

(i) A corporation shall be determined under the rules of this section that are applicable to the determination of a shareholder’s percentage stock ownership interest in a loss corporation (see paragraphs (f)(18)(i) through (iii) of this section),

(ii) A partnership shall be equal to the relative fair market value of such person’s partnership interest to the total fair market value of all outstanding partnership interests, determined without regard to any limited and preferred partnership interest that is described in paragraph (h)(2)(ii)(C) of this section,

(iii) A trust shall be determined in accordance with the principles of section 318(a)(2)(B) for determining the constructive ownership of stock,

(iv) An estate shall be determined in accordance with the principles of section 318(a)(2)(A) for determining the constructive ownership of stock, and

(v) All other entities shall be determined by reference to the person’s rel-

ative economic interest in the entity, taking into account all of the relevant facts and circumstances.

(g) *5-percent shareholder*—(1) *In general.* Subject to the rules of paragraphs (k)(2) and (4) of this section, the term *5-percent shareholder* means—

(i) An individual that owns, at any time during the testing period,

(A) A direct ownership interest in the stock of the loss corporation of five percent or more or

(B) An indirect ownership interest in the stock of the loss corporation of five percent or more by virtue of an ownership interest in any one first tier entity or higher tier entity,

(ii) A public group, of either a first tier entity or a higher tier entity, identified as a 5-percent shareholder under paragraph (j)(1)(iv)(A) or (B) of this section,

(iii) A public group of the loss corporation identified as a 5-percent shareholder under paragraph (j)(1)(iv)(C) of this section, and

(iv) A public group, of the loss corporation, a first tier entity or a higher tier entity, identified as a 5-percent shareholder under paragraph (j)(2) or (3) of this section. An individual owning five percent or more of the stock of the loss corporation at any time during the testing period is a 5-percent shareholder notwithstanding that the individual may own less than five percent of the stock of the loss corporation on the testing date. See paragraph (g)(5)(i)(B) of this section for rules permitting a loss corporation to make an adjustment in cases described in the preceding sentence.

(2) *Determination of whether a person is a 5-percent shareholder.* Except as provided in paragraphs (k)(2) and (4) of this section, a person shall be treated as constructively owning stock of the loss corporation pursuant to paragraph (h)(2) of this section only if the loss corporation stock is attributed to such person in the person’s capacity as a higher tier entity or a 5-percent owner of the first tier entity or higher tier entity from which such stock is attributed. See paragraph (k)(3) of this section for rules explaining the extent of the obligation of the loss corporation to determine the identity of its 5-percent shareholders. Nothing in this

paragraph (g)(2), however, shall limit the attribution of loss corporation stock under section 318(a)(2) and paragraph (h) of this section to a public owner.

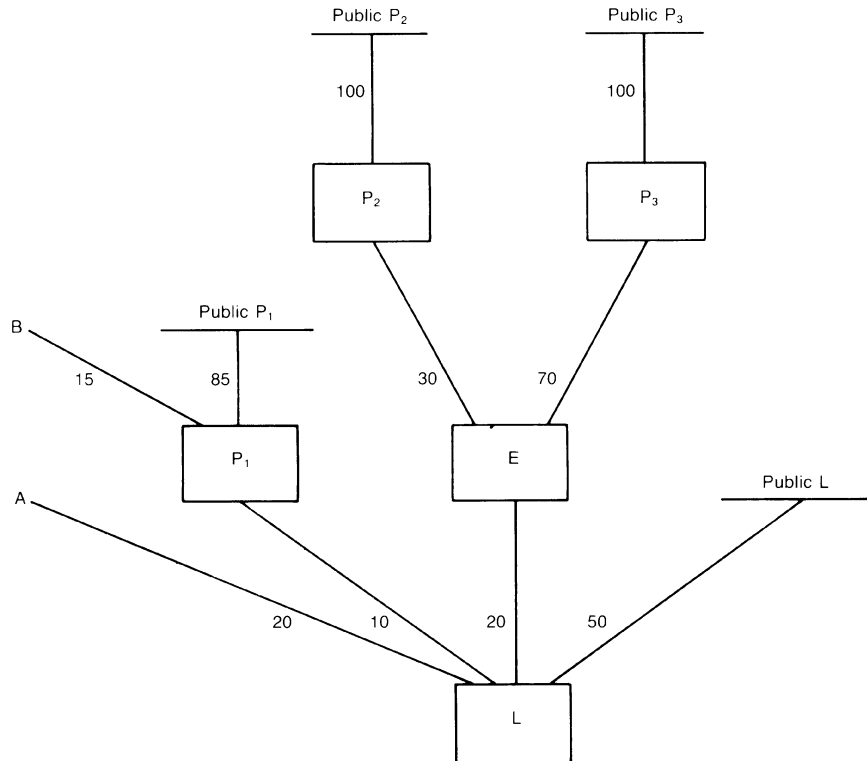
(3) *Determination of the percentage stock ownership interest of a 5-percent shareholder.* Subject to the rules of paragraphs (k)(2) and (4) of this section, in determining a 5-percent shareholder's percentage ownership interest in the loss corporation, the shareholder's direct ownership interest, if any, and each indirect ownership interest that he may have in the loss corporation in his capacity as a 5-percent owner of any one first tier entity or higher tier entity, if any, are required

to be added together and taken into account with respect to such shareholder only to the extent that each such direct or indirect ownership interest constitutes five percent or more of the stock of the loss corporation.

(4) *Examples.*

*Example (1)* (i) Twenty percent of L stock is owned by A, 10 percent is owned by P<sub>1</sub>, 20 percent is owned by E, a joint venture, and the remaining 50 percent of L stock is owned by Public L. P<sub>1</sub> is owned 15 percent by B and 85 percent by Public P<sub>1</sub>. E is owned 30 percent by P<sub>2</sub> and 70 percent by P<sub>3</sub>, which, in turn, are owned by Public P<sub>2</sub> and Public P<sub>3</sub>, respectively.

(ii) The ownership structure of L is illustrated by the following chart:



(iii) P<sub>1</sub> and E, each of which has a direct ownership interest in L of five percent or more, are first tier entities. The shareholders with direct ownership interests in L

who individually own less than five percent of L are public shareholders (Public L). B, who has a direct ownership interest of five percent or more in P<sub>1</sub>, is a 5-percent owner of

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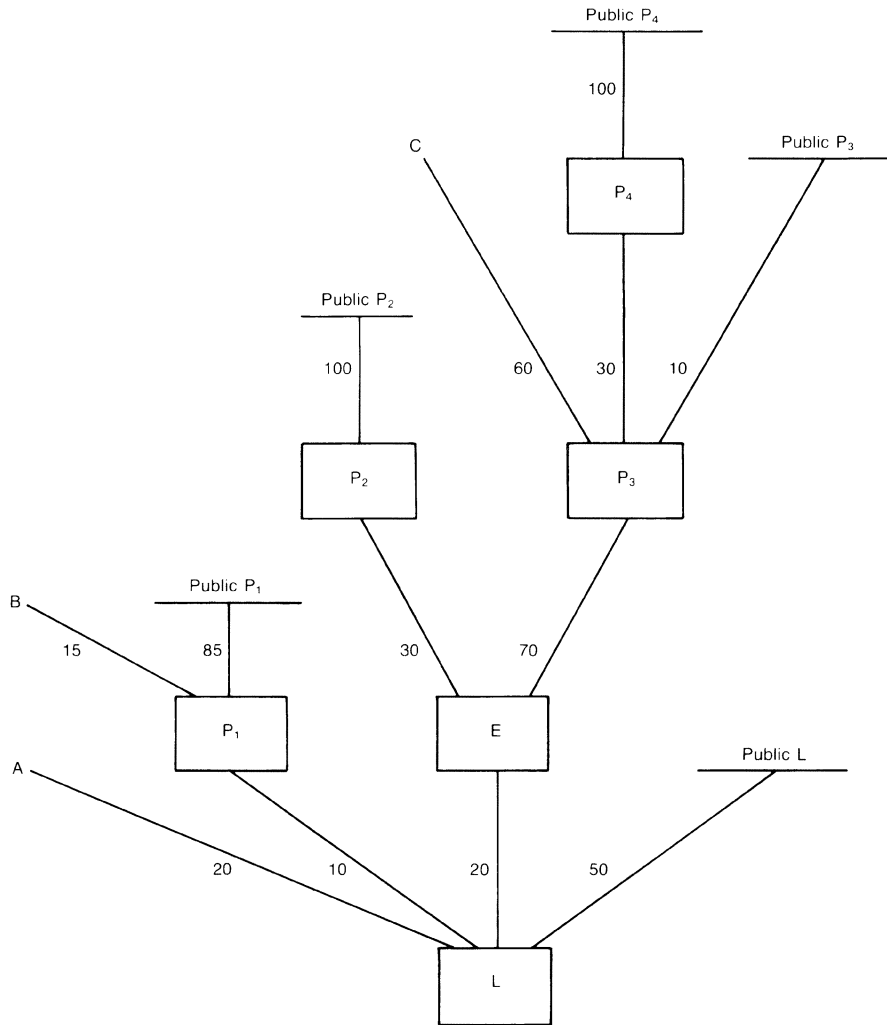
P, P<sub>2</sub> and P<sub>3</sub>, and P<sub>3</sub>, each of which has a direct ownership interest in a first tier entity (E) of five percent or more, are higher tier entities with respect to L and, because neither entity is owned at any time during the testing period by a higher tier entity, they also are highest tier entities. The shareholders of P<sub>2</sub> and P<sub>3</sub> (Public P<sub>2</sub> and Public P<sub>3</sub>, respectively) are public owners of such entities, because none of those shareholders own five percent or more of either entity at any time during the testing period.

(iv) A, who has a 20 percent direct ownership interest in L, is a 5-percent shareholder of L. Because, by application of the constructive ownership rules of paragraph (h) of this section, B owns only 1.5 percent of L stock in his capacity as a 5-percent owner of P<sub>1</sub> (15

percent ownership of P<sub>1</sub> × 10 percent ownership of L), B is not a 5-percent shareholder of L, even though he is a 5-percent owner of P<sub>1</sub>. Under the rules of paragraph (j) of this section, therefore, B is treated as a member of Public P<sub>1</sub>. See *Example (3)* of paragraph (j)(1)(vi) of this section for a determination of which public owners and public shareholders constitute public groups that are treated as 5-percent shareholders of L.

*Example (2)* (i) The facts are the same as in *Example (1)*, except that P<sub>3</sub> is owned 60 percent by C, 30 percent by P<sub>4</sub>, and 10 percent by Public P<sub>3</sub>. The stock of P<sub>4</sub> is owned by a group of persons (Public P<sub>4</sub>), none of whom own five percent or more of the stock of P<sub>4</sub>.

(ii) The ownership structure of L is illustrated by the following chart:



(iii) The defined terms are the same as in *Example (1)*, except that P<sub>3</sub> is a higher tier entity, not a highest tier entity, because five percent or more of P<sub>3</sub> is, in turn, owned by another entity (P<sub>4</sub>). P<sub>4</sub>, which owns five percent or more of a higher tier entity (P<sub>3</sub>), also is a higher tier entity and, because it is not owned at any time during any testing period by any entity that is also a higher tier entity, P<sub>4</sub> is a highest tier entity. All of the shareholders of P<sub>4</sub>, none of which own a direct ownership interest of five percent or more in P<sub>4</sub>, are public owners of P<sub>4</sub>.

(iv) C is a 5-percent owner of P<sub>3</sub> and, under the constructive ownership rules of para-

graph (h) of this section, C indirectly owns 8.4 percent of L ([60 percent ownership of P<sub>3</sub>] × [70 percent ownership of E] × [20 percent ownership of L]), in his capacity as a 5-percent owner of P<sub>3</sub>. B is a 5-percent owner of P<sub>1</sub> and, under the constructive ownership rules of paragraph (h) of his section, B owns 1.5 percent of L ([15 percent ownership of P<sub>1</sub>] × [10 percent ownership of L]) in his capacity as a 5-percent owner of P<sub>1</sub>. Therefore, C is a 5-percent shareholder of L, but B is not a 5-percent shareholder of L, even though he is a 5-percent owner of P<sub>1</sub>. See *Example (4)* of

paragraph (j)(1)(vi) of this section for a determination of which public owners and public shareholders constitute public groups that are treated as separate 5-percent shareholders of L.

*Example (3)* (i) L is owned 30 percent by A and 70 percent by P. A owns six percent of P stock and the balance (94 percent) is owned equally by 500 unrelated shareholders ("Public P").

(ii) A is a 5-percent shareholder because he directly owns 30 percent of L. Even though A is a 5-percent owner of P, A's 4.2 percent indirect ownership interest in L (six percent ownership interest in P × P's 70 percent ownership of L) is generally not taken into account in determining A's ownership interest, because such indirect ownership interest is less than five percent. Instead, A's 4.2 percent indirect interest is treated under paragraph (j)(1)(iv) of this section as owned by Public P. If, however, L has actual knowledge of A's less-than-five-percent indirect ownership interest in L and is thus subject to paragraph (k)(2) of this section, or paragraph (k)(4) of this section otherwise applies, L must take A's total 34.2 percent ownership interest into account in determining A's percentage ownership in L.

*Example (4)*. The facts are the same as in *Example (3)*, except that A owns ten percent of P's stock. Because A's indirect ownership interest in L in his capacity as a 5-percent owner of P is five percent or more, both A's 30 percent direct ownership interest in L and his seven percent indirect ownership interest in L (10 percent ownership interest in P × P's 70 percent ownership of L) are taken into account in determining his ownership interest in L, without regard to L's actual knowledge or whether paragraph (k)(4) of this section applies.

*Example 5* See § 1.382-3(a)(1)(ii) for additional examples with respect to the definition of an entity.

(5) *Stock ownership presumptions in connection with certain acquisitions, and dispositions of loss corporation stock—(i) In general.* For purposes of this section—

(A) If an individual owns less than five percent of the stock of a loss corporation during the testing period (excluding the testing date) and acquires an amount of such stock so that the individual becomes a 5-percent shareholder on the testing date, the loss corporation may treat any interest in the loss corporation owned by such individual prior to that acquisition as owned by a public group during the period of such individual's ownership of that interest and as not owned by the

5-percent shareholder during the same period, and

(B) If a 5-percent shareholder's percentage ownership interest in the loss corporation is reduced to less than five percent, the loss corporation may presume that the remaining stock owned by such 5-percent shareholder immediately after such reduction is the stock owned by such shareholder for each subsequent testing date having a testing period that includes the date on which the reduction occurred as long as such shareholder continues to own less than five percent of the stock of the loss corporation. In that event, such ownership interest shall be treated as owned by a separate public group for purposes of the rules of paragraph (j)(2)(vi) of this section.

(ii) *Example.*

*standing. All of the L stock is owned equally by 40 unrelated, individual shareholders, including A (who owns 2.5 percent of L stock). Because no person owns as much as five percent of L stock, Public L is the only 5-percent shareholder of L. See paragraph (j)(1) of this section. A purchases 5,000 shares of L stock over a public stock exchange on June 8, 1989. The purchase is an owner shift. When added to his ownership interest before that date (the testing date), A owns 7,500 shares of L stock (7.5 percent). Under paragraph (g)(5)(i)(A) of this section, L may treat A and Public L as having owned 0 percent and 100 percent, respectively, at all times prior to June 8, 1989 (rather than having owned 2.5 percent by A and 97.5 percent by Public L, even if L has actual knowledge of A's less than five percent ownership interest). The increase in A's stock ownership of L as of June 8, 1989 thus would be 7.5 percentage points, rather than 5.0 percentage points, for purposes of determining whether an ownership change occurs on that testing date and any subsequent testing date.*

(h) *Constructive ownership of stock—(1) In general.* Subject to certain modifications set forth in this section and section 382(l)(3), the constructive ownership rules of section 318(a) generally apply for purposes of determining ownership of loss corporation stock.

(2) *Attribution from corporations, partnerships, estates and trusts—(i) In general.* Stock owned (directly or indirectly) by an entity shall be attributed to its owners—

(A) Except as otherwise provided in this section, by treating the stock attributed pursuant to section 318(a)(2) as no longer being owned by the entity from which it is attributed, and

(B) If attribution is from a corporation, without regard to the 50 percent stock ownership limitation contained in section 318(a)(2)(C).

(ii) *Limitation on attribution from entities with respect to certain interests.* Section 318(a)(2) shall not apply to treat the stock of the loss corporation that is owned directly by a first tier entity (or indirectly by any higher tier entity) as being indirectly owned by any person that has an ownership interest in the first tier entity (or any higher tier entity) to the extent that such interest is (or is attributable to)—

(A) Stock of any such entity that is described in section 1504(a)(4),

(B) Any ownership interest in any such entity that does not constitute stock under paragraph (f)(18)(ii) of this section, or

(C) If the entity is not a corporation, any ownership interest in any such entity that has characteristics similar to the interests described in paragraph (h)(2)(ii)(A) or (B) of this section.

The ownership interests described in this paragraph (h)(2)(ii) shall not be taken into account in determining a person's percentage ownership interest in an entity under paragraph (f)(24) of this section.

(iii) *Limitation on attribution from certain entities.* For purposes of this section, except as provided in paragraphs (k)(2) and (4) of this section, each of the following shall be treated as an individual who is unrelated to any other owner (direct or indirect) of the loss corporation—

(A) Any entity other than a higher tier entity that owns five percent or more of the loss corporation stock (determined without regard to paragraph (h)(2)(i)(A) of this section) on a testing date, a first tier entity or the loss corporation,

(B) A qualified trust described in section 401(a),

(C) Any State, any possession of the United States, the District of Columbia, the United States (or any agency or instrumentality thereof), any for-

eign government, or any political subdivision of any of the foregoing, and

(D) Any other person designated by the Internal Revenue Service in the Internal Revenue Bulletin.

Stock of a loss corporation that is owned by any such person shall thus not be attributed to any other person for purposes of this section. See paragraph (g)(2) of this section limiting attribution from a first tier entity or a higher tier entity to any person that is not a 5-percent owner or a higher tier entity.

(iv) *Examples.*

*Example (1).* All the stock of L is owned by A. B and C respectively own 70 and 30 percent of the outstanding P stock. P acquires 60 percent of the outstanding L stock from A on July 1, 1988 (a testing date). After the acquisition, P is a first tier entity and a higher tier entity of L. B and C are each 5-percent owners of P and also are 5-percent shareholders of L having a 42 percent and 18 percent stock ownership interest in L, respectively, through the operation of the constructive ownership rules of paragraph (h) of this section. Because B and C together have increased their ownership in L by more than 50 percentage points during the testing period ending on the testing date (60 percent on the testing date and 0 percent prior thereto), an ownership change occurs with respect to L on July 1, 1988.

*Example (2).* The facts are the same as in *Example (1)*, except that B and C are not shareholders in a corporation, but instead are partners in a general partnership. E, B and C respectively own 70 percent and 30 percent of E. E acquires 60 percent of the L stock on July 1, 1988. The results are the same as in *Example (1)*.

*Example (3).* The facts are the same as in *Example (1)*, except that the acquisition is accomplished in a transaction that qualifies under section 351(a). In that transaction, HC is formed through (i) a contribution of money by P in exchange for 60 shares of HC common stock and (ii) a contribution of all the outstanding shares of L stock plus cash by A in exchange for 40 shares of HC common stock and 30 shares of HC preferred stock that is described in section 1504(a)(4). The respective values of each share of HC stock, common and preferred, are equal. The stock of L is attributed to A through his interest in HC common stock, but not through his interest in HC preferred stock (see paragraph (h)(2)(ii)(A) of this section). Thus, A is treated as owning indirectly only 40 percent of L. B and C are 5-percent shareholders of L having indirect ownership interests in L of 42 percent and 18 percent, respectively, through their ownership of HC common stock. The

results are therefore the same as in *Example (1)*.

(3) *Attribution to corporations, partnerships, estates and trusts.* Except as otherwise provided by regulation under section 382 or by the Internal Revenue Service in the Internal Revenue Bulletin, the rules of section 318(a)(3) shall not apply in determining the ownership of stock under this section.

(4) *Option attribution—(i) In general.* Solely for the purpose of determining whether there is an ownership change on any testing date, stock of the loss corporation that is subject to an option shall be treated as acquired on any such date, pursuant to an exercise of the option by its owner on that date, if such deemed exercise would result in an ownership change. The preceding sentence shall be applied separately with respect to—

(A) Each class of options (*i.e.*, options with terms that are identical, issued by the same issuer, and issued on the same date) owned by each 5-percent shareholder (or person who would be a 5-percent shareholder if the option were treated as exercised), and

(B) Each 5-percent shareholder, each owner of an option who would be a 5-percent shareholder if the option were treated as exercised, and each combination of such persons.

(ii) *Examples.*

*Example (1).* (i) A owns all of the 100 shares of outstanding L stock. A grants options for the purchase of his L stock, exercisable for 10 years from the date of issuance, in the following transactions: An option to B for four shares (issued January 1, 1988), an option to C for six shares (issued June 1, 1989), and an option to D for 15 shares (issued July 30, 1989). On July 30, 1990, A sells 41 shares of his L stock to BB.

(ii) Pursuant to paragraph (a)(2)(i) of this section, the date on which each option is acquired is a testing date. The issuance of options to acquire L stock to each of B, C, and D is not treated as an acquisition of the underlying stock on any such testing date since such treatment with respect to any one of the option owners (or any combination thereof) would not have resulted in an ownership change on any of those testing dates.

(iii) The date on which BB acquires 41 shares also is a testing date. BB's acquisition of 41 percent of the L stock, taken together with the shift in ownership that would result if the options held by B, C and D were exercised, would result in an ownership change,

because the stock owned or treated as owned by Public L (a group including only B, the sole shareholder who owns less than five percent of L stock), C, D and BB would have increased by 66 percentage points (four, six, 15, and 41 percentage points, respectively) during the testing period. Subject to paragraph (h)(4)(ix) of this section, the options are treated as exercised and an ownership change occurs on July 30, 1990, pursuant to paragraph (h)(4)(i) of this section. Accordingly, no new testing period can begin before July 31, 1990. Under paragraph (h)(4)(x)(F) of this section, the option attribution rules of paragraph (h)(4)(i) of this section shall not be applicable with respect to any of the options owned by B, C, and D immediately before the ownership change until such time, if any, that such options are transferred to (or by) 5-percent shareholder (or a person who would be a 5-percent shareholder if such option were exercised). In addition, the subsequent exercise of any of those options by A, B, or C (the persons owning such options immediately before the ownership change) is disregarded. See paragraph (h)(4)(vi) of this section. Also see paragraph (h)(4)(viii) of this section for the treatment of options that lapse or are forfeited.

(iv) The facts are the same as in (i), except that the sale of A's 41 shares of L stock to BB occurs on July 30, 1995. Because the options are treated as exercised and the related stock is treated as acquired on the July 30, 1995 testing date, the results are the same as described in (iii).

*Example (2)* (i) A owns all of the outstanding 100 shares of the stock of L. On July 22, 1988, the value of A's stock in L is \$500 and the following agreements are entered into: (i) A sells 40 shares of his L stock to B for \$200, (ii) in exchange for \$10, A grants B an option to acquire the balance of his L stock for \$305 at any time before July 22, 1992, and (iii) L grants A an option to acquire 100 shares of L stock at a price of \$600 exercisable until such time as B's option is no longer outstanding.

(ii) If the stock subject to the options owned by both A and B were treated as acquired on the July 22, 1988 testing date, B would have increased his ownership interest in L by only 50 percentage points to 50 percent ((40 shares purchased + 60 shares acquired pursuant to the option)/200 outstanding shares of L stock, including 100 shares deemed outstanding pursuant to the option issued to A by L) as compared with 0 percent prior to July 22, 1988. In determining whether the options with respect to the stock of L would, if exercised, result in an ownership change, paragraph (h)(4)(i)(B) of this section requires that such options be treated as exercised separately with respect to each 5-percent shareholder, each person who would be a 5-percent shareholder if the option were treated as exercised or each

combination of such persons. Therefore, by treating the option owned by A as not having been exercised and the option owned by B as having been exercised, B's interest in L increases by 100 percentage points during the testing period. An ownership change with respect to L therefore results from the transactions occurring on July 22, 1988.

(iii) *Contingencies.* Except as provided in paragraph (h)(4)(x)(D) of this section, the extent to which an option is contingent or otherwise not currently exercisable shall be disregarded for purposes of this section.

(iv) *Series of options.* For purposes of this section, an option to acquire an option with respect to the stock of the loss corporation, and each one of a series of such options, shall be considered as an option to acquire such stock.

(v) *Interests that are similar to options.* For purposes of this section,

(A) An interest that is similar to an option includes, but is not limited to, a warrant, a convertible debt instrument, an instrument other than debt that is convertible into stock, a put, a stock interest subject to risk of forfeiture, and a contract to acquire or sell stock, and

(B) Any such interest shall be treated as an option.

(vi) *Actual exercise of options—(A) In general.* The actual exercise of any option in existence immediately before and after an ownership change, whether or not the option was treated as exercised in connection with the ownership change under paragraph (h)(4)(i) of this section, shall be disregarded for purposes of this section, but only if the option is exercised by the 5-percent shareholder (or person who would have been a 5-percent shareholder if the options owned by such person had been exercised immediately before the ownership change) who owned the option immediately before and after such ownership change.

(B) *Actual exercise within 120 days of deemed exercise.* If the actual exercise of an option occurs on or before the end of the period which is 120 days after the date on which the option is treated as exercised under paragraph (h)(4)(i) of this section, the loss corporation may elect to treat paragraphs (h)(4)(i) and (vi)(A) of this section as not applying to such option and take into account only the acquisition of loss corporation

stock resulting from the actual exercise of the option. An election under this paragraph (h)(4)(vi)(B) shall have no effect on the determination of whether an ownership change occurs, but shall apply only for the purpose of determining the date on which the change date occurs. An election under this paragraph (h)(4)(vi)(B) shall be made in the statement described in paragraph (a)(2)(ii) of this section.

(vii) *Effect of deemed exercise of options on the outstanding stock of the loss corporation—(A) Right or obligation to issue stock.* Solely for purposes of determining whether an ownership change has occurred under paragraph (h)(4)(i) of this section, the deemed exercise of an option with respect to unissued stock (or treasury stock) of a corporation shall result in a corresponding increase in the amount of its total outstanding stock.

(B) *Right or obligation to acquire outstanding stock by the loss corporation.* Solely for purposes of determining whether an ownership change has occurred under paragraph (h)(4)(i) of this section, the deemed exercise of a right to transfer outstanding stock to the issuing corporation (or a right of the issuing corporation to acquire its stock) shall result in a corresponding decrease in the amount of its total outstanding stock.

(C) *Effect on value of old loss corporation.* The deemed exercise of an option with respect to unissued stock (or treasury stock) under paragraph (h)(4)(i) of this section shall have no effect on the determination of the value of the old loss corporation and the computation of the section 382 limitation. See section 382(l)(1)(B) disregarding capital contributions made during the two-year period preceding the change date for purposes of computing the section 382 limitation.

(viii) *Options that lapse or are forfeited.* If an option that is treated as exercised under paragraph (h)(4)(i) of this section lapses unexercised or the owner of such option irrevocably forfeits his right to acquire stock pursuant to the option, the option shall be treated for purposes of this section as if it never had been issued. In that case, the loss



corporation may file an amended return for prior years (subject to any applicable statute of limitations) if the section 382 limitation was thus inapplicable. If paragraph (h)(4)(i) of this section applied to an option (or options) with respect to a taxable year for which an income tax return has not been filed by the date that the option (or options) lapses or is irrevocably forfeited, the loss corporation may treat paragraph (h)(4)(i) of this section as inapplicable to such option (or options).

(ix) *Option rule inapplicable if pre-change losses are de minimis.* Paragraph (h)(4)(i) of this section shall not apply to treat the stock of the loss corporation as acquired by the owner of an option if, on a testing date, the amount of pre-change losses (determined as if the testing date were a change date and treating the amount of any net unrealized built-in loss as a pre-change loss) is less than twice the amount determined by multiplying.

(A) The value of the loss corporation (as determined under section 382(e)) on the testing date, by

(B) The long-term tax exempt rate (as defined in section 382(f)) for the calendar month in which the testing date occurs.

(x) *Options not subject to attribution.* Paragraph (h)(4)(i) of this section shall not apply to—

(A) *Long-held options with respect to actively traded stock.* Any option with respect to stock of the loss corporation which stock is actively traded on an established securities market (within the meaning of section 1273(b)) for which market quotations are readily available, if such option has been continuously owned by the same 5-percent shareholder (or a person who would be a 5-percent shareholder if such option were exercised) for at least three years, but only until the earlier of such time as—

(1) The option is transferred by or to a 5-percent shareholder (or a person who would be a 5-percent shareholder if such option were exercised), or

(2) The fair market value of the stock that is subject to the option exceeds the exercise price for such stock on the testing date. For purposes of this paragraph (h)(4)(x)(A), options with respect to the stock of a loss corporation that

are assumed (or substituted) in a reorganization and converted into options with respect to the stock of another party to the reorganization shall not be treated as transferred, provided that there are no changes in the terms of the options, other than that the stock that may be acquired pursuant to the option is that of another party to the reorganization and that the amount of stock subject to the option is adjusted only to reflect the exchange ratio for the exchange of stock of the loss corporation in the reorganization.

(B) *Right to receive or obligation to issue a fixed dollar amount of value of stock upon maturity of certain debt.* Any right to receive or obligation to issue stock pursuant to the terms of a debt instrument that, in economic terms, is equivalent to nonconvertible debt because the right to receive stock of the issuer of a fixed dollar amount is based upon the fair market value for such stock determined at or about the date the stock is transferred pursuant to such right or obligation (*i.e.*, the amount of the stock transferred pursuant to the option is equal to a fixed dollar amount, divided by the value of each share of such stock at or about the date of the stock transfer). This paragraph (h)(4)(x)(B) shall not apply if the method for determining the fair market value of the stock of the issuer is intended to or, in fact, provides the owner of the debt instrument with a participation in any appreciation of any stock of the issuer.

(C) *Right or obligation to redeem stock of the loss corporation.* Any right or obligation of the loss corporation to redeem any of its stock at the time such stock is issued, but only to the extent such stock is issued to persons who are not 5-percent shareholders immediately before the issuance.

(D) *Options exercisable only upon death, disability or mental incompetency.* Any option entered into between owners of the same entity (or an owner and the entity in which the owner has a direct ownership interest) with respect to such owner's ownership interest in the entity that is exercisable only upon the death, complete disability or mental incompetency of such owner.

(E) *Right to receive or obligation to issue stock as interest or dividends.* Any

right to receive or obligation to issue stock of a corporation in payment of interest or dividends by the issuing corporation. (For an example illustrating this exception, see paragraph (j)(2)(iv)(B) of this section.)

(F) *Options outstanding following an ownership change—(1) In general.* Any option in existence immediately before and after an ownership change, whether or not the option was treated as exercised in connection with the ownership change under paragraph (h)(4)(i) of this section, but only so long as the option continues to be owned by the 5-percent shareholder (or person who was treated as a 5-percent shareholder) who owned the option immediately before and after such ownership change.

≤(2) *Example (i) A, B, C and D own all of the outstanding stock of L. A owns 70 shares of L stock and each of B, C and D own 10 shares of L stock. On July 12, 1988, L issues warrants to each of its shareholders entitling them to acquire an additional 8.5 shares of L stock for each share of stock owned. (ii) If B, C and D, but not A, each exercise their respective rights to acquire an additional 85 shares of L stock (10 shares × 8.5 shares that may be acquired for each share owned) on July 12, 1988, their combined ownership interest in L on that date would exceed 80 percent (255 shares deemed to be acquired + 30 shares actually owned)/355 shares outstanding (actual and deemed)). B, C and D thus would increase their ownership interest in L by 50.3 percentage points during the testing period, causing an ownership change, because, under paragraph (h)(4)(i)(B) of this section, the options are treated as exercised if the exercise would cause an ownership change.*

(iii) Following the ownership change, paragraph (h)(4)(i) of this section applies to prevent A's right to acquire 595 shares of L stock (70 shares × 8.5 shares that may be acquired for each share owned) or the rights held by B, C, or D, to be treated as exercised on any subsequent testing date, except to the extent that those rights are transferred. To the extent any of those options are transferred following the ownership change, paragraph (h)(4)(i) of this section will apply to any such options on the date of the transfer and on any subsequent testing date.

(G) *Right to acquire loss corporation stock pursuant to a default under a loan agreement.* Any right to acquire stock of a corporation by a bank (as that term is defined in section 581), an insurance company (as that term is defined in § 1.801-3(a)), or a trust qualified under section 401(a) solely as the result of a default under a loan agreement en-

tered into in the ordinary course of the trade or business of such bank, life insurance company or qualified trust.

(H) *Agreement to acquire or sell stock owned by certain shareholders upon retirement.* Any option entered into between noncorporate owners of the same entity (or a noncorporate owner and the entity in which the owner has a direct ownership interest) with respect to such owner's ownership interest in the entity, but only if each of such owners actively participate in the management of the entity's trade or business, the option is issued at a time that the loss corporation is not a loss corporation and the option is exercisable solely upon the retirement of such owner. An option with terms described in both this paragraph (h)(4)(x)(H) and in paragraph (h)(4)(x)(D) of this section shall also not be subject to paragraph (h)(4)(i) of this section.

(I) [Reserved]

(J) *Title 11 or similar case.* See § 1.382-9(o) which excepts certain options created by or under a plan of reorganization in a title 11 or similar case from the operation of paragraph (h)(4)(i) of this section.

(K)-(Y) [Reserved]

(xi) *Certain transfers of options disregarded.* Transfers of options between persons who are not 5-percent shareholders (and between members of separate public groups resulting from the application of the segregation rules of paragraphs (j)(2) and (3)(iii) of this section) are not taken into account. Transfers of options in any of the circumstances described in section 382(l)(3)(B) are also disregarded and the transferee shall be treated as having owned the option for the period that it was owned by the transferor.

(xii) *Exercise of an option that has not been treated as stock.* The acquisition of stock pursuant to the actual exercise of an option (other than an option described in paragraph (h)(4)(vi)(A) of this section) shall not be disregarded.

(xiii) *Effective date.* See paragraph (m)(4)(vi) of this section for special rules regarding the effective date of the provisions of this paragraph (h)(4).

(5) *Stock transferred under certain agreements.* Notwithstanding paragraph (h)(4) of this section, no shift results solely because under section 1058(a)—

(i) A shareholder transfers stock of a corporation pursuant to an agreement that meets the requirements of section 1058(b), or

(ii) A person having rights under such an agreement exchanges those rights for stock identical to the stock transferred pursuant to the agreement.

(6) *Family attribution.* For purposes of this section—

(i) Paragraphs (1) and (5)(B) of section 318(a) shall not apply,

(ii) An individual and all members of his family described in section 318(a)(1) shall be treated as one individual,

(iii) Subject to paragraph (k)(2) of this section, paragraph (h)(6)(ii) of this section shall not apply to members of a family who, without regard to that paragraph (h)(6)(ii), would not be 5-percent shareholders, and

(iv) If under paragraph (h)(6)(ii) of this section, an individual may be treated as a member of more than one family, and each family that is treated as one individual is a 5-percent shareholder (or would be treated as a 5-percent shareholder if such individual were treated as a member of such family), then such individual shall be treated only as a member of the family that results in the smallest increase in the total percentage stock ownership of the 5-percent shareholders on the testing date and shall not be treated as the member of any other family.

(i) [Reserved]

(j) *Aggregation and segregation rules.* For purposes of this section, except as provided in paragraphs (k)(2) and (4) of this section—

(1) *Aggregation of public shareholders and public owners into public groups—(i) Public group.* Under this paragraph (j), a loss corporation or other entity can be treated as owned, in whole or in part, by one or more public groups. A public group can include public shareholders, public owners, and 5-percent owners who are not 5-percent shareholders of the loss corporation.

(ii) *Treatment of a public group that is a 5-percent shareholder.* Each public group that is treated as a 5-percent shareholder under paragraph (g)(1)(ii), (iii) or (iv) of this section shall be treated as one individual. See paragraph (j)(2)(iv) for a rule combining certain de minimis public groups.

(iii) *Presumption of no cross-ownership.*

The public owners, 5-percent owners who are not 5-percent shareholders and public shareholders in any public group, subject to paragraphs (j)(2)(iii), (k)(2) and (k)(4) of this section, are presumed not to be members of any other public group. It also is presumed that each such person is unrelated to all other shareholders (direct and indirect) of the loss corporation. See paragraph (h)(6)(iii) of this section. The members of a public group that exists by virtue of its direct ownership interest in an entity are presumed not to be members (and not to be related to a member) of any other public group that exists at any time by virtue of its direct ownership interest in any other entity. To the extent that the presumptions adopted in this paragraph (j)(1)(iii) are not applicable because the loss corporation has actual knowledge of facts to the contrary and is thus subject to paragraph (k)(2) of this section, public shareholders, public owners and 5-percent owners who are not 5-percent shareholders may be aggregated into additional public groups.

(iv) *Identification of the public groups treated as 5-percent shareholders—(A) Analysis of highest tier entities.* The loss corporation must identify first tier entities and higher tier entities in order to identify any highest tier entities that must be identified under paragraph (k)(3) of this section. The loss corporation must then identify any 5-percent owners of each such highest tier entity who indirectly own, at any time during the testing period, five percent or more of the loss corporation through the ownership interest in such highest tier entity. Under paragraph (g)(1)(i)(B) of this section, any such 5-percent owner is a 5-percent shareholder. See paragraph (k)(3) of this section for rules explaining the extent of the obligation of the loss corporation to determine the identity of its shareholders. Each person who has an ownership interest in any highest tier entity and who is not treated as a 5-percent shareholder (*i.e.*, persons who are public owners or 5-percent owners who are not 5-percent shareholders) is a member of the public group of that highest tier entity. A public group, so identified, that indirectly owns five percent

or more of the loss corporation on the testing date is treated under paragraph (g)(1)(ii) of this section as a 5-percent shareholder. If the public group so identified owns less than five percent of the loss corporation on the testing date, such public group is treated as part of the public group of the next lower tier entity.

(B) *Analysis of other higher tier entities and first tier entities.* The analysis and aggregation of public groups described in paragraph (j)(1)(iv)(A) of this section is repeated for any next lower tier entity and successively for any next lower tier entity of any entity described in this paragraph (j)(1)(iv)(B) until applied to each first tier entity.

(C) *Aggregation of the public shareholders.* The public shareholders are aggregated and, under paragraph (g)(1)(iii) of this section, are treated as a public group that is a 5-percent shareholder without regard to whether such group, at any time during the testing period, owns five percent or more of the loss corporation. For this purpose, if the public group of any first tier entity indirectly owns less than five percent of the loss corporation on the testing date, and is thus not treated as a 5-percent shareholder, but is treated as part of the public group of the loss corporation under paragraph (j)(1)(iv)(A) or (B) of this section, the ownership interest of that group is included in the public group of the loss corporation referred to in the preceding sentence.

(v) *Appropriate adjustments.* A loss corporation may apply the principles of paragraph (g)(5) of this section with respect to—

(A) Any public group that is treated as a 5-percent shareholder on the testing date if such public group, at any time during the testing period, was treated as part of the public group of the next lower tier entity, or

(B) Any public group that is treated as part of the public group of a next lower tier entity if such public group, at any time during the testing period, was part of the public group of a higher tier entity that was treated as a 5-percent shareholder and had a direct or indirect ownership interest in such lower tier entity.

(vi) *Examples.*

*Example (1) (i)* All of the stock of L is owned by 1,000 shareholders, none of whom own as much as five percent of L stock ("Public L"). All of the stock of P is owned by 150,000 shareholders, none of whom own as much as five percent of P stock ("Public P"). Between July 12, 1988 and August 13, 1988, P purchases all of the L stock through a series of transactions on the public stock exchange. P's percentage of direct stock ownership in L increases from 4.9 percent to five percent on July 15, 1988, and from 50 percent to 51 percent on July 30, 1988.

*(ii)* Before July 15, 1988, P is a public shareholder of L. On and after July 15, 1988, P is a first tier entity (and a highest tier entity) of L. Accordingly, under the rules of paragraph (j)(1) of this section, Public P, on and after July 15, 1988, is treated as a public group that is a 5-percent shareholder. Each acquisition by P on and after such date affects the percentage of L stock that is owned by Public P and thus constitutes an owner shift.

*(iii)* Immediately after the transaction on July 30, 1988, P owns 51 percent of L stock. Under paragraph (j)(1)(iv)(A) of this section, Public P thus owns 51 percent of L. Under paragraph (j)(1)(iv)(C) of this section, Public L, the public group that includes the public shareholders of L, is treated as a 5-percent shareholder that owns 49 percent of L. Under paragraph (j)(1)(iii) of this section, Public L and Public P are presumed not to have any common members and it is also presumed that no member of either public group is related to any other member of either of the two public groups.

*(iv)* Assuming that the presumption provided in paragraph (j)(1)(iii) of this section (*i.e.*, that no person owns stock in both P and L) is not rebutted to any extent, Public P is treated as a 5-percent shareholder whose stock ownership in L, as of the July 30, 1988 testing date, has increased by 51 percentage points over its lowest percentage of stock ownership in L at any time during the testing period (0 percent prior to July 12, 1988). Accordingly, an ownership change with respect to L occurs as a result of P's acquisition on July 30, 1988. L is thus a new loss corporation and its pre-change losses are subject to limitation under section 382.

*Example (2) (i)* All of the stock of P is owned by 1,000 unrelated shareholders, none of whom owns as much as five percent of P stock. L<sub>1</sub> is a wholly owned subsidiary of P. On January 2, 1988, P distributes all of the L<sub>1</sub> stock pro rata to its shareholders.

*(ii)* Prior to the stock distribution, the public owners of P are members of a public group ("Public P") that is treated as a 5-percent shareholder owning 100 percent of the stock of L<sub>1</sub>.

See paragraph (j)(1)(iv)(A) of this section. Following the stock distribution to the P shareholders, L<sub>1</sub> is owned by 1,000 public

shareholders that are members of a public group ("Public L<sub>1</sub>") that is treated as a 5-percent shareholder owning 100 percent of the stock of L<sub>1</sub>. See paragraph (j)(1)(iv)(C) of this section.

(iii) Public P and Public L<sub>1</sub> are treated as unrelated, individual 5-percent shareholders under paragraph (j)(1)(iii) of this section. Although the members of one public group are presumed not to be members of any other public group under paragraph (j)(1)(iii) of this section, L<sub>1</sub> has actual knowledge that all of its public shareholders immediately following the distribution (Public L<sub>1</sub>) received L<sub>1</sub> stock pro rata in respect to the outstanding P stock and thus were also members of Public P. Applying paragraph (k)(2) of this section, the loss corporation may take into account the identity of ownership interests between Public L<sub>1</sub> and Public P to establish that Public L<sub>1</sub> did not increase its percentage ownership in L<sub>1</sub>. Accordingly, the transaction would not constitute an owner shift.

*Example (3) (i)* The facts are the same as in *Example (1)* of paragraph (g)(4) of this section. Thus, 20 percent of L stock is owned by A, 10 percent is owned by P<sub>1</sub>, 20 percent is owned by E, a joint venture, and the remaining 50 percent of L stock is owned by Public L. P<sub>1</sub> is owned 15 percent by B and 85 percent by Public P<sub>1</sub>. E is owned 30 percent by P<sub>2</sub> and 70 percent by P<sub>3</sub>, which are owned by Public P<sub>2</sub> and Public P<sub>3</sub>, respectively. See *Example (1)(ii)* of paragraph (g)(4) of this section for a chart illustrating this ownership structure.

(ii) The public owners of P<sub>2</sub> and P<sub>3</sub> (Public P<sub>2</sub> and Public P<sub>3</sub>, respectively), are public groups that are treated as 5-percent shareholders of L, because each such public group indirectly owns five percent or more of L stock (six percent by Public P<sub>2</sub> [(30 percent ownership of E)×(20 percent ownership of L)] and 14 percent by Public P<sub>3</sub> [(70 percent ownership of E)×(20 percent ownership of L)]). The public owners of P<sub>1</sub> ("Public P<sub>1</sub>"), who indirectly own 8.5 percent of L stock [(85 percent ownership of P<sub>1</sub>)×(10 percent ownership of L)] and B, who indirectly owns 1.5 percent of L and is thus included in Public P<sub>1</sub> under paragraph (j)(1)(iv)(A) of this section, are members of a public group that is treated as a 5-percent shareholder of L that owns ten percent of L stock. Finally, the public group

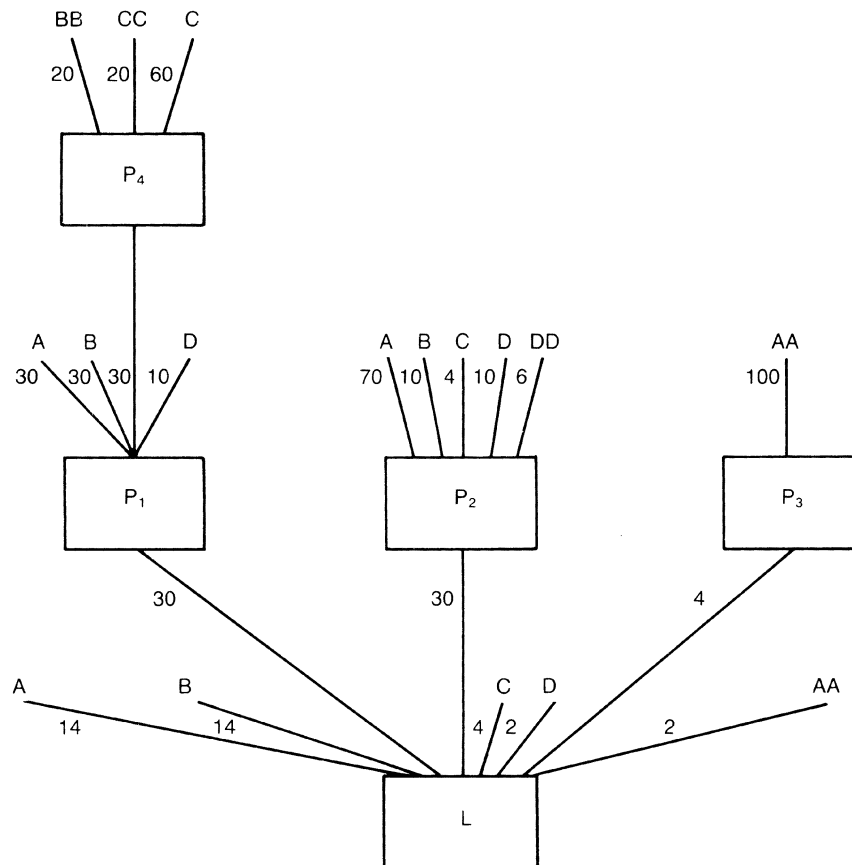
of L ("Public L") is a 5-percent shareholder that owns 50 percent of L. Accordingly, A, Public L, Public P<sub>1</sub> (including B), Public P<sub>2</sub>, and Public P<sub>3</sub> are the only 5-percent shareholders of L.

*Example (4) (i)* The facts are the same as *Example (3)* above, except that P<sub>3</sub> is owned 60 percent by C, 30 percent by P<sub>4</sub>, and 10 percent by P<sub>3</sub>. The stock of P<sub>4</sub> is publicly traded and is owned by Public P<sub>4</sub>. The facts are thus the same as in *Example (2)* in paragraph (g)(4) of this section. See *Example (2)(ii)* of paragraph (g)(4) of this section for a chart illustrating this ownership structure.

(ii) The public owners of P<sub>4</sub> (a highest tier entity) are members of a public group that indirectly owns 4.2 percent of L ([30 percent ownership of P<sub>3</sub>]×[70 percent ownership of E]×[20 percent ownership of L]). For purposes of identifying public groups that are 5-percent shareholders, L is not required to identify P<sub>4</sub> as a highest tier entity under paragraph (k)(3) of this section because P<sub>4</sub> does not own five percent or more of L stock. Moreover, under paragraph (h)(2)(iii) of this section, P<sub>4</sub> generally is treated as an individual from which there is no attribution of loss corporation stock. The public group of P<sub>3</sub> (including P<sub>4</sub>) indirectly owns 5.6 percent of L ([40 percent of P<sub>3</sub>]×[70 percent ownership of E]×[20 percent of L]), and is thus a 5-percent shareholder of L. The public groups of P<sub>2</sub> and P<sub>1</sub> (both Public P<sub>1</sub> and B), respectively, also own five percent or more of L stock and are thus 5-percent shareholders of L. In addition, the public group of L is a 5-percent shareholder regardless of whether it owns five percent of L stock. Accordingly, A, Public L, Public P<sub>3</sub> (including P<sub>4</sub>), Public P<sub>2</sub>, and Public P<sub>1</sub> (including B), are the only 5-percent shareholders of L.

*Example (5)(i)* On September 4, 1987, L is owned 14 percent by each of A and B, 30 percent by each of P<sub>1</sub> and P<sub>2</sub>, four percent by each of C and P<sub>3</sub>, and two percent by each of D and AA. P<sub>1</sub> is owned 30 percent by each of A, B, and P<sub>4</sub> and 10 percent by D. P<sub>2</sub> is owned 70 percent by A, 10 percent by each of B and D, six percent by DD and four percent by C. AA owns 100 percent of the stock of P<sub>3</sub>. P<sub>4</sub> is owned 60 percent by C and 20 percent by each of BB and CC.

(ii) The ownership structure of L is illustrated by the following chart:



(iii) In order to identify L's 5-percent shareholders and their respective ownership interests in L on September 4, 1987, the rules of paragraph (j)(1) of this section apply to identify the public groups that are treated as separate 5-percent shareholders. Analysis begins with any highest tier entity, such as P<sub>4</sub>. Each of P<sub>4</sub>'s shareholders is a 5-percent owner of P<sub>4</sub>. C<sup>4</sup> owns 5.4 percent of L in his capacity as a 5-percent owner of P<sub>4</sub> and therefore is a 5-percent shareholder. Notwithstanding that C actually owns, directly and by attribution, 10.6 percent of L (four percent directly, 5.4 percent indirectly through P<sub>4</sub>, and 1.2 percent through P<sub>2</sub>), C's ownership interest in L as a 5-percent shareholder is presumed to include only the 5.4 percent indirect ownership through P<sub>4</sub>. (Under paragraphs (g) and (k)(2) of this section, however, L must account for C's direct and indirect ownership interests in deter-

mining whether an ownership change occurs on any testing date if it has actual knowledge of such ownership on or before the date that its income tax return is filed for the taxable year that includes the testing date). Although BB and CC are each 5-percent owners of P<sub>4</sub>, they are not 5-percent shareholders and therefore are members of the public group of P<sub>4</sub>. Because the public group of P<sub>4</sub> indirectly owns only 3.6 percent of L, it is treated under paragraph (j)(1)(iv)(A) of this section as part of the public group of the next lower tier entity, P<sub>1</sub>.

(iv) With respect to P<sub>1</sub>, a first tier entity, each of its shareholders are 5-percent owners. Because A and B each indirectly own nine percent of L as 5-percent owners of P<sub>1</sub> and A indirectly owns 21 percent of L as a 5-percent owner of P<sub>2</sub>, they are each 5-percent shareholders without regard to their direct

ownership interests in L. A's ownership interest in L as a 5-percent shareholder is 44 percent (14 percent directly, nine percent in his capacity as a 5-percent owner of P<sub>1</sub>, and 21 percent in his capacity as a 5-percent owner of P<sub>2</sub>). B's ownership interest in L as a 5-percent shareholder is 23 percent (14 percent directly and nine percent in his capacity as a 5-percent and nine percent in his capacity as a 5-percent owner of P<sub>1</sub>). B's ownership interest as a 5-percent shareholder does not include the three percent interest he owns indirectly through P<sub>2</sub>. (Under paragraphs (g) and (k)(2) of this section, however, L must account for B's direct and indirect ownership interests, including his three percent interest through P<sub>2</sub>, in determining whether an ownership change occurs on any testing date if L has actual knowledge of such ownership on or before the date that its income tax return is filed for the taxable year that includes the testing date.) D is a 5-percent owner of P<sub>1</sub>. Although D owns eight percent of L (two percent directly, three percent indirectly through P<sub>1</sub>, and three percent indirectly through P<sub>2</sub>), he is not a 5-percent shareholder because he does not own five percent or more of L stock either directly or in his capacity as a 5-percent owner of either P<sub>1</sub> or P<sub>2</sub>. (Under paragraphs (g) and (k)(2) of this section, however, L must account for D's direct and indirect ownership interests in determining whether an ownership change occurs on any testing date to the extent L has actual knowledge of such ownership amounting to five percent or more of L stock before the date that its income tax return is filed for the taxable year that includes the testing date.) The public group of P<sub>1</sub> (comprised of the public group of P<sub>4</sub> and D's direct ownership interest in P<sub>1</sub>) has a 6.6 percent interest in L and is therefore treated as a separate 5-percent shareholder.

(v) With respect to highest tier entity P<sub>2</sub>, D is a 5-percent owner who is not a 5-percent shareholder for the reason described in the preceding subdivision. DD is a 5-percent owner of P<sub>2</sub>, who is not a 5-percent shareholder, because DD indirectly owns only 1.8 percent of L. Assuming that L does not have actual knowledge of B's and C's direct ownership interest in P<sub>2</sub>, those interests are accounted for in computing the ownership interest are accounted for in computing the ownership interest of the public group of P<sub>2</sub>. Therefore, each of P<sub>2</sub>'s shareholders, except A who is a 5-percent shareholder in his capacity as a 5-percent owner of P<sub>2</sub>, are treated as members of the public group of P<sub>2</sub> that owns nine percent of L and is thus treated as a separate 5-percent shareholder.

(vi) Because the direct ownership interest of P<sub>3</sub> is less than five percent, it is a public shareholder. Therefore, assuming that L does not have actual knowledge of C's, D's, or AA's direct and/or indirect ownership interests in L, the public group of L is a separate

5-percent shareholder owning 12 percent of L (comprised of the direct ownership interests of C, D, AA and P<sub>3</sub>).

(2) *Segregation rules applicable to transactions involving the loss corporation*—(i) *In general.* For purposes of this section, if—

(A) A transaction is described in paragraph (j)(2)(iii) of this section, and

(B) The loss corporation has one or more direct public groups immediately before and after the transaction,

the stock owned by such direct public group or groups is subject to the segregation rules described in paragraph (j)(2)(iii) of this section for purposes of determining whether an ownership change has occurred on the date of the transaction (and on any subsequent testing date with a testing period that includes the date of such transaction). See paragraph (j)(3) of this section for the application of the rules of this paragraph (j)(2) to transactions involving first tier entities or higher tier entities.

(ii) *Direct public group.* For purposes of this section, a direct public group is any public group of the loss corporation described in paragraph (j)(1)(iv)(C) of this section or any public group of the loss corporation resulting from the application of paragraph (j)(2)(iii) or (j)(3)(i) of this section.

(iii) *Transactions to which segregation rules apply*—(A) *In general.* The segregation rules of this paragraph (j)(2)(iii) apply to any transaction described in paragraph (j)(2)(iii)(B), (C), (D), (E), or (F) of this section in the manner specified. The presumptions adopted by this paragraph (j)(2)(iii) shall not apply only if, and to the extent that, the loss corporation either has actual knowledge of facts to the contrary regarding its stock ownership and is thus subject to paragraph (k)(2) of this section, or is subject to paragraph (k)(4) of this section. Any direct public group that is required to be identified as a result of a transaction described in paragraph (j)(2)(iii) of this section shall be treated as a 5-percent shareholder under paragraph (g)(1)(iv) of this section without regard to whether such group, at any time during the testing period, owns five percent or more of the loss corporation stock. To the extent that the presumptions are rebutted, the public

shareholders, public owners and 5-percent owners who are not 5-percent shareholders may be aggregated into additional public groups. For an exception applicable to certain regulated investment companies, see § 1.382-3(k)(1).

(B) *Certain equity structure shifts and transactions to which section 1032 applies—(1) In general.* In the case of—

(i) A transaction that is an equity structure shift that also is described in section 381(a)(2) and in which the loss corporation is a party to the reorganization, or

(ii) A transfer of the stock of the loss corporation (including treasury stock) by the loss corporation in any other transaction to which section 1032 applies,

each direct public group that exists immediately after such transaction shall be segregated so that each direct public group that existed immediately before the transaction is treated separately from the direct public group that acquires stock of the loss corporation in the transaction. The direct public group that acquires stock of the loss corporation in the transaction is presumed not to include any members of any direct public group that existed immediately before the transaction. For purposes of this paragraph (j)(2)(iii)(B), a person is treated as acquiring stock of the loss corporation in a reorganization as the result of the person's ownership interest in another corporation that succeeds to the loss corporation's pre-change losses (determined as if the testing date were the change date and treating the amount of any net unrealized built-in loss as a pre-change loss) in a transaction to which section 381(a)(2) applies. In determining whether a transaction is described in section 1032 for purposes of this paragraph (j)(2)(iii)(B), the transfer by the loss corporation of any interest not constituting stock that is treated as stock under paragraph (f)(18)(iii) of this section shall be treated as the transfer of stock. See § 1.382-3(j) for exceptions to the segregation rules of this paragraph (j)(2)(iii)(B)(1).

(2) *Examples.*

*Example (1) (i)* P<sub>1</sub> owns 60 percent of the stock of L. The remaining L stock (40 percent) is owned by Public L. A owns 40 percent of the P<sub>1</sub> stock. The remaining P<sub>1</sub> stock

(60 percent) is owned by Public P<sub>1</sub>. P<sub>2</sub> is a publicly traded corporation owned by shareholders who each own less than five percent of P<sub>2</sub> stock (Public P<sub>2</sub>).

(ii) On May 22, 1988, L merges into P<sub>2</sub> in a transaction described in section 368(a)(1)(A), with the shareholders of L receiving an amount of P<sub>2</sub> stock equal to 70 percent of the value of P<sub>2</sub> immediately after the reorganization.

(iii) Immediately before the merger, L's 5-percent shareholders were Public L (40 percent), Public P<sub>1</sub> (36 percent), and A (24 percent). Although the shareholders of P<sub>2</sub> (immediately before the merger) do not acquire any stock in the merger, they are treated as acquiring a direct ownership interest in the loss corporation in the reorganization because P<sub>2</sub> succeeds to the pre-change losses of L in a transaction to which section 381(a)(2) applies. As a result of the merger, which constitutes a transaction described in (j)(2)(iii)(B)(1) of this section, L's direct public group, Public L, must be segregated from the direct public group that would otherwise exist after the transaction (Public L and Public P<sub>2</sub>). Public L, the direct public group that exists before the merger, has a continuing 28 percent interest in the loss corporation [70 percent of P<sub>2</sub> shares received in the merger × 40 percent shares of L owned prior to the merger] that must be segregated from the interests acquired by Public P<sub>2</sub>.

(iv) In addition, Public P<sub>1</sub>, which owns five percent or more of the stock of P<sub>2</sub> through P<sub>1</sub>'s ownership interest in P<sub>2</sub>, also is segregated from any other public group (*i.e.*, both Public L and Public P<sub>2</sub>) under paragraph (j)(1) of this section. Therefore, under paragraphs (j)(1) and (2) of this section, Public P<sub>2</sub> (excluding the members of Public L and Public P<sub>1</sub> immediately before the merger) is treated as a separate public group and 5-percent shareholder.

(v) The only 5-percent shareholder whose interest in the loss corporation, P<sub>2</sub>, has increased during the testing period is Public P<sub>2</sub>. Its interest has increased by 30 percentage points. Accordingly, no ownership change results from the merger. For purposes of measuring the shift in ownership of P<sub>2</sub> on any subsequent testing date with a testing period that includes May 22, 1988 (the date on which L merged into P<sub>2</sub>), Public P<sub>2</sub> will continue to be treated as a direct public group, separate from Public L (the members of which own P<sub>2</sub> stock as a result of the merger) and Public P<sub>1</sub>.

*Example (2) (i)* P and L are each owned by 21 equal shareholders. Each of 14 of the shareholders of P and L are owners of both corporations ("common owners"). L has actual knowledge of this cross ownership, therefore, as a group, these persons own 66⅔ percent of each of P and L. P stock has a value of \$600 and L stock has a value of \$400.



(ii) P merges into L under section 368(a)(1)(A) on June 10, 1988. Ordinarily, the direct public group of L that exists immediately before the transaction would be segregated from the direct public group that acquires stock in the merger (the public group of P immediately before the merger). In view of the common ownership of P and L, however, a third group may be created under paragraph (j)(2)(iii)(A) of this section so that L's owners following the merger would be: The common owners (66⅔ percent), Public L, less the common owners, 13 1/3 percent, and Public P, less the common owners (20 percent). Accordingly, the only 5-percent shareholder increasing its ownership interest by 20 percentage points and no ownership change occurs as a result of the merger.

*Example (3) (i)* L is entirely owned by Public L. L commences and completes a public offering of common stock on January 22, 1988, with the result that its outstanding stock increases from 100,000 shares to 300,000 shares. No person owns as much as five percent of L stock following the public offering.

(ii) The public offering of L stock is a transaction to which section 1032 applies. Immediately before the public offering, L's only 5-percent shareholder was Public L, a direct public group. Therefore, Public L (as in existence immediately before the transaction) must be segregated from the direct public group that would otherwise exist immediately after the transaction. Under paragraph (j)(2)(iii)(B)(i) of this section, the acquisition of 200,000 shares of L stock in the public offering must be treated as acquired by a direct public group ("New Public L") that is separate from Public L. Each such public group is treated as an individual that is a separate 5-percent shareholder. See paragraphs (g)(1)(iv) and (j)(1)(ii) of this section.

(iii) As a result of the public offering, L has two 5-percent shareholders, Public L and New Public L, which own 33⅓ percent and 66⅔ percent of the stock of L, respectively. Because the members of New Public L are presumed not to be members of Public L (and not to be related to any such members), the ownership interest of New Public L immediately prior to the offering of stock was 0 percent.

(iv) New Public L is a 5-percent shareholder that has increased its ownership interest in L by more than 50 percentage points during the testing period (by 66⅔ percentage points). Thus, there is an ownership change with respect to L. For purposes of subsequent transactions, Public L and New Public L will not be segregated into two public groups because a new testing period commences on the day following the change date, January 23, 1988 (*i.e.*, any subsequent testing date will not have a testing period that includes the date of the public offering).

*Example (4)* The facts are the same as in *Example (3)*, but L establishes that 60,000 shares

of the newly issued L stock were acquired by its shareholders of record on the date of the stock issuance (*i.e.*, members of Public L, referred to as Acquiring Public L) by persons owning 27 percent of the L stock immediately before the stock issuance. Accordingly, L has actual knowledge that New Public L acquired no more than 140,000 shares of L stock in the public offering. Under paragraphs (j)(2)(iii) and (k)(2) of this section, New Public L may be treated as having increased its ownership interest in L by 46⅔ percentage points (140,000 shares acquired in the offering/300,000 shares outstanding). L also has actual knowledge that the members of Public L owning 27 percent of L stock immediately before the stock issuance (27,000 shares/100,000 shares outstanding) own 29 percent of L stock immediately after such issuance (27,000 shares + 60,000 shares acquired in the offering/300,000 shares outstanding). Assuming that L chooses to take its actual knowledge into account for purposes of determining whether an ownership change occurred on January 22, 1988, Public L is segregated into two direct public groups immediately before the stock issuance so that the two percentage point increase in the ownership interest in L by Acquiring Public L is taken into account. The total increased ownership interest in L by New Public L and Acquiring Public L on the testing date over their lowest ownership interest during the testing period is 48 2/3 percent. Thus, no ownership change occurs with respect to L.

*Example (5) (i)* L is owned entirely by 10,000 unrelated individuals, none of whom own as much as five percent of L stock ("Public L"). P is owned entirely by 1,500 unrelated individuals, none of whom own as much as five percent of P stock ("Public P"). On December 22, 1988, L acquires all of the P stock from Public P in exchange for L stock representing 25 percent of the value of L, in a transaction described in section 368(a)(1)(B).

(ii) Under paragraph (j)(2)(iii)(B)(i) of this section, Public L, the direct public group that owns L stock immediately before and after the transaction to which section 1032 applies, is treated separately from Public P, the direct public group that acquires L stock in the transaction. Because Public P's percentage ownership interest in L increases to only 25 percent (as compared with 0 percent before the acquisition), no ownership change occurs. For purposes of determining whether an ownership change occurs on any testing date with a testing period that includes December 22, 1988, Public L and Public P will continue to be treated as separate 5-percent shareholders.

(iii) See *Example (4)* in paragraph (j)(3)(iv) of this section for the application of paragraph (j)(2)(iii)(B) of this section to a reorganization under section 368(a)(1)(B) in which the loss corporation is acquired.

(C) *Redemption-type transactions—(1) In general.* In the case of a transaction in which the loss corporation acquires its stock in exchange for property, each direct public group that exists immediately before the transaction shall be segregated at that time (and thereafter) so that the stock that is acquired in the transaction is treated as owned by a separate public group from each public group that owns the stock that is not acquired. For purposes of the preceding sentence, the term property shall include stock described in section 1504(a)(4) and stock described in paragraph (f)(18)(ii) of this section. Each direct public group that owned the stock that is acquired in the transaction is presumed not to own any such stock immediately after the transaction.

(2) *Examples.*

*Example (1).* L is entirely owned by Public L. There are 500,000 shares of L stock outstanding. On July 12, 1988, L acquires 150,000 shares of its stock for cash. Because L's acquisition is a redemption, Public L is segregated into two different public groups immediately before the transaction (and thereafter) so that the redeemed interests ("Public RL") are treated as part of a public group that is separate from the ownership interests that are not redeemed ("Public CL"). Therefore, as a result of the redemption, Public CL's interest in L increases by 30 percentage points (from 70 percent (350,000/500,000) to 100 percent) on the July 12, 1988 testing date. Because the resulting increase is not more than 50 percentage points, no ownership change occurs. For purposes of determining whether an ownership change occurs on any subsequent testing date having a testing period that includes such redemption, Public CL is treated as a 5-percent shareholder whose percentage ownership interests in L increased by 30 percentage points as a result of the redemption.

*Example (2).* L is entirely owned by Public L. There are 250,000 shares of L common stock outstanding. On April 22, 1988, L acquires 100,000 shares of its outstanding common stock in exchange for 100,000 shares of preferred stock described in section 1504(a)(4). (The transaction thus constitutes a recapitalization within the meaning of section 368(a)(1)(E).) As a result of the recapitalization, which is a transaction described in paragraph (j)(2)(iii)(C) of this section, Public L is segregated into two different public groups immediately before the transaction (and thereafter) so that the stock acquired by L is treated as owned by a public group ("Public RL") that is separate from the pub-

lic group that owns the stock that is not so acquired ("Public CL"). Therefore, as a result of the transaction, Public CL's interest in L increases by 40 percentage points (from 60 percent to 100 percent). Because the resulting increase is not more than 50 percentage points, no ownership change occurs. For purposes of determining whether an ownership change occurs on any subsequent testing date with a testing period that includes the date of the recapitalization, Public CL is treated as a separate 5-percent shareholder whose percentage ownership interest increased by 40 percentage points as a result of the redemption type transaction.

(D) *Acquisition of loss corporation stock as the result of the ownership of a right to acquire stock—(1) In general.* In the case of a deemed acquisition of stock of the loss corporation as the result of the ownership of a right issued by the loss corporation to acquire such stock (see paragraph (h)(4) of this section), each direct public group that exists immediately after such acquisition shall be segregated so that each direct public group that existed immediately before the transaction is treated separately from the direct public group that is deemed to acquire stock of the loss corporation as a result of the ownership of the right to acquire such stock. The direct public group that is treated as acquiring stock of the loss corporation in the transaction is presumed not to include any members of any direct public group that existed immediately before the transaction. In applying the rules of paragraph (h)(4) of this section, the segregation rules of this paragraph (j)(2)(iii)(D) shall apply before making the determination required under that paragraph (h)(4) of this section. See § 1.382-3(j)(9) for rules relating to this paragraph (j)(2)(iii)(D).

(2) *Example.*

(i) L has 700,000 shares of common stock outstanding. Public L owns all of the outstanding L common stock. On May 20, 1988, L issues a class of debentures to the public that, in the aggregate, may be converted into 300,000 shares of L common stock. On September 7, 1988, P<sub>1</sub> acquires 210,000 shares of L common stock over a public stock exchange. None of the L debentures have been converted as of that date.

(ii) By virtue of L's issuance of convertible debentures, May 20, 1988 is a testing date. See paragraph (a)(2)(i) of this section. Immediately before the issuance of the convertible debentures, L's only 5-percent shareholder

was Public L, a direct public group. Therefore, under paragraph (j)(2)(iii)(D) of this section, Public L must be segregated from the direct public group that would otherwise exist immediately after the transaction for the purpose of applying paragraph (h)(4) of this section, so that any acquisition of L stock through the conversion of L's debentures is treated as made by a public group other than Public L ("New Public L"). Assuming the largest increase in the total percentage stock ownership of New Public L on the testing date (see paragraph (h)(4) of this section), New Public L would have increased its ownership interest in L by 30 percentage points. Therefore, the stock of L would not be treated as acquired pursuant to a deemed conversion of the L debentures on May 20, 1988, under paragraph (h)(4) of this section, because the conversion would not cause an ownership change.

(iii) P<sub>1</sub>'s acquisition of L common stock results in second testing date. For the purpose of applying paragraph (h)(4) of this section, Public L must again be segregated from the direct public group that would otherwise result from conversion of the debentures, so that a deemed acquisition of L stock through the conversion of L's debentures on September 7, 1988 is treated as made by a public group other than Public L ("New Public L"). As on the previous testing date, New Public L would have increased its ownership interest in L by 30 percentage points if it were treated as having acquired L common stock pursuant to the conversion of the L debentures. The increase in New Public L's ownership, taken together with P<sub>1</sub>'s 21 percentage point ownership increase in L during the testing period [210,000 shares deemed converted/(700,000 (actual) + 300,000 (deemed) shares outstanding)], results in an ownership change.

(E) *Transactions identified in the Internal Revenue Bulletin.* Any transaction that is designated by the International Revenue Service in the Internal Revenue Bulletin shall be subject to the rules, as provided in such bulletin, similar to the rules described in this paragraph (j)(2)(iii).

(F) *Issuance of rights to acquire loss corporation stock—(I) In general.* In the case of any transaction that is described in paragraph (j)(2)(iii)(B), (D) or (E) of this section in which the loss corporation issues rights to acquire its stock to the members of more than one public group, those rights shall be presumed to be exercised pro rata by each such public group as those rights are actually exercised. See § 1.382-3(j)(10) for an exception to the application of the rule of this paragraph

(j)(2)(iii)(F)(I) to stock issued on the exercise of a transferable option.

(2) *Example.*

(i) L, which has six million shares outstanding, is owned entirely by Public L and P is owned entirely by Public P. On November 30, 1988, P merges into L in a transaction qualifying under section 368(a)(1)(A) with Public P receiving four million shares of L stock as a result of the reorganization. Under paragraph (j)(2)(iii)(B) of this section, Public L and Public P continue to be treated as separate public groups following the merger. Pursuant to the plan of reorganization, L also issues an amount of warrants in L stock pro rata to Public L and Public P that, if exercised, would result in the issuance of an additional two million shares of L stock. On November 30, 1989, when only one-half of the outstanding warrants have been exercised, A acquires all of the unexercised warrants.

(ii) Without regard to the warrants distributed in reorganization, Public P's ownership interest in L increases by 40 percentage points on November 30, 1988, relative to its lowest ownership interest in L at any time during the testing period (0 percent prior to the merger). For purposes of determining whether an ownership change occurs on November 30, 1988, the segregation rules of paragraphs (j)(2)(iii)(B) and (D) of this section does not require that a third direct public group be separately identified and treated as acquiring the warrants, because L has actual knowledge that Public L and Public P acquired the distributed warrants in proportion to their respective ownership interests in L stock. Because the largest increase in the ownership of L on the testing date results from treating only Public P as exercising the distributing warrants, in which event, its ownership interest would increase by 44.4 percentage points ([four million shares acquired in the merger + 800,000 shares deemed acquired]/10.8 million (actual and deemed) shares outstanding), the issuance of the warrants by L does not cause an ownership change on November 30, 1988.

(iii) Under paragraph (j)(2)(iii)(F)(I) of this section, each actual exercise of warrants to acquire one million shares of L stock between November 30, 1988 and November 30, 1989 is treated as made pro rata by Public L and Public P (600,000 shares to Public L and 400,000 shares to Public P). Accordingly, as a result of the actual exercises of warrants during that period the ownership interests of the only 5-percent shareholders, Public L and Public P, are proportionately increased.

(iv) A's acquisition of the all of the outstanding warrants on November 30, 1989 requires the determination whether there has been an ownership change with respect to L, because A would be 5-percent shareholder

under paragraph (g)(1)(i) of this section owning  $8\frac{1}{3}$  percent of the L stock if the acquired warrants were exercised (one million shares deemed acquired/12 million (actual and deemed) shares outstanding). See paragraph (a)(2)(i) of this section. Under paragraph (h)(4)(i) of this section, A is not treated as having exercised those warrants, because an ownership change would not result. (Public P's  $36\frac{2}{3}$  percentage point increase [(four million shares acquired in the merger + 400,000 shares deemed acquired)/12 million (actual and deemed) shares outstanding] and A's  $8\frac{1}{3}$  percentage point increase is not greater than 50 percentage points).

(iv) *Combination of de minimis public groups—(A) In general.* Notwithstanding paragraph (j)(2)(iii)(A) of this section, any public group first identified during a taxable year, as a result of any transaction described in paragraph (j)(2)(iii)(B), (D), (E), or (F) of this section, that owns less than five percent of loss corporation stock may be combined, at the option of the loss corporation, with any other such groups also first identified as a result of any such transaction that occurs during such taxable year.

(B) *Example.*

(i) L is widely held with no person owning as much as five percent of the L stock at any time ("Public L"). L's taxable year ends on December 31. On January 1, 1989, L issues a class of debt maturing on December 31, 2019 ("Class A Debentures") with respect to which it will semi-annually issue L stock in discharge of its interest obligation. In addition, L issues an amount of L stock to the public in two separate transactions during 1989. As a percentage of the L stock outstanding at the close of L's taxable year on December 31, 1989, L issued .45 percent of its stock on each of two dates in payment of interest with respect to the Class A Debentures, 4.5 percent of its stock in the first stock offering and six percent of its stock in the second stock offering. During 1990, L did not issue stock other than in payment of interest with respect to the Class A Debentures. As a percentage of L stock outstanding on December 31, 1990, L issued .41 percent of its stock on each of two dates during 1990 with respect to its outstanding debt.

(ii) Under paragraph (h)(4)(x)(E) of this section, L's obligation to issue stock in satisfaction of the interest with respect to the Class A Debentures until December 31, 2019, is not subject to paragraph (h)(4)(i) of this section and thus is taken into account only as such stock is issued.

(iii) The application of the segregation rules of paragraphs (j)(2)(iii)(B) and (iv) of this section require the identification of at

least two additional, separate direct public groups during 1989. First, the persons who acquire six percent of L stock in a public offering to which section 1032 applies must be treated as a separate 5-percent shareholder ("Public 1L"). See paragraph (j)(2)(iii)(B) of this section. Even though this group was first identified in 1989, it may not be combined with other public groups also first identified in 1989 because it owns five percent or more of L stock. Second, although each of the three other issuances of L stock during the year ordinarily result in the identification of an additional, separate direct public group, each such direct public group may be combined with the two other such groups into a single public group ("Public 2L"). As of the end of 1989, Public 2L would own a total of 5.4 percent of the stock of L.

(iv) The application of the segregation rules of paragraphs (j)(2)(iii)(B) and (iv) of this section require the identification of at least one additional, direct public group during 1990. Because each additional, direct public group first identified in 1990 acquires less than five percent of L stock, they may be combined into a single public group ("Public 3L") owning .82 percent of the stock of L. Public 3L is treated as a five percent shareholder even though it owns less than five percent of the stock of L. See paragraph (j)(2)(iv)(A) of this section.

(v) *Multiple transactions—(A) In general.* If a transaction (or any part thereof) is described by more than one subdivision of paragraph (j)(2)(iii) of this section, each such subdivision shall apply to the transaction (or each part of the transaction) in the manner that results in the largest increase in the percentage stock ownership by the 5-percent shareholders.

(B) *Example.*

(i) All of the common stock of L is owned by 1,000 unrelated persons, none of whom owns as much as five percent of the L stock ("Public CL"). L has outstanding a class of preferred stock described in section 1504(a)(4) that is owned in equal amounts by 500 unrelated persons ("Public PL").

(ii) On September 4, 1988, L rearranges its capital structure by redeeming 70 percent of the common stock owned by 700 of the shareholders in exchange for cash. In addition, all of the preferred stock is exchanged for a new class of common stock (nonvoting) representing 40 percent of the value of L.

(iii) With respect to the part of the transaction that is treated as a redemption under paragraph (j)(2)(iii)(C) of this section (the exchange of common stock for cash), Public CL is segregated into two different public groups immediately before the transaction (and

thereafter) so that the owners of the redeemed stock ("Public RCL") are treated as part of a public group that is separate from the public group comprised of the owners of the stock that is not redeemed ("Public CCL"). As a result of the redemption, Public CCL's percentage ownership interest in L thus increases by 30 percentage points from 30 percent to 60 percent (taking into account all transactions occurring on the testing date, because the change in ownership is measured under paragraph (a)(1)(i) of this section by reference to each 5-percent shareholder's ownership interest immediately after the testing date). In addition, the exchange of preferred stock for nonvoting common stock is a transaction to which section 1032 applies. Under paragraph (j)(2)(v) of this section, the part of the transaction to which section 1032 applies is also subject to the segregation rules in the manner specified in paragraph (j)(2)(iii)(B) of this section. Accordingly, Public PL, the direct public group that acquires L nonvoting common stock in exchange for L preferred stock, must be treated as a separate public group from the other direct public groups, Public CCL and Public RCL. As a separate public group, Public PL's percentage stock ownership in L increases by 40 points (as compared to 0 percent prior to the transaction).

(iv) In summary, Public CCL increases its percentage ownership in L by 30 percentage points and Public PL increases its percentage ownership by 40 percentage points. Consequently, an ownership change occurs with respect to L on September 4, 1988.

(vi) *Acquisitions made by either a 5-percent shareholder or the loss corporation following application of the segregation rules.* Unless a different proportion is established by either the loss corporation or the Internal Revenue Service, the acquisition of loss corporation stock by either a 5-percent shareholder or the loss corporation on any date on which more than one public group of the loss corporation exists by virtue of the application of the rules of this paragraph (j)(2) shall be treated as being made proportionately from each public group existing immediately before such acquisition. See paragraph (g)(5)(i)(B) of this section for the application of this paragraph to the ownership interest of a 5-percent shareholder that owns less than five percent of the stock of the loss corporation on the testing date.

(3) *Segregation rules applicable to transactions involving first tier entities or higher tier entities—(i) Dispositions.* If a loss corporation is owned, in whole or

in part, by a public group (or groups), the rules of paragraphs (j)(2)(iii)(B) and (iv) of this section shall apply to any transaction in which a first tier entity or an individual that owns a direct ownership interest in the loss corporation of five percent or more transfers a direct ownership interest in the loss corporation to public shareholders. Therefore, each direct public group that exists immediately after such a disposition shall be segregated so that the ownership interests of each public group that existed immediately before the transaction are treated separately from the public group that acquires stock of the loss corporation as a result of the disposition by the individual or first tier entity. The principles of this paragraph (j)(3)(i) shall also apply to transactions in which an ownership interest in a higher tier entity that owns five percent or more of the loss corporation (determined without regard to the application of paragraph (h)(2)(i)(A) of this section) or a first tier entity is transferred to a public owner or 5-percent owner who is not a 5-percent shareholder.

(ii) *Example.*

(A) L is owned equally by Public L, P and E. Public L consists of 150 equal, unrelated shareholders. P is owned by Public P, a group consisting of 1,500 equal, unrelated shareholders. E is a partnership and none of its partners are 5-percent owners. On October 22, 1988, E sells its entire interest in L over a public stock exchange. No individual or entity acquires as much as five percent of L's stock as the result of E's disposition of the L stock.

(B) The disposition of the L stock by E is a transaction that causes the segregation of L's direct public group that exists immediately before the transaction (Public L) from the direct public group that acquires L stock in the transaction (Public EL). As a result, L has three 5-percent shareholders, Public L, Public P (through the application of paragraph (j)(1) of this section) and Public EL, each of which owns 33⅓ percent of L stock. Therefore, Public EL is a 5-percent shareholder that has increased its ownership interest in L by 33⅓ percentage points during the testing period. For purposes of subsequent transactions, Public L and Public EL will continue to be treated as separate direct public groups until any subsequent testing date that does not have a testing period that includes E's disposition of L stock.

(iii) *Other transactions affecting direct public groups of a first tier entity or higher tier entity.* The rules of paragraphs (j)(2)(i), (iii), (iv) and (v) of this section shall apply to transactions described in such paragraphs that involve either a higher tier entity that owns five percent or more of the loss corporation (determined without regard to the application of paragraph (h)(2)(i)(A) of this section) or a first tier entity. In applying those rules for purposes of this paragraph (j)(3)(iii), each direct public group of a first tier entity or a higher tier entity is any public group of any such entity identified in paragraph (j)(1)(iv)(A) or (B) of this section or resulting from the application of this paragraph (j)(3)(iii). The principles of paragraph (j)(2)(iii)(C) of this section also shall apply to any transaction that has the effect of a redemption-type transaction (e.g., an acquisition by the loss corporation of stock in a first tier entity).

(iv) *Examples.*

*Example (1)* The facts are the same as in *Example (1)* of paragraph (j)(2)(iii)(B)(2) of this section, except that Public L and P<sub>1</sub> own 40 percent and 60 percent, respectively, of the stock of HC which, in turn, owns 100 percent of L and HC merges into P<sub>2</sub>. Under paragraph (j)(3)(iii) of this section, the rules of paragraph (j)(2)(iii)(B) of this section apply to segregate HC's direct public group (Public L) immediately before the merger from the direct public group (Public P<sub>2</sub>) that acquires loss corporation stock in the merger. The consequences of the merger of HC into P<sub>2</sub> are thus the same as in *Example (1)* of paragraph (j)(2)(iii)(B)(2) of this section.

*Example (2)* (i) Twenty-five individual shareholders each own four percent of L ("Public L"). Public L is therefore the only 5-percent shareholder of L. Each of the shareholders of L contribute their L stock to a newly formed corporation, HC. In exchange for their contribution of L stock, HC issues 100 percent of each of its two classes of common stock (voting and nonvoting).

(ii) The formation of HC, a first tier entity of L, is a transaction to which section 1032 applies. Under paragraph (j)(3)(iii) of this section, the rules of paragraphs (j)(1)(iii) and (j)(2)(iii)(B) of this section are applied to this transaction with the result that the shareholders of HC, immediately after the issuance of HC stock, are presumed not to include any persons that previously had a direct or indirect ownership interest in L. The presumption underlying those rules, however, is rebutted by establishing that all of the HC stock outstanding immediately after

the transaction was issued solely in exchange for L stock. Thus, Public HC (immediately after the transaction) and Public L (immediately before the transaction) would be treated owned by the same direct public group.

*Example (3)* (i) All of the stock of L is owned by unrelated shareholders, none of whom owns as much as five percent of L stock. P also is owned by unrelated shareholders, none of whom owns as much as five percent of P stock. On November 22, 1988, P incorporates P<sub>1</sub> with a contribution of P stock. Immediately thereafter, P<sub>1</sub> acquires all of the properties of L in exchange for its P stock in a forward triangular merger qualifying under sections 368 (a)(1)(A) and (a)(2)(D). The P stock transferred by P<sub>1</sub> equals 45 percent of the total outstanding P stock.

(ii) Immediately before the merger of L into P<sub>1</sub>, P's only 5-percent shareholder was Public P, a direct public group of P. The rules of paragraph (j)(2)(iii)(B) of this section thus apply to the transaction under paragraph (j)(3)(i) of this section since P, a first tier entity, is a party to the reorganization described in such paragraph. Although Public P does not acquire any stock in the merger, it is treated as acquiring stock in the loss corporation, P<sub>1</sub>, because such corporation succeeds to the pre-change losses of L in a transaction to which 381(a) applies. As a result of the merger, Public P, the direct public group of P that exists immediately before the merger, must be segregated from the direct public groups acquiring P stock in the reorganization. Public P is, therefore, treated as acquiring 55 percent of the outstanding stock of the loss corporation, P<sub>1</sub>, in the transaction. The transaction, therefore, results in an ownership change for P<sub>1</sub>.

*Example (4)* (i) L is owned 20 percent by A and 80 percent by 1,000 unrelated individuals and entities, none of whom owns as much as five percent of L stock ("Public L"). P is owned 10 percent by B, 40 percent by E, and 50 percent by 5,000 unrelated individuals, none of whom owns as much as five percent of P stock ("Public P"). E is owned 30 percent by C and 70 percent by 30 unrelated individuals, none of whom owns as much as five percent of E ("Public E").

(ii) On October 31, 1987, P acquires all of the L stock from A and Public L in exchange for P stock representing 20 percent of the value of P (determined immediately after the acquisition) in a transaction described in section 368(a)(1)(B). After the acquisition, P is owned eight percent by B, 32 percent by E, four percent by A, and 56 percent by 6,000 unrelated individuals, none of whom owns as much as five percent of P. Because L is wholly owned by P immediately after the acquisition, L, under paragraph (j)(1) of this section, is treated as owned as follows: Eight percent by B, 9.6 percent by C (through C's ownership

interest in E, a highest tier entity, and E's ownership interest in P, a first tier entity), 22.4 percent by Public E (through its ownership interest in E and E's ownership interest in P), four percent by A, and 56 percent by the shareholders who each own less than five percent of L through their ownership interest in P.

(iii) Under paragraph (j)(3)(iii) of this section, the rules of paragraph (j)(2)(iii)(B) of this section apply to the reorganization since the transaction involved a first tier entity of L. Thus, the direct public group of P that exists immediately after the transaction must be segregated into two public groups—the direct public group of P that existed immediately before the acquisition (Public P) is treated separately from the direct public group consisting of the persons who acquire P stock in the transaction (Public L). Accordingly, immediately after the reorganization, Public P and Public L own 40 percent and 16 percent of L, respectively. See paragraph (h) of this section. (Under paragraph (g)(5)(ii)(B) of this section, L may treat the four percent of L stock owned by A immediately after the reorganization as the amount of L stock owned by A for each subsequent testing date having a testing period that includes the reorganization.)

(iv) In summary, after applying the rules of paragraphs (j)(1) and (3) of this section, L is treated as owned as follows:

5-percent shareholder	Percentage ownership interest
A .....	4.0
B .....	8.0
C .....	9.6
Public E .....	22.4
Public P .....	40.0
Public L .....	16.0

(v) The reorganization results in an ownership change, because B, C, Public E and Public P, all of whom are 5-percent shareholders, together have increased their percentage ownership in L by 80 percentage points as compared to their lowest percentage ownership in L at any time during the testing period (0 percent prior to the acquisition).

(v) *Acquisitions made by a 5-percent shareholder, a higher tier entity, or a first tier entity following application of the segregation rules.* The rules of paragraph (j)(2)(vi) of this section shall apply to the acquisition of an ownership interest in a first tier entity (or higher tier entity) if more than one direct public group of any such entity are segregated under the rules of this paragraph (j)(3). Accordingly, an acquisition by such an entity or a 5-percent shareholder of any ownership interest in such an enti-

ty shall be treated as made proportionately from the direct public groups resulting from the application of this paragraph (j)(3).

(k) *Operating rules—(1) Presumptions regarding stock ownership.* Subject to paragraphs (k)(2) and (4) of this section, for purposes of applying paragraphs (f), (g), (h), and (j)(1) of this section—

(i) *Stock subject to regulation by the Securities and Exchange Commission.* With respect to loss corporation stock that is described in Rule 13d-1(d) of Regulation 13D-G (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities and Exchange Act of 1934 (“registered stock”), a loss corporation may rely on the existence and absence of filings of Schedules 13D and 13G (or any similar schedules) as of any date to identify all of the corporation's shareholders who have a direct ownership interest of five percent or more (both individuals and first tier entities) on such date. A loss corporation may similarly rely on the existence and absence of such filings as of any date with respect to registered stock of any first tier entity or any higher tier entity to identify the 5-percent owners of any such entities on such date who indirectly own five percent or more of the loss corporation stock, and are thus 5-percent shareholders, and to identify any higher tier entities of such entities.

(ii) *Statements under penalties of perjury.* A loss corporation may rely on a statement, signed under penalties of perjury, by an officer, director, partner, trustee, executor or similar responsible person, on behalf of a first tier entity or a higher tier entity to establish the extent, if any, to which the ownership interests of any 5-percent owners or higher tier entities with respect to such entities have changed during a testing period. A loss corporation may not rely on such a statement (A) that it knows to be false or (B) that is made by either a first tier entity or higher tier entity that owns 50 percent or more of the stock of the loss corporation. For purposes of the preceding sentence, any first tier entities and higher tier entities that are known by the loss corporation to be members of

the same controlled group (within the meaning of section 267(f)) shall be treated as one corporation.

(2) *Actual knowledge regarding stock ownership.* For purposes of this section (other than paragraphs (g)(5) and (j)(1)(v) of this section), to the extent that the loss corporation has actual knowledge of stock ownership on any testing date (or acquires such knowledge before the date that the income tax return is filed for the taxable year in which the testing date occurs) by—

(i) An individual who would be a 5-percent shareholder, but for the application of paragraphs (h)(2)(iii), (h)(6)(iii) or (g)(2) of this section, or

(ii) A 5-percent shareholder that would be taken into account, but for paragraphs (h)(2)(iii), (h)(6)(iii) or (g)(3) of this section,

the loss corporation must take such stock ownership into account for purposes of determining whether an ownership change has occurred on that testing date. If a loss corporation acquires such knowledge after such income tax return is filed, the loss corporation may take such ownership into account for purposes of determining whether an ownership change occurred on that testing date and, if appropriate, file an amended income tax return (subject to any applicable statute of limitations). To the extent the loss corporation has actual knowledge on or after any testing date regarding the ownership interest in the loss corporation by members of one public group (described in paragraphs (g)(1)(ii), (iii) or (iv) of this section) and the ownership interest of those members in the loss corporation as members in another such public group, the loss corporation may take such ownership into account for purposes of determining whether an ownership change occurred on that testing date.

(3) *Duty to inquire as to actual stock ownership in the loss corporation.* For purposes of this section, the loss corporation is required to determine the stock ownership on each testing date (and, except as otherwise provided in this section, the changes in the stock ownership during the testing period) of—

(i) Any individual shareholder who has a direct ownership interest of five

percent or more in the loss corporation.

(ii) Any first tier entity,

(iii) Any higher tier entity that has an indirect ownership interest of five percent or more in the loss corporation (determined without regard to paragraph (h)(2)(i)(A) of this section), and

(iv) Any 5-percent owner who indirectly owns five percent or more of the stock of the loss corporation in his capacity as a 5-percent owner in any one first tier entity or higher tier entity.

The loss corporation does not have any obligation to inquire or to determine facts relating to the stock ownership of any shareholders other than those described in the preceding sentence. In addition, the loss corporation does not have any obligation to inquire or to determine if the actual facts relating to the stock ownership of any shareholder are consistent with the ownership interests of the loss corporation as determined by applying the presumptions and other rules of paragraphs (g), (h), (j) or (k)(1) of this section.

(4) *Ownership interest structured to avoid the section 382 limitation.* For purposes of this section, if the ownership interests in a loss corporation are structured by a person with a direct or indirect ownership interest in the loss corporation to avoid treating a person as a 5-percent shareholder (or to permit the loss corporation to rely on the presumption provided in paragraph (g)(5)(i)(B) of this section) for a principal purpose of circumventing the section 382 limitation, then—

(i) Paragraph (h)(2)(iii) of this section shall not apply with respect to the ownership interests so structured and the constructive ownership rules of paragraph (h)(2)(i) of this section shall thus apply to attribute stock from any entity without regard to the amount of stock it owns in the loss corporation or any other corporation,

(ii) Paragraphs (g)(2) and (3) of this section shall be modified with respect to the ownership interests so structured so that the ownership interest of a person includes all of an individual's direct and indirect ownership in the loss corporation, without regard to whether each such interest represents five percent or more of the stock of the loss corporation, and



(iii) Paragraph (g)(5)(i)(B) of this section shall not apply with respect to the ownership interests so structured so that the ownership interest of a person takes into account his actual ownership interest in the loss corporation.

This paragraph (k)(4) shall apply, however, only if application would result in an ownership change.

(5) *Example.*

L is owned by 25 individuals who each own four percent of the outstanding L stock. A purchases 40 percent of L stock from such shareholders on August 13, 1988. Thereafter, B plans to acquire 15 percent of the L stock. B is advised concerning the potential application of section 382 to L. On February 1, 1989, B acquires a 15 percent interest in L pursuant to a program in which each of four corporations, P<sub>1</sub> through P<sub>4</sub>, each of which is wholly-owned by B, acquire a 3.75 percent interest in L. A principal purpose of acquiring the L stock through four corporations is to avoid treating B as owning any ownership interest in L amounting to as much as five percent, and thus to circumvent the section 382 limitation by avoiding an ownership change. Under paragraph (k)(4) of this section, the limitation on the constructive ownership rules of paragraph (h)(2)(iii) of this section are disregarded and B is treated as a 5-percent shareholder owning 15 percent of the stock of L by virtue of his ownership interests in P<sub>1</sub> through P<sub>4</sub>, notwithstanding paragraph (g)(2) of this section. Accordingly, an ownership change occurs with respect to L.

(6) *First tier entity or higher tier entity that is a foreign corporation or entity.* [Reserved]

(l) *Changes in percentage ownership which are attributable to fluctuations in value.* [Reserved]

(m) *Effective date—(1) In general.* Except as provided in this paragraph (m), section 382 shall apply to any ownership change that occurs immediately after an owner shift or an equity structure shift that occurs after December 31, 1986, or any other event occurring after such date that requires the determination of whether an ownership change has occurred under paragraph (a)(2)(i) of this section. In the case of an equity structure shift (including an equity structure shift that also constitutes an owner shift), any equity structure shift completed pursuant to a plan of reorganization adopted before January 1, 1987, shall be treated as occurring on the date such plan was adopted. Therefore, section 382 shall

apply to any ownership change occurring immediately after—

(i) An owner shift (excluding an owner shift that also constitutes an equity structure shift) that occurs on or after January 1, 1987,

(ii) An equity structure shift that occurs after December 31, 1986, if it is completed pursuant to a plan of reorganization adopted on or after January 1, 1987, or

(iii) Any transfer or issuance of an option, or other interest that is similar to an option, that occurs on or after January 1, 1987 and that is taken into account under paragraph (a)(2)(i) of this section.

With respect to equity structure shifts completed pursuant to plans adopted before January 1, 1987, section 382 shall be inapplicable only if the equity structure shift that is treated as occurring on the date the plan of reorganization for such shift was adopted (or other event occurring after the adoption of such plan) results in an ownership change before January 1, 1987. In that event, a new testing period for the loss corporation shall begin on the day after such ownership change.

(2) *Plan of reorganization.* For purposes of paragraph (m)(1) of this section, a plan of reorganization shall be treated as adopted on the earlier of—

(i) The first date that the boards of directors of all the parties to the reorganization have adopted the plan or have recommended adoption to their shareholders, or

(ii) The date the shareholders approve such reorganization.

If there is an ownership change with respect to a subsidiary as the result of a reorganization of the parent, the treatment of the subsidiary under this paragraph (m)(2) shall be governed by the classification of the parent-level transaction. For purposes of the preceding sentence, a corporation shall be treated as a subsidiary of another corporation only if the other corporation owns stock in that corporation meeting the requirements of section 1504(a)(2).

(3) *Earliest commencement of the testing period.* For purposes of determining if an ownership change has occurred at any time after May 5, 1986, the testing period shall begin no earlier than May

6, 1986. Under paragraph (d)(4) of this section, therefore, shifts in the ownership of stock of the loss corporation prior to May 6, 1986 are disregarded.

(4) *Transitional rules*—(i) *Rules provided in paragraph (j) of this section for testing dates before September 4, 1987.* For purposes of determining whether an ownership change occurs for any testing date before September 4, 1987.

(A) The rules of paragraph (j)(1) of this section shall apply only to stock of the loss corporation acquired after May 5, 1986, by any first tier entity or higher tier entity and shall not apply to any stock acquired by such an entity on or before that date.

(B) The rules of paragraph (j)(2) of this section shall apply only to equity structure shifts in which more than one corporation is a party to the reorganization and shall not apply to any other transactions, and

(C) The rules of paragraph (j)(3) of this section shall apply only to—

(1) Dispositions of stock acquired by an individual, a first tier entity or higher tier entity after May 5, 1986 (and shall not apply to dispositions of stock acquired on or before such date), and

(2) Equity structure shifts in which more than one corporation is a party to the reorganization (and shall not apply to any other transactions).

For any testing date before September 4, 1987, however, the loss corporation is permitted to apply all of the rules of paragraph (j) of this section. A loss corporation that applies the rules of paragraph (j) of this section under the preceding sentence must apply all of the rules of such paragraph in determining whether any ownership change occurs on any testing dates after May 5, 1986.

(ii) *Example.*

(i) L is owned entirely by 10,000 unrelated individuals, none of whom owns as much as five percent of the stock of L ("Public L"). P is owned entirely by 1,000 unrelated individuals, none of whom owns as much as five percent of the stock of P ("Public P").

(ii) Between March 1, 1987 and June 1, 1987, P acquires 45 percent of L stock in a series of transactions. On June 15, 1987, L redeems 20 percent of the L stock from Public L.

(iii) Under paragraph (m)(4)(i)(A) of this section, the rules of paragraph (j)(1) of this section apply to the acquisitions made by P, because they occurred after May 5, 1986. Accordingly, following those acquisitions, the

stock of L is owned 45 percent by Public P and 55 percent by Public L. Because the increase in the percentage ownership by Public P as a result of P's stock purchases is not more than 50 percent, no ownership change occurs as the result of P's purchases.

(iv) On or after September 4, 1987, the rules of paragraph (j)(2)(iii)(C) of this section apply to treat any L stock that is redeemed as owned by a public group that is separate from the public group owning the stock that is not redeemed. (Under paragraph (j)(2)(iii)(C) of this section, the continuing shareholders of Public L, who owned 35 percent of the stock of L before the redemption ((55 percent—20 percent)/100 percent) increase their ownership interest in L by 8.8 percentage points as a result of such redemption (43.8 percent—35 percent)). Those rules, however, do not apply to the June 15, 1987 redemption because it occurs before the date that paragraph (j)(2)(iii) of this section generally is effective. (Until September 4, 1987, paragraph (j)(2)(iii) of this section generally is effective only for equity structure shifts in which more than one corporation is a party to the reorganization.) Solely because of the application of paragraph (j)(1) of this section to P's acquisitions of L stock, Public P's ownership interest in L as a result of the redemption has increased from 45 percentage points to 56.2 percentage points which, compared to its lowest percentage ownership interest at any time during the testing period (0 percent prior to March 1, 1987), is a more than 50 percentage point increase thus causing an ownership change with respect to L on June 15, 1987.

(iii) *Rules provided in paragraph (j) of this section for testing dates on or after September 4, 1987.* For purposes of determining whether an ownership change occurs for any testing date on or after September 4, 1987, the rules of paragraphs (j)(2) and (3) of this section shall not apply to identify any public group resulting from—

(A) Any transaction described in such paragraphs (j)(2) and (3), unless that transaction is also described in paragraph (m)(4)(i)(B) or (C) of this section, or

(B) Any disposition of stock acquired on or before May 5, 1986, but only if such disposition or other transaction occurs before September 4, 1987. Thus, for example, the rules of paragraph (j)(2)(iii)(D) of this section shall apply only to rights to acquire stock of the loss corporation issued on or after such date.

(iv) *Rules provided in paragraphs (f)(18)(ii) and (iii) of this section.* For

purposes of determining whether an ownership change occurs for any testing date, the rules of paragraphs (f)(18)(ii) and (iii) of this section apply only to stock (or any other ownership interest) that is—

(A) Issued on or after September 4, 1987, or

(B) Transferred to (or by) a person who is a 5-percent shareholder (or would be a 5-percent shareholder if paragraph (f)(18)(iii) of this section were applicable) on or after September 4, 1987.

(v) *Rules provided in paragraph (a)(2)(ii) of this section.* The information statement required under paragraph (a)(2)(ii) of this section is not required to be filed with respect to any taxable year for which the due date (including extensions) of the income tax return of the loss corporation is on or before October 5, 1987.

(vi) *Rules provided in paragraph (h)(4) of this section.* The rules provided in paragraph (h)(4) of this section do not apply on any testing date on or after November 5, 1992. The rule provided in paragraph (h)(4)(viii) of this section applies to the lapse or forfeiture of any option treated as exercised under paragraph (h)(4)(i) of this section. If an option is treated as exercised under paragraph (h)(4)(i) of this section, and the option is actually exercised on a day that is within 120 days after the date on which the option is treated as exercised, the rule provided in paragraph (h)(4)(vi)(B) of this section applies (even if the actual exercise of the option occurs on a date on which the rules of paragraph (h)(4) of this section would not otherwise apply). Thus, in such a case, the loss corporation may elect to treat paragraphs (h)(4)(i) and (vi)(A) of this section as not applying to the option and take into account only the acquisition of loss corporation stock resulting from the actual exercise of the option.

(vii) *Rules provided in paragraph (a)(2)(i) of this section.* The rules provided in paragraph (a)(2)(i) of this section apply to determine whether dates prior to November 5, 1992, are testing dates. For rules regarding the determination of whether dates on or after November 5, 1992, are testing dates, see § 1.382-2(a)(4).

(5) *Bankruptcy proceedings—(i) In general.* In the case of a reorganization described in section 368(a)(1)(G) or an exchange of debt for stock in a title 11 or similar case (within the meaning of section 368(a)(3)), section 382 shall not apply to any ownership change resulting from such a reorganization or proceeding if a petition in such case was filed with the court before August 14, 1986. Accordingly, any shift in ownership in the loss corporation arising out of such reorganization or proceeding shall not be taken into account for purposes of determining whether an ownership change occurs on any testing date that occurs after December 31, 1986.

(ii) *Example.*

(i) L filed a petition in bankruptcy on September 29, 1985. As a result of a title 11 bankruptcy reorganization of L that is confirmed by a court on February 2, 1988, there is a shift in the ownership of L so that JK increased her interest in L by 24 percentage points relative to her lowest ownership interest in L during the testing period. JK is the only 5-percent shareholder of L following the reorganization whose interest in L increased as a result of the transaction. On December 25, 1988, GK purchases 42 percent of the outstanding stock of L from shareholders other than JK.

(ii) There is no ownership change on December 25, 1988 because the 24 percentage point increase in JK's ownership interest in L is not taken into account under paragraph (m)(6)(i) of this section.

(iii) The facts are the same as in (i), except that the acquisitions by JK and GK occurred on August 5, 1986 and September 26, 1986, respectively. Because paragraph (m)(6)(i) of this section is only applicable with respect to the determination of whether an ownership change has occurred on any testing date that occurs after December 31, 1986, there is an ownership change as a result of GK's acquisition on September 26, 1986. Accordingly, section 382 is inapplicable to such ownership change under paragraph (m)(1) of this section because it occurred prior to January 1, 1987. Under paragraph (d)(2) of this section, the testing period for determining whether an ownership change occurs on any subsequent testing date shall commence no earlier than September 27, 1986.

(6) *Transactions of domestic building and loan associations.* The rules of paragraph (j)(2)(iii)(B) of this section (and the application of those rules by virtue of paragraph (j)(3) of this section) shall not apply to a public offering of stock

by a domestic building and loan association described in section 591 (or any corporation that owns stock in the association meeting the requirements of section 1504(a)(2)) prior to January 1, 1989. In the case of any transaction described in the preceding sentence, any transitory ownership of stock by any entity that is an underwriter shall be disregarded so that the rules of paragraph (j)(1) of this section shall not apply to treat such stock as owned by the owners of the underwriter and thus the rules of paragraph (j)(3)(i) of this section shall not apply to the disposition of such stock by the underwriter. For purposes of this paragraph (m)(7)—

(i) Ownership shall be considered transitory only with respect to an underwriter acquiring stock in a firm commitment underwriting to the extent the stock is disposed of pursuant to the offer (but in no event later than sixty (60) days after the initial offering) and,

(ii) To the extent a transaction may be described both by paragraph (j)(2)(iii)(B) of this section and any other provision of paragraph (j)(2)(iii) or (3) of this section, paragraph (j)(2)(v)(A) of this section shall not apply and the transaction shall be treated as described solely by paragraph (j)(2)(iii)(B) of this section.

(7) *Transactions not subject to section 382*—(i) *Application of old section 382.* Old section 382 shall not apply to a loss corporation on or after the date on which an ownership change occurs, but only if such ownership change results in the application of the section 382 limitation (as defined in section 382(b)) with respect to the loss corporation.

(ii) *Effect on testing period.* The application of old section 382 to a transaction is disregarded for purposes of paragraph (d)(2) of this section unless the transaction that results in such application is the last component of an ownership change after May 5, 1986 that is not subject to section 382 under the effective date rules of this paragraph (m) (e.g., an ownership change occurring as the result of an individual's purchase of more than 50 percent of L stock on any date on or before December 31, 1986).

(iii) *Termination of old section 382.* [Reserved]

(8) *Options issued or transferred before January 1, 1987*—(i) *Options issued before May 6, 1986.* An option issued before May 6, 1986, is subject to the rules of paragraph (h)(4) of this section only if it is transferred by (or to) a 5-percent shareholder (or a person who would be a 5-percent shareholder if the option were treated as exercised) on or after such date. In all other cases, such an option shall not be subject to paragraph (h)(4)(i) of this section, but shall be subject to paragraph (h)(4)(xii) of this section. Thus, for example, a warrant to acquire stock of the loss corporation issued before May 6, 1986 shall not be subject to paragraph (h)(4) of this section unless the warrant is transferred by (or to) a 5-percent shareholder. The exercise of such a warrant, however, would be taken into account as required by this paragraph (m)(8)(i) and paragraph (h)(4)(xi) of this section.

(ii) *Options issued on or after May 6, 1986 and before September 18, 1986.* An option issued or transferred on or after May 6, 1986, and before September 18, 1986, is subject to the rules of paragraph (h)(4) of this section.

(iii) *Options issued on or after September 18, 1986 and before January 1, 1987.* An option issued or transferred on or after September 18, 1986, and before January 1, 1987, is subject to the rules of paragraph (h)(4) of this section, except that the option shall be treated for purposes of this section as if it never had been issued in the event that either—

(A) The option lapses unexercised or is irrevocably forfeited by the holder thereof, or

(B) On the date the option was issued, there was no significant likelihood that such option would be exercised within the five-year period from the date of such issuance and a purpose for the issuance of the option was to cause an ownership change prior to January 1, 1987.

(9) *Examples.* The rules of this paragraph (m) may be illustrated by the following examples.

*Example (1)* (i) A owns all 100 outstanding shares of L stock. A sells 11 shares to B on January 1, 1986. The January 1, 1986 testing date is disregarded under paragraph (m)(3) of this section. A sells another 40 shares to B on

January 1, 1988. B's second stock purchase is an owner shift that does not result in an ownership change. B's percentage ownership interest on the testing date (51 percent) is only 40 percentage points greater than the lowest percentage of L stock owned by B at any time during the testing period (11 percent on and after May 6, 1986).

(ii) The facts are the same as in (i). In addition A sells 20 shares of his L stock to C on July 1, 1990. C's stock purchase is an owner shift. Because B and C together have increased their respective ownership interests in L by 40 and 20 percentage points relative to their lowest percentage stock ownership interests in L at any time during the testing period, C's purchase causes an ownership change. The testing period for any subsequent ownership change begins on the first day following C's acquisition, July 2, 1990.

*Example (2)* (i) C has owned 100 percent of L since March 22, 1980. On October 13, 1986, P merges into L. As a result of the merger, 40 percent of L stock is acquired by A, the sole shareholder of P. The merger of P into L is both an equity structure shift and an owner shift. The transaction, however, is not an ownership change with respect to L, because A's percentage ownership interest has increased by only 40 percentage points. On August 22, 1987, B purchases 15 percent of the L stock from C. B's purchase constitutes an owner shift resulting in an ownership change that is subject to section 382 because the aggregate increases in percentage ownership by B and C (respectively 40 percent and 15 percent) is more than 50 percentage points.

(ii) The facts are the same as in (i), except that the plan of reorganization is adopted on October 13, 1986, and the merger is completed on July 22, 1987. The result is the same as in (i).

(iii) The facts are the same as in (ii), except that the reorganization is completed on August 22, 1987, and B's purchase of the L stock occurs one month earlier, on July 22, 1987. Assume that after the reorganization on August 22, 1987, A and B own 40 percent and 15 percent, respectively, of L stock. Although the merger occurred pursuant to a plan of reorganization adopted before 1987, L is subject to section 382 following the equity structure shift, because the merger would not have caused an ownership change if it had been completed in 1986 after the commencement of the L's testing period.

(iv) The facts are the same as in (ii), except that B's purchase occurs on June 7, 1986. Assume that immediately after the reorganization on August 22, 1987, A and B own 40 percent and 15 percent, respectively, of L stock. Since the reorganization pursuant to a plan adopted before 1987, taken together with the other shifts in the ownership of L's stock between May 5, 1986, and December 31, 1986, would have caused an ownership change, section 382 does not apply as a result of the

merger. Since an ownership change occurs as a result of the merger, L's testing period for purposes of any subsequent ownership change begins on October 14, 1986.

(v) The facts are the same as in (iv), except that B makes an additional purchase from C of one percent of L's stock on February 14, 1987. The result is the same as in (iv). B's additional purchase, however, is taken into account for the purpose of determining whether there is a second ownership change with respect to L.

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#### § 1.382-3 Definitions and rules relating to a 5-percent shareholder.

(a) *Definitions*—(1) *Entity*—(i) *In general*. An entity is any corporation, estate, trust, association, company, partnership or similar organization. An entity includes a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of stock. A principal element in determining if such an understanding exists is whether the investment decision of each member of a group is based upon the investment decision of one or more other members. However, the participation by creditors in formulating a plan for an insolvency workout or a reorganization in a title 11 or similar case (whether as members of a creditors' committee or otherwise) and the receipt of stock by creditors in satisfaction of indebtedness pursuant to the workout or reorganization do not cause the creditors to be considered an entity.

(ii) *Examples*. The following examples illustrate the provisions of paragraph (a)(1)(i) of this section.

*Example 1.* (i) L corporation has 1,000 shares of common stock outstanding. For the three-year period ending on October 1, 1992, L's stock was owned by unrelated individuals, none of whom owned five percent or more of L. A group of 20 individuals who previously owned no stock (the "Group") agree among themselves to acquire more than 5 percent of L's stock. The Group is not a corporation,