

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

T.D. 8663

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Transfers to Investment Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations amending regulations under section 351(e) of the Internal Revenue Code relating to transfers to investment companies. The final regulations concern the treatment of certain transfers to a controlled corporation. Generally, the final regulations amend the regulations to provide when certain transfers will not cause a diversification of the transferors' interests.

EFFECTIVE DATE: These regulations are effective May 2, 1996.

FOR FURTHER INFORMATION CONTACT: Andrew M. Eisenberg, (202) 622-7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

1. Background

This document contains final regulations under section 351. The final regulations provide for the treatment of certain transfers to a controlled corporation. Section 351(a) provides that no gain or loss will be recognized if one or more persons transfer property to a corporation solely in exchange for stock in the corporation and immediately after the exchange such person or persons are in control of the corporation. Section 351(e)(1) provides that section 351(a) will not apply to a transfer of property to an investment company.

On August 10, 1995, the **Federal Register** published a notice of proposed rulemaking (CO-19-95), amending regulations under section 351 of the Internal Revenue Code relating to transfers of property to an investment company (60 FR 40794). The proposed rules were based on the conclusion that transfers of diversified portfolios are not inconsistent with the Congressional purpose of section 351(e)(1).

2. Public Comments and the Final Regulations

The IRS received comments from the public on the proposed regulations. No public hearing was requested and none was held. The comments received were generally supportive of the proposed regulations. After consideration of all the comments, the regulations proposed by CO-19-95 are adopted as revised by this Treasury decision. The principal comments on the proposed regulations are discussed below.

Government securities are not treated as securities of an issuer for purposes of the 25 and 50-percent tests. Several commentators suggested that the final regulations include specific assurance that Government securities are not treated as securities of an issuer in applying the 25 and 50-percent tests contained in section 368(a)(2)(F)(ii). The proposed regulations generally adopt the section 368(a)(2)(F)(ii) tests for purposes of determining whether a portfolio of stocks and securities is diversified. However, the proposed regulations modify the 25 and 50-percent tests of section 368(a)(2)(F)(ii) by including Government securities in total assets (clause (iv) of section 368(a)(2)(F) excludes Government securities from total assets for purposes of the 25 and 50-percent tests in clause (ii) of section 368(a)(2)(F)). The final regulations clarify that Government securities, while included in total assets, are not treated as securities of an issuer for purposes of the numerator of the 25 and 50-percent tests of section 368(a)(2)(F)(ii).

The transfer of a diversified portfolio of stocks and securities by any transferor satisfies the modified diversification test. One commentator suggested that the final regulations should clarify that any person, rather than corporate transferors only, may satisfy the modi-

fied diversification test. The commentator is concerned that the use of the section 368(a)(2)(F)(ii) tests, which are adopted from a provision that applies only to transfers by corporations, may imply that the tests as applied in section 351 are limited to corporate transferors.

The Treasury and IRS do not intend to limit application of the final regulations solely to corporate transferors. The final regulations provide that a portfolio will be diversified if it satisfies the 25 and 50-percent tests of section 368(a)(2)(F)(ii) (as modified), rather than section 368(a)(2)(F)(ii), generally.

Transfers of interests in real property to an investment company. One commentator suggested that the final regulations adopt a rule whereby transfers of real property would not result in the diversification of the transferors' interests if each transferor transfers a diversified portfolio of real property to a Real Estate Investment Trust. The subject of real property transfers is beyond the scope of these final regulations.

Retroactive effect of the final regulations. Several commentators suggested that the final regulations include a retroactive effective date. The final regulations allow taxpayers who transfer diversified, but nonidentical, portfolios of stocks and securities before May 2, 1996, to choose to treat the transfers consistent with the final regulations or as transfers resulting in diversification. However, transfers completed on or after May 2, 1996 are subject to the final regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submit-

ted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Andrew M. Eisenberg, Office of Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendment to the Regulations

Accordingly, 26 CAR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.351-1 is amended by:

1. Redesignating paragraph (c)(6) as paragraph (c)(7).
2. Adding new paragraph (c)(6) to read as set forth below.

§1.351-1 Transfer to corporation controlled by transferor.

* * * * *

(c) * * *

(6)(i) For purposes of paragraph (c)(5) of this section, a transfer of stocks and securities will not be treated as resulting in a diversification of the transferors' interests if each transferor transfers a diversified portfolio of stocks and securities. For purposes of this paragraph (c)(6), a portfolio of stocks and securities is diversified if it satisfies the 25 and 50-percent tests of section 368(a)(2)(F)(ii), applying the relevant provisions of section 368(a)(2)(F). However, Government securities are included in total assets for purposes of the denominator of the 25 and 50-percent tests (unless the Government securities are acquired to meet the 25 and 50-percent tests), but are not treated as securities of an issuer for purposes of the numerator of the 25 and 50-percent tests.

(ii) Paragraph (c)(6)(i) of this section is effective for transfers completed

on or after May 2, 1996. Transfers of diversified (within the meaning of paragraph (c)(6)(i) of this section), but nonidentical, portfolios of stocks and securities completed before May 2, 1996, may be treated either—

(A) Consistent with paragraph (c)(6)(i) of this section; or

(B) As resulting in diversification of the transferors' interests.

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Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved March 6, 1996.

Leslie Samuels,
Assistant Secretary of Treasury.

(Filed by the Office of the Federal Register on May 1, 1996, 8:45 a.m., and published in the issue of the Federal Register for May 2, 1996, 61 F.R. 19544)
