

Revenue Code as applicable (for example, sections 72 and 101(a)). The lender must take the amount into account as a payment received with respect to a split-dollar loan, in accordance with paragraph (k) of this section. No amount received by a lender with respect to a split-dollar loan is treated as an amount received by reason of the death of the insured.

(n) *Effective date*—(1) *General rule.* This section applies to any split-dollar life insurance arrangement entered into after September 17, 2003. For purposes of this section, an arrangement is entered into as determined under § 1.61-22(j)(1)(ii).

(2) *Modified arrangements treated as new arrangements.* If an arrangement entered into on or before September 17, 2003 is materially modified (within the meaning of § 1.61-22(j)(2)) after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification.

[T.D. 9092, 68 FR 54352, Sept. 17, 2003]

§ 1.7874-1T Disregard of affiliate-owned stock (temporary).

(a) *Scope.* Section 7874(c)(2)(A) provides that stock of the foreign corporation referred to in section 7874(a)(2)(B) held by members of the expanded affiliated group that includes such foreign corporation (the EAG) shall not be taken into account in determining, for purposes of section 7874(a)(2)(B)(ii), the percentage of stock in such foreign corporation held, after the acquisition, by former shareholders or partners of the domestic corporation or partnership referred to in section 7874(a)(2)(B)(i) (the domestic entity) by reason of having held stock or a partnership interest in the domestic entity. This section provides rules under section 7874(c)(2)(A).

(b) *General rule.* Except as provided in paragraph (c) of this section, for purposes of the ownership percentage determination required by section 7874(a)(2)(B)(ii), stock held by one or more members of the EAG is not included in either the numerator or the denominator of the fraction that determines such percentage. For purposes of this § 1.7874-1T, stock held by a partnership shall be considered as held proportionately by its partners.

(c) *Special rules.* For purposes of the ownership percentage determination required by section 7874(a)(2)(B)(ii), stock held by one or more members of the EAG shall be included in the denominator, but not in the numerator, of the fraction that determines the percentage if:

(1)(i) Before the acquisition, 80 percent or more of the stock (by vote or value) or the capital or profits interest in the domestic entity was owned directly or indirectly by the corporation that is the common parent of the EAG after the acquisition; and

(ii) After the acquisition, stock held by non-members of the EAG by reason of holding stock or a capital or profits interest in the domestic entity, if any, does not exceed 20 percent of the stock (by vote or value) of the foreign corporation; or

(2) After the acquisition, the former shareholders or partners of the domestic entity do not own, in the aggregate, directly or indirectly, more than 50 percent of the stock (by vote or value) of any member of the EAG.

(d) *Disregard of subsidiary-owned interests.* Stock or partnership interests owned by an entity in which at least 50 percent of the stock (by vote or value), or at least 50 percent of the capital or profits interest, is owned directly or indirectly by the issuer of such stock or by the partnership in question shall not be taken into account for purposes of:

(1) Determining the percentage of ownership of an entity under paragraphs (c)(1) and (c)(2) of this section; or

(2) Treating stock held by one or more members of the EAG as included in the denominator but not in the numerator under paragraph (c) of this section.

(e) *Examples.* The application of this section is illustrated by the following examples. It is assumed that all transactions in the examples occur after March 4, 2003. In all the examples, *the EAG* means the expanded affiliated group which includes the foreign corporation that has completed the direct or indirect acquisition referred to in section 7874(a)(2)(B)(i). In all the examples, if an entity or other person is not described as either domestic or foreign,

it may be either domestic or foreign. The analysis of the following examples is limited to a discussion of issues under section 7874, even though the examples may raise other issues (for example, under section 367):

Example 1. Disregard of hook stock. (i) *Facts.* A is a domestic corporation with 100 shares of a single class of common stock outstanding. A's stock is held by a group of individuals. Pursuant to a plan, A forms F, a foreign corporation, and transfers to F the stock of several wholly owned foreign subsidiaries, in exchange for 90 shares of F stock. F then forms Merger Sub, a domestic corporation. Under a merger agreement and state law, Merger Sub merges into A, with A surviving the merger as a subsidiary of F. In exchange for their A stock, the former shareholders of A receive, in the aggregate, 100 shares of F stock. A continues to hold 90 shares of F stock.

(ii) *Analysis.* F has indirectly acquired substantially all the properties of A pursuant to a plan. After the acquisition, the former shareholders of A own 100 shares of F stock by reason of holding stock in A, and A owns 90 shares of F stock. Under paragraph (b) of this section, the 90 shares of F stock held by A, a member of the EAG, are not included in either the numerator or the denominator of the fraction that determines the percentage of F stock owned by former shareholders of A by reason of holding stock in A. Accordingly, the fraction is 100/100 and the percentage is 100%. If the condition stated in section 7874(a)(2)(B)(iii) regarding relatively insubstantial business activities in F's country of incorporation is satisfied, F is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

Example 2. Intra-group restructuring; wholly owned corporation. (i) *Facts.* USS, a domestic corporation, has 100 shares of common stock outstanding, all of which are owned by P, a corporation. As part of an internal restructuring within the P group, USS transfers all its assets to FS, a newly formed foreign corporation, in exchange for stock of FS, in a reorganization described in section 368(a)(1)(F). P exchanges its USS stock for FS stock under section 354.

(ii) *Analysis.* FS has acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. P, the common parent of the EAG, held more than 80% of the stock of USS before the acquisition. After the acquisition, less than 20% of FS's stock is owned by non-members of the EAG. Under paragraph (c)(1) of this section, the FS stock owned by P by reason of holding stock in USS is included in the denominator but not in the numerator of the fraction that determines the percentage of FS stock owned by former shareholders of USS by reason of

holding stock in USS. Accordingly, the fraction is 0/100 and the percentage is 0%. FS is not a surrogate foreign corporation.

Example 3. Intra-group restructuring; wholly owned corporation. (i) *Facts.* The facts are the same as in *Example 2* except that USS does not transfer any of its assets. P transfers all 100 shares of USS stock to FS in exchange for FS stock.

(ii) *Analysis.* FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. P, the common parent of the EAG, held more than 80% of the stock of USS before the acquisition. After the acquisition, less than 20% of FS's stock is owned by non-members of the EAG. Under paragraph (c)(1) of this section, the FS stock owned by P by reason of holding stock in USS is included in the denominator but not in the numerator of the fraction that determines the percentage of stock owned by former shareholders of USS by reason of holding stock in USS. Accordingly, the fraction is 0/100 and the percentage is 0%. FS is not a surrogate foreign corporation.

Example 4. Intra-group restructuring; less than wholly owned corporation. (i) *Facts.* The facts are the same as in *Example 2* except that P owns 85 shares of USS stock. The remaining 15 shares of USS stock are owned by A, a person unrelated to P. As part of an internal restructuring within the P group, P and A transfer all their USS stock to FS, in exchange for an equal number of shares of FS stock.

(ii) *Analysis.* FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. After the acquisition, P owns 85 shares of FS stock by reason of holding stock in USS, and A owns 15 shares of FS stock by reason of holding stock in USS. Before the acquisition, USS was more than 80% owned by P, which is the common parent of the EAG, and after the acquisition, less than 20% of FS's stock is owned by non-members of the EAG (i.e., by A) by reason of holding stock in USS. Under paragraph (c)(1) of this section, the FS stock owned by P is included in the denominator, but is not included in the numerator, of the fraction that determines the percentage of FS stock owned by former shareholders of USS by reason of holding stock in USS. Accordingly, the fraction is 15/100 and the percentage is 15%. FS is not a surrogate foreign corporation. FS is a controlled foreign corporation.

Example 5. Formation of joint venture corporation. (i) *Facts.* M, a corporation, owns all the outstanding stock of S, a domestic corporation engaged in business Y in the United States. B, a corporation unrelated to M, owns several foreign subsidiaries that are engaged in business Y outside the United States. M and B enter into an agreement under which each will transfer certain assets

to FJV, a newly formed foreign corporation, in exchange for stock of FJV. FJV will conduct business Y on a worldwide basis. Pursuant to the plan, M transfers to FJV all the outstanding stock of S in exchange for 40 shares of FJV stock, and B transfers to FJV the stock of several foreign corporations in exchange for 60 shares of FJV stock. FJV has no other stock outstanding.

(ii) *Analysis.* FJV has indirectly acquired substantially all the properties held directly or indirectly by S pursuant to a plan. After the acquisition, M owns 40 shares of FJV stock by reason of holding stock in S, and B owns the remaining 60 shares of FJV stock. M does not own, directly or indirectly, more than 50% of the stock of any member of the EAG. Under paragraph (c)(2) of this section, the FJV stock owned by B is included in the denominator but not the numerator of the fraction that determines the percentage of FJV stock owned by former shareholders of S by reason of holding stock in S. Accordingly, the fraction is 40/100 and the percentage is 40%. FJV is not a surrogate foreign corporation.

Example 6. Acquisition of existing joint venture entity. (i) *Facts.* K and L are unrelated corporations. T is a domestic corporation with 100 shares of stock outstanding, 55 of which are held by K and 45 of which are held by L. K and L contribute their T stock to U, a newly formed foreign corporation, in exchange for an equal number of shares of U stock.

(ii) *Analysis.* U has indirectly acquired substantially all the properties held directly or indirectly by T pursuant to a plan. After the acquisition, K owns 55 shares of U stock by reason of holding stock in T, and L owns 45 shares of U stock by reason of holding stock in T. Under paragraph (b) of this section, the U stock held by K is not included in either the numerator or the denominator of the fraction that determines the percentage of U stock owned by former shareholders of T by reason of holding stock in T. Accordingly, the fraction is 45/45 and the percentage is 100%. If the EAG does not have substantial business activities in U's country of incorporation when compared to the total business activities of the EAG, U is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

Example 7. Intra-group restructuring; less than wholly owned partnership. (i) *Facts.* LLC, a Delaware limited liability company engaged in the conduct of a trade or business, is 90% owned by C, a corporation, and 10% owned by D, a person unrelated to C. LLC has not elected to be treated as an association taxable as a corporation. As part of an internal restructuring within the C group, C and D transfer their interests in LLC to E, a newly formed foreign corporation, in exchange for 90 shares and 10 shares, respec-

tively, of E's common stock, which are all of the issued and outstanding shares of E.

(ii) *Analysis.* LLC is a domestic partnership for Federal income tax purposes. E has indirectly acquired substantially all the properties constituting a trade or business of LLC pursuant to a plan. After the acquisition, C holds 90% of E's stock by reason of holding a capital or profits interest in LLC, and D holds 10% of E's stock by reason of holding a capital or profits interest in LLC. Before the acquisition, LLC is more than 80% owned by C, the common parent of the EAG, and after the acquisition, less than 20% of E's stock is owned by non-members of the EAG (that is by D) by reason of holding a capital or profits interest in LLC. Under paragraph (c)(1) of this section, the E stock held by C is included in the denominator but not the numerator of the fraction that determines the percentage of E stock owned by former partners of LLC by reason of holding an interest in LLC. Accordingly, the fraction is 10/100 and the percentage is 10%. E is not a surrogate foreign corporation.

Example 8. Acquisition of 50-50 joint venture partnership. (i) *Facts.* The facts are the same as in *Example 7* except that C and D each own 50% of the capital and profits interests in LLC. C and D transfer their interests in LLC to G, a newly formed foreign corporation, in exchange for 50 shares each of G's common stock, which are all of the issued and outstanding shares of G.

(ii) *Analysis.* G has indirectly acquired substantially all the properties constituting a trade or business of LLC, a domestic partnership, pursuant to a plan. After the acquisition, C and D each hold 50% of G's stock by reason of holding an interest in LLC. G is not included in an expanded affiliated group after the acquisition. Accordingly, none of the stock of G is disregarded under this section in determining the percentage of G stock held by former partners of LLC by reason of holding an interest in LLC. Thus, the fraction is 100/100 and the percentage is 100%. If the EAG does not have substantial business activities in G's country of incorporation when compared to the total business activities of the EAG, G is a surrogate foreign corporation which is treated as a domestic corporation under section 7874(b).

(e) *Effective date.* This section applies to taxable years ending after March 4, 2003.

[T.D. 9238, 70 FR 76687, Dec. 28, 2005]

§ 1.7874-2T Surrogate foreign corporation (temporary).

(a) *Scope.* This section provides rules under section 7874(a)(2)(B) for determining whether a foreign corporation shall be treated as a surrogate foreign