

will first offer the stock to ABC at a price equal to the fair market value of the stock on the first date the stock is offered for sale. Since D is an employee of Y within the meaning of section 3306(i) of the Code and her stock in Y is subject to a condition which substantially restricts or limits her right to dispose of such stock and runs in favor of ABC Partnership, under paragraph (b)(5) of this section such stock is treated as not outstanding for purposes of determining whether ABC and Y are members of a parent-subsidary group of trades or businesses under common control. Thus, ABC Partnership is considered to own stock possessing 100 percent of the voting power and value of the stock of Y. Accordingly, ABC Partnership and Y Corporation are members of a parent-subsidary group of trades or businesses under common control. The result would be the same if D's husband, instead of D, owned directly the 40 percent stock interest in Y and such stock was subject to a right of first refusal running in favor of ABC Partnership.

(f) *Exception*—(1) *In general.* If an interest in an organization (including stock of a corporation) is owned by a person directly or with the application of the rules of paragraph (b) of § 1.414(c)-4 and such ownership results in the membership of that organization in a group of two or more trades or businesses under common control for any period, then the interest will not be treated as an excluded interest under paragraph (b) or (c) of this section if the result of applying such provisions is that the organization is not a member of a group of two or more trades or businesses under common control for the period.

(2) *Example.* The provisions of this paragraph may be illustrated by the following example:

*Example.* Corporation P owns directly 50 of the 100 shares of the only class of stock of corporation S. A, an officer of P, owns directly 30 shares of S stock which P has an option to acquire. If, under paragraph (b)(4) of this section, the 30 shares owned directly by A are treated as not outstanding, P would be treated as owning stock possessing only 71 percent (50/70) of the total voting power and value of S stock, and S should not be a member of a parent-subsidary group of trades or businesses under common control. However, because the 30 shares owned by A that P has an option to purchase are considered as owned by P under paragraph (b)(2) of this section, and that ownership plus P's direct ownership of 50 shares result in S's membership in a parent-subsidary group of trades or

businesses under common control for 1985, the provisions of this paragraph apply. Therefore, A's stock is not treated as an excluded interest and S is a member of a parent-subsidary group consisting of P and S.

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#### § 1.414(c)-4 Rules for determining ownership.

(a) *In general.* In determining the ownership of an interest in an organization for purposes of § 1.414(c)-2 and § 1.414(c)-3, the constructive ownership rules of paragraph (b) of this section shall apply, subject to the operating rules contained in paragraph (c). For purposes of this section the term "interest" means: in the case of a corporation, stock; in the case of a trust or estate, an actuarial interest; in the case of a partnership, an interest in the profits or capital; and in the case of a sole proprietorship, the proprietorship.

(b) *Constructive ownership*—(1) *Options.* If a person has an option to acquire any outstanding interest in an organization, such interest shall be considered as owned by such person. For this purpose, an option to acquire an option, and each one of a series of such options shall be considered as an option to acquire such interest.

(2) *Attribution from partnerships*—(i) *General.* An interest owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the profits or capital of the partnership in proportion to such partner's interest in the profits or capital, whichever such proportion is greater.

(ii) *Example.* The provisions of paragraph (b)(2)(i) of this section may be illustrated by the following example:

*Example.* A, B, and C, unrelated individuals, are partners in the ABC Partnership. The partners' interest in the capital and profits of ABC are as follows:

(IN PERCENT)		
Partner	Capital	Profits
A .....	36	25
B .....	60	71
C .....	4	4

The ABC Partnership owns the entire outstanding stock (100 shares) of X Corporation. Under paragraph (b)(2)(i) of this section, A is considered to own the stock of X owned by

the partnership in proportion to his interest in capital (36 percent) or profits (25 percent), whichever such proportion is greater. Therefore, A is considered to own 36 shares of X stock. Since B has a greater interest in the profits of the partnership than in the capital, B is considered to own X stock in proportion to his interest in such profits. Therefore, B is considered to own 71 shares of X stock. Since C does not have an interest of 5 percent or more in either the capital or profits of ABC, he is not considered to own any shares of X stock.

(3) *Attribution from estates and trusts*—

(i) *In general.* An interest in an organization (hereinafter called an “organization interest”) owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary of such estate or trust who has an actuarial interest of 5 percent or more in such organization interest, to the extent of such actuarial interest. For purposes of this subparagraph, the actuarial interest of each beneficiary shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of the organization interest to satisfy the beneficiary’s rights. A beneficiary of an estate or trust who cannot under any circumstances receive any part of an organization interest held by the estate or trust, including the proceeds from the disposition thereof, or the income therefrom, does not have an actuarial interest in such organization interest. Thus, where stock owned by a decedent’s estate has been specifically bequeathed to certain beneficiaries and the remainder of the estate has been specifically bequeathed to other beneficiaries, the stock is attributable only to the beneficiaries to whom it is specifically bequeathed. Similarly a remainderman of a trust who cannot under any circumstances receive any interest in the stock of a corporation which is a part of the corpus of the trust (including any accumulated income therefrom or the proceeds from a disposition thereof) does not have an actuarial interest in such stock. However, an income beneficiary of a trust does have an actuarial interest in stock if he has any right to the income from such stock even though under the terms of the trust instrument such stock can never be distributed to him.

The factors and methods prescribed in § 20.2031-7 or, for certain prior periods, § 20.2031-7A (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes shall be used for purposes of this subdivision in determining a beneficiary’s actuarial interest in an organization interest owned directly or indirectly by or for an estate or trust.

(ii) *Special rules for estates.* (A) For purposes of this paragraph (b)(3) with respect to an estate, property of a decedent shall be considered as owned by his or her estate if such property is subject to administration by the executor or administrator for the purposes of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent’s heirs, legatees or devisees immediately upon death.

(B) For purposes of this paragraph (b)(3) with respect to an estate, the term “beneficiary” includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution.

(C) For purposes of this paragraph (b)(3) with respect to an estate, a person shall no longer be considered a beneficiary of an estate when all the property to which he or she is entitled has been received by him or her, when he or she no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote possibility that it will be necessary for the estate to seek the return of property from him or her or to seek payment from him or her by contribution or otherwise to satisfy claims against the estate or expenses of administration.

(iii) *Grantor trusts, etc.* An interest owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E, part I, subchapter J of the Code (relating to grantors and others treated as substantial owners) is considered as owned by such person.

(4) *Attribution from corporations*—(i) *General.* An interest owned, directly or indirectly, by or for a corporation shall be considered as owned by any person who owns (directly and, in the case of a parent-subsidiary group of trades or

businesses under common control, with the application of paragraph (b)(1) of this section, or in the case of a brother-sister group of trades or business under common control, with the application of this section), 5 percent or more in value of the stock in that proportion which the value of the stock which such person so owns bears to the total value of all the stock in such corporation.

(ii) *Example.* The provisions of paragraph (b)(4)(i) of this section may be illustrated by the following example:

*Example.* B, an individual, owns 60 of the 100 shares of the only class of outstanding stock of corporation P. C, an individual, owns 4 shares of the P stock, and corporation X owns 36 shares of the P stock. Corporation P owns, directly and indirectly, 50 shares of the stock of corporation S. Under this subparagraph, B is considered to own 30 shares of the S stock ( $60/100 \times 50$ ), and X is considered to own 18 shares of S stock ( $36/100 \times 50$ ). Since C does not own 5 percent or more in the value of P stock, he is not considered as owning any of the S stock owned by P. If in this example, C's wife had owned directly 1 share of the P stock, C and his wife would each be considered as owning 5 shares of the P stock, and therefore C and his wife would be considered as owning 2.5 shares of the S stock ( $5/100 \times 50$ ).

(5) *Spouse*—(i) *General rule.* Except as provided in paragraph (b)(5)(ii) of this section, an individual shall be considered to own an interest owned, directly or indirectly, by or for his or her spouse, other than a spouse who is legally separated from the individual under a decree of divorce, whether interlocutory or final, or a decree of separate maintenance.

(ii) *Exception.* An individual shall not be considered to own an interest in an organization owned, directly or indirectly, by or for his or her spouse on any day of a taxable year of such organization, provided that each of the following conditions are satisfied with respect to such taxable year:

(A) Such individual does not, at any time during such taxable year, own directly any interest in such organization;

(B) Such individual is not a member of the board of directors, a fiduciary, or an employee of such organization and does not participate in the manage-

ment of such organization at any time during such taxable year;

(C) Not more than 50 percent of such organization's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities; and

(D) Such interest in such organization is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such interest and which run in favor of the individual or the individual's children who have not attained the age of 21 years. The principles of § 1.414(c)-3(d)(6)(i) shall apply in determining whether a condition is a condition described in the preceding sentence.

(iii) *Definitions.* For purposes of paragraph (b)(5)(ii)(C) of this section, the gross income of an organization shall be determined under section 61 and the regulations thereunder. The terms "interest", "royalties", "rents", "dividends", and "annuities" shall have the same meaning such terms are given for purposes of section 1244(c) and § 1.1244(c)-1(e)(1).

(6) *Children, grandchildren, parents, and grandparents*—(i) *Children and parents.* An individual shall be considered to own an interest owned, directly or indirectly, by or for the individual's children who have not attained the age of 21 years, and if the individual has not attained the age of 21 years, an interest owned, directly or indirectly, by or for the individual's parents.

(ii) *Children, grandchildren, parents, and grandparents.* If an individual is in effective control (within the meaning of § 1.414(c)-2(c)(2)), directly and with the application of the rules of this paragraph without regard to this subdivision, of an organization, then such individual shall be considered to own an interest in such organization owned, directly or indirectly, by or for the individual's parents, grandparents, grandchildren, and children who have attained the age of 21 years.

(iii) *Adopted children.* For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual.

(iv) *Example.* The provisions of this subparagraph (6) may be illustrated by the following example:

*Example:* (A) *Facts.* Individual F owns directly 40 percent of the profits interest of the DEF Partnership. His son, M, 20 years of age, owns directly 30 percent of the profits interest of DEF, and his son, A, 30 years of age, owns directly 20 percent of the profits interest of DEF. The 10 percent remaining of the profits interest and 100 percent of the capital interest of DEF is owned by an unrelated person.

(B) *F's ownership.* F owns 40 percent of the profits interest in DEF directly and is considered to own the 30 percent profits interest owned directly by M. Since, for purposes of the effective control test contained in paragraph (b)(6)(ii) of this section, F is treated as owning 70 percent of the profits interest of DEF, F is also considered as owning the 20 percent profits interest of DEF owned by his adult son, A. Accordingly, F is considered as owning a total of 90 percent of the profits interest in DEF.

(C) *M's ownership.* Minor son, M, owns 30 percent of the profits interest in DEF directly, and is considered to own the 40 percent profits interest owned directly by his father, F. However, M is not considered to own the 20 percent profits interest of DEF owned directly by his brother, A, and constructively by F, because an interest constructively owned by F by reason of family attribution is not considered as owned by him for purposes of making another member of his family the constructive owner of such interest. (See paragraph (c)(2) of this section.) Accordingly, M is considered as owning a total of 70 percent of the profits interest of the DEF Partnership.

(D) *A's ownership.* Adult son, A, owns 20 percent of the profits interest in DEF directly. Since, for purposes of determining whether A effectively controls DEF under paragraph (b)(6)(ii) of this section, A is treated as owning only the percentage of profits interest he owns directly, he does not satisfy the condition precedent for the attribution of the DEF profits interest from his father. Accordingly, A is considered as owning only the 20 percent profits interest in DEF which he owns directly.

(c) *Operating rules—(1) In general.* Except as provided in paragraph (c)(2) of this section, an interest constructively owned by a person by reason of the application of paragraph (b) (1), (2), (3), (4), (5), or (6) of this section shall, for the purposes of applying such paragraph, be treated as actually owned by such person.

(2) *Members of family.* An interest constructively owned by an individual by reason of the application of paragraph (b) (5) or (6) of this section shall not be treated as owned by such individual for

purposes of again applying such subparagraphs in order to make another the constructive owner of such interest.

(3) *Precedence of option attribution.* For purposes of this section, if an interest may be considered as owned under paragraph (b)(1) of this section (relating to option attribution) and under any other subparagraph of paragraph (b) of this section, such interest shall be considered as owned by such person under paragraph (b)(1) of this section.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example 1.* A, 30 years of age, has a 90 percent interest in the capital and profits of DEF Partnership. DEF owns all the outstanding stock of corporation X and X owns 60 shares of the 100 outstanding shares of corporation Y. Under paragraph (c)(1) of this section, the 60 shares of Y constructively owned by DEF by reason of paragraph (b)(4) of this section are treated as actually owned by DEF for purposes of applying paragraph (b)(2) of this section. Therefore, A is considered as owning 54 shares of the Y stock (90 percent of 60 shares).

*Example 2.* Assume the same facts as in example (1). Assume further that B, who is 20 years of age and the brother of A, directly owns 40 shares of Y stock. Although the stock of Y owned by B is considered as owned by C (the father of A and B) under paragraph (b)(6)(i) of this section, under paragraph (c)(2) of this section such stock may not be treated as owned by C for purposes of applying paragraph (b)(6)(ii) of this section in order to make A the constructive owner of such stock.

*Example 3.* Assume the same facts as in example (2), and further assume that C has an option to acquire the 40 shares of Y stock owned by his son, B. The rule contained in paragraph (c)(2) of this section does not prevent the reattribution of such 40 shares to A because, under paragraph (c)(3) of this section, C is considered as owning the 40 shares by reason of option attribution and not by reason of family attribution. Therefore, since A is in effective control of Y under paragraph (b)(6)(ii) of this section, the 40 shares of Y stock constructively owned by C are reattributed to A. A is considered as owning a total of 94 shares of Y stock.

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