if a person acquires stock of a corporation from an underwriter in exchange for cash in a qualified underwriting transaction, the person who acquires stock from the underwriter is treated as transferring cash directly to the corporation in exchange for stock of the corporation and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a corporation issues stock for cash in an underwriting in which either the underwriter is an agent of the corporation or the underwriter's ownership of the stock is transitory.

(ii) Effective date. This paragraph
(a) (3) is effective for qualified underwriting transactions occurring on or after the date of publication of the final regulation in the Federal Register.

Par. 3. In § 1.721–1, paragraph (c) is added to read as follows:

§1.721–1 Nonrecognition of gain or loss on contribution.

*

(c) Underwritings of partnership interests—(1) In general. For the purpose of section 721, if a person acquires a partnership interest from an underwriter in exchange for cash in a qualified underwriting transaction, the person who acquires the partnership interest is treated as transferring cash directly to the partnership in exchange for the partnership interest and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a partnership issues partnership interests for cash in an underwriting in which either the underwriter is an agent of the partnership or the underwriter's ownership of the partnership interests is transitory.

(2) *Effective date.* This paragraph (c) is effective for qualified underwriting transactions occurring on or after the date of publication of the final regulation in the **Federal Register.**

Margaret Milner Richardson,

Commissioner of Internal Revenue. [FR Doc. 95–19447 Filed 8–9–95; 8:45 am] BILLING CODE 4830–01–U

26 CFR Part 1

[CO-19-95]

RIN 1545-AT43

Transfers to Investment Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes amendments to regulations relating to transfers to investment companies. The amendments are necessary to clarify existing regulations relating to certain transfers to a controlled corporation. Generally, the regulations will be amended to provide when certain transfers will not cause a diversification of the transferors' interests.

DATES: Written comments and requests for a public hearing must be received by November 8, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (CO–19–95), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (CO–19–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

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

SUPPLEMENTARY INFORMATION:

Background

This document proposes amendments to the Income Tax Regulations (26 CFR part 1) under section 351 of the Internal Revenue Code of 1986. 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 the transferors control the transferee corporation. Section 351(e)(1) provides that section 351(a) will not apply to a transfer of property to an investment company.

The rule of section 351(e)(1) was enacted as part of the Foreign Investors Tax Act of 1966, with the goal of preventing individuals from achieving tax-free diversification by the transfer of one or a few stocks or securities to a corporation (referred to as a swap fund). See generally H. Rep. No. 1049, 94th Cong., 2d Sess. (Apr. 27, 1976).

Section 1.351-1(c)(1) states that a transfer to an investment company will occur when (i) the transfer results in diversification of the transferors' interests and (ii) the transferee is a Regulated Investment Company (RIC), Real Estate Investment Trust (REIT), or a corporation more than 80 percent of the value of whose assets (excluding cash and non-convertible debt obligations) are readily marketable stocks or securities. Section 1.351-1(c)(5) provides that 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.

As part of the Tax Reform Act of 1976 (the 1976 Act), Congress enacted sections 683(a) and 721(b), which incorporate the section 351(e) rules for transfers to a trust and a partnership, respectively.

The 1976 Act also addressed reorganizations of investment companies by enacting section 368(a)(2)(F). This legislation was intended to prevent the tax-free merger of a closely held corporation holding an undiversified group of assets into a publicly held diversified investment company, resulting in a tax-free diversification of the interests of the target shareholders.

Section 368(a)(2)(F)(i) provides that a transaction between two "investment companies" otherwise qualifying as a reorganization will not qualify as a reorganization for any corporation in the transaction that is not a RIC, REIT, or corporation described in section 368(a)(2)(F)(ii). Section 368(a)(2)(F)(iii) defines an investment company as a RIC, REIT, or corporation with at least 50 percent of its assets comprised of stocks or securities and 80 percent of its assets held for investment. A corporation satisfies section 368(a)(2)(F)(ii) if not more than 25 percent of the value of its total assets is invested in the stock and securities of any one issuer and not more than 50 percent of the value of its total assets is invested in the stock and securities of five or fewer issuers. For purposes of the section 368(a)(2)(F)(ii) test, all members of a controlled group of corporations (within the meaning of section 1563(a)) shall be treated as one issuer. Also, a person holding stock in a RIC, REIT, or other investment company (as defined in section 368(a)(2)(F)(iii)) that meets the requirements of section 368(a)(2)(F)(ii) shall be treated as holding its proportionate share of the assets held by the company. Section 368(a)(2)(F)(iv) provides that in determining total assets, certain assets shall be excluded, including cash and cash items (including receivables), Government securities, and assets acquired to meet section 368(a)(2)(F)(ii) or to cease to be an investment company. Section 368(a)(2)(F)(v) provides that section 368(a)(2)(F) shall not apply if the stock of each investment company is owned substantially by the same persons in the same proportions. Section 368(a)(2)(F)(vii) defines securities for purposes of clauses (ii) and (iii) of section 368(a)(2)(F).