

§ 1.544-5 Convertible securities.

Under section 544(b) outstanding securities of a corporation such as bonds, debentures, or other corporate obligations, convertible into stock of the corporation (whether or not convertible during the taxable year) shall be considered as outstanding stock of the corporation. The consideration of convertible securities as outstanding stock is subject to the exception that, if some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be considered as outstanding stock although the others are not so considered, but no convertible securities shall be considered as outstanding stock unless all outstanding securities having a prior conversion date are also so considered. For example, if outstanding securities are convertible in 1954, 1955 and 1956, those convertible in 1954 can be properly considered as outstanding stock without so considering those convertible in 1955 or 1956, and those convertible in 1954 and 1955 can be properly considered as outstanding stock without so considering those convertible in 1956. However, the securities convertible in 1955 could not be properly considered as outstanding stock without so considering those convertible in 1954 and the securities convertible in 1956 could not be properly considered as outstanding stock without so considering those convertible in 1954 and 1955. For the restriction on the applicability of the rule of this section, see paragraph (b) of § 1.544-1.

§ 1.544-6 Constructive ownership as actual ownership.

(a) *General rules.* (1) Stock constructively owned by a person by reason of the application of the rule provided in section 544(a)(1), relating to stock not owned by an individual, shall be considered as actually owned by such person for the purpose of again applying such rule or of applying the family and partnership rule provided in section 544(a)(2), in order to make another person the constructive owner of such stock, and

(2) Stock constructively owned by a person by reason of the application of the option rule provided in section

544(a)(3) shall be considered as actually owned by such person for the purpose of applying either the rule provided in section 544(a)(1), relating to stock not owned by an individual, or the family and partnership rule provided in section 544(a)(2) in order to make another person the constructive owner of such stock, but

(3) Stock constructively owned by an individual by reason of the application of the family and partnership rule provided in section 544(a)(2) shall not be considered as actually owned by such individual for the purpose of again applying such rule in order to make another individual the constructive owner of such stock.

(b) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. A's wife, AW, owns all the stock of the M Corporation, which in turn owns all the stock of the O Corporation. The O Corporation in turn owns all the stock of the P Corporation. Under the rule provided in section 544(a)(1), relating to stock not owned by an individual, the stock in the P Corporation owned by the O Corporation is considered to be owned constructively by the M Corporation, the sole shareholder of the O Corporation. Such constructive ownership of the stock of the M Corporation is considered as actual ownership for the purpose of again applying such rule in order to make AW, the sole shareholder of the M Corporation, the constructive owner of the stock of the P Corporation. Similarly, the constructive ownership of the stock by AW is considered as actual ownership for the purpose of applying the family and partnership rule provided in section 544(a)(2) in order to make A the constructive owner of the stock of the P Corporation, if such application is necessary for any of the purposes set forth in paragraph (b) of § 1.544-1. But the stock thus constructively owned by A may not be considered as actual ownership for the purpose of again applying the family and partnership rule in order to make another member of A's family, for example, A's father, the constructive owner of the stock of the P Corporation.

Example 2. B, an individual, owns all the stock of the R Corporation which has an option to acquire all the stock of the S Corporation, owned by C, an individual, who is not related to B. Under the option rule provided in section 544(a)(3) the R Corporation may be considered as owning constructively the stock of the S Corporation owned by C. Such constructive ownership of the stock by the R Corporation is considered as actual ownership for the purpose of applying the

rule provided in section 544(a)(1), relating to stock not owned by an individual, in order to make B, the sole shareholder of the R Corporation, the constructive owner of the stock of the S Corporation. The stock thus constructively owned by B by reason of the application of the rule provided in section 544(a)(1) likewise is considered as actual ownership for the purpose, if necessary, of applying the family and partnership rule provided in section 544(a)(2), in order to make another member of B's family, for example, B's wife, BW, the constructive owner of the stock of the S Corporation. However, the family and partnership rule could not again be applied so as to make still another individual the constructive owner of the stock of the S Corporation, that is, the stock constructively owned by BW could not be considered as actually owned by her in order to make BW's father the constructive owner of such stock by a second application of the family and partnership rule.

§ 1.544-7 Option rule in lieu of family and partnership rule.

(a) If, in determining the ownership of stock, such stock may be considered as constructively owned by an individual by an application of either the family and partnership rule (section 544(a)(2)) or the option rule (section 544(a)(3)), such stock shall be considered as owned constructively by the individual by reason of the application of the option rule.

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

Example. Two brothers, A and B, each own 10 percent of the stock of the M Corporation, and A's wife, AW, also owns 10 percent of the stock of such corporation. AW's husband, A, has an option to acquire the stock owned by her at any time. It becomes necessary, for one of the purposes stated in section 544(a)(4), to determine the stock ownership of B in the M Corporation. If the family and partnership rule were the only rule that applied in the case, B would be considered, under that rule, as owning 20 percent of the stock of the M Corporation, namely, his own stock plus the stock owned by his brother. In that event, B could not be considered as owning the stock held by AW since (1) AW is not a member of B's family and (2) the constructive ownership of such stock by A through the application of the family and partnership rule in his case is not considered as actual ownership so as to make B the constructive owner by a second application of the same rule with respect to the ownership of the stock. However, there is more than the family and partnership rule involved in this ex-

ample. As the holder of an option upon the stock, A may be considered the constructive owner of his wife's stock by the application of the option rule and without reference to the family relationship between A and AW. If A is considered as owning the stock of his wife by application of the option rule, then such constructive ownership by A is regarded as actual ownership for the purpose of applying the family and partnership rule so as to make another member of A's family, for example, B, the constructive owner of the stock. Hence, since A may be considered as owning his wife's stock by applying either the family-partnership rule or the option rule, the provisions of section 544(a)(6) apply and accordingly A must be considered the constructive owner of his wife's stock under the option rule rather than the family-partnership rule. B thus becomes the constructive owner of 30 percent of the stock of the M corporation, namely, his own 10 percent, A's 10 percent, and AW's 10 percent constructively owned by A as the holder of an option on the stock.

§ 1.545-1 Definition.

(a) Undistributed personal holding company income is the amount which is subject to the personal holding company tax imposed under section 541. Undistributed personal holding company income is the taxable income of the corporation adjusted in the manner described in section 545(b) and § 1.545-2, and section 545(c) and § 1.545-3, less the deduction for dividends paid. See part IV (section 561 and following), subchapter G, chapter 1 of the Code, and the regulations thereunder, relating to the dividends paid deduction.

(b) For purposes of the imposition of the personal holding company tax on a foreign corporation, resident or non-resident, which files or causes to be filed a return, the undistributed personal holding company income shall be computed on the basis of the taxable income from sources within the United States, and such income shall be adjusted in accordance with the principles of section 545(b) and § 1.545-2, and section 545(c) and § 1.545-3. For purposes of the imposition of such tax on a foreign corporation, resident or non-resident, which files no return, the undistributed personal holding company income shall be computed on the basis of the gross income from sources within the United States without allowance of any deductions. For purposes of this