held for investment unless they are (i) held primarily for sale to customers in the ordinary course of business, or (ii) used in the trade or business of banking, insurance, brokerage, or a similar trade or business.

(4) In making the determination required under subparagraph (1)(ii)(*c*) of this paragraph, stock and securities in subsidiary corporations shall be disregarded and the parent corporation shall be deemed to own its ratable share of its subsidiaries' assets. A corporation shall be considered a subsidiary if the parent owns 50 percent or more of (i) the combined voting power of all classes of stock entitled to vote, or (ii) the total value of shares of all classes of stock outstanding.

(5) A transfer ordinarily results in the diversification of the transferors' interests if two or more persons transfer nonidentical assets to a corporation in the exchange. For this purpose, if any transaction involves one or more transfers of nonidentical assets which, taken in the aggregate, constitute an insignificant portion of the total value of assets transfered, such transfers shall be disregarded in determining whether diversification has occurred. If there is only one transferor (or two or more transferors of identical assets) to a newly organized corporation, the transfer will generally be treated as not resulting in diversification. If a transfer is part of a plan to achieve diversification without recognition of gain, such as a plan which contemplates a subsequent transfer, however delayed, of the corporate assets (or of the stock or securities received in the earlier exchange) to an investment company in a transaction purporting to qualify for nonrecognition treatment, the original transfer will be treated as resulting in diversification.

(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.

(7) The application of subparagraph (5) of this paragraph may be illustrated as follows:

Example (1). Individuals A, B, and C organize a corporation with 101 shares of common stock. A and B each transfers to it $10,000 worth of the only class of stock of corporation X, listed on the New York Stock Exchange, in exchange for 50 shares of stock. C transfers $200 worth of readily marketable securities in corporation Y for one share of stock. In determining whether or not diversification has occurred, C's participation in the transaction will be disregarded. There is, therefore, no diversification, and gain or loss will not be recognized.

Example (2). A, together with 50 other transferors, organizes a corporation with 100 shares of stock. A transfers $10,000 worth of stock in corporation X, listed on the New York Stock Exchange, in exchange for 50 shares of stock. Each of the other 50 transferors transfers $200 worth of readily marketable securities in corporations other than X in exchange for one share of stock. In determining whether or not diversification has occurred, all transfers will be taken into account. Therefore, diversification is present, and gain or loss will be recognized.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6942, 32 FR 20977, Dec. 29, 1967; T.D. 8665, 61 FR 19189, May 1, 1996; T.D. 8663, 61 FR 19545, May 2, 1996]

§ 1.351–2 Receipt of property.

(a) If an exchange would be within the provisions of section 351(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. No loss to the recipient shall be recognized.

(b) See section 357 and the regulations pertaining to that section for applicable rules as to the treatment of liabilities as ''other property'' in cases subject to section 351, where another party to the exchange assumes a liability, or acquires property subject to a liability.

(c) See sections 358 and 362 and the regulations pertaining to those sections for applicable rules with respect to the determination of the basis of stock, securities, or other property received in exchanges subject to section 351.

(d) See part I (section 301 and following), subchapter C, chapter 1 of the Code, and the regulations thereunder for applicable rules with respect to the taxation of dividends where a distribution by a corporation of its stock or securities in connection with an exchange subject to section 351(a) has the effect of the distribution of a taxable dividend.

(e) See §1.356–7(a) for the applicability of the definition of nonqualified preferred stock in section 351(g)(2) for stock issued prior to June 9, 1997, and for stock issued in transactions occurring after June 8, 1997, that are described in section 1014(f)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 921). See §1.356–7(c) for the treatment of preferred stock received in certain exchanges for common or preferred stock described in section 351(g)(2)(C)(i)(II).

[T.D. 6500, 25 FR 11607, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8904, 65 FR 58650, Oct. 2, 2000]

§ 1.351–3 Records to be kept and information to be filed.

(a) Every person who received the stock or securities of a controlled corporation, or other property as part of the consideration, in exchange for property under section 351, shall file with his income tax return for the taxable year in which the exchange is consummated a complete statement of all facts pertinent to such exchange, including—

(1) A description of the property transferred, or of his interest in such property, together with a statement of the cost or other basis thereof, adjusted to the date of transfer.

(2) With respect to stock of the controlled corporation received in the exchange, a statement of—

(i) The kind of stock and preferences, if any;

(ii) The number of shares of each class received; and

(iii) The fair market value per share of each class at the date of the exchange.

(3) With respect to securities of the controlled corporation received in the exchange, a statement of—

(i) The principal amount and terms; and

(ii) The fair market value at the date of exchange.

(4) The amount of money received, if any.

(5) With respect to other property received—

(i) A complete description of each separate item;

(ii) The fair market value of each separate item at the date of exchanges; and

(iii) In the case of a corporate shareholder, the adjusted basis of the other property in the hands of the controlled corporation immediately before the distribution of such other property to the corporate shareholder in connection with the exchange.

(6) With respect to liabilities of the transferors assumed by the controlled corporation, a statement of—

(i) The nature of the liabilities;

(ii) When and under what circumstances created;

(iii) The corporate business reason for assumption by the controlled corporation; and

(iv) Whether such assumption eliminates the transferor's primary liability.

(b) Every such controlled corporation shall file with its income tax return for the taxable year in which the exchange is consummated—