

Reg. 1.367(a)-3(d)(3), Example 8
368(a)(1)(C)
 (formerly Example 7)

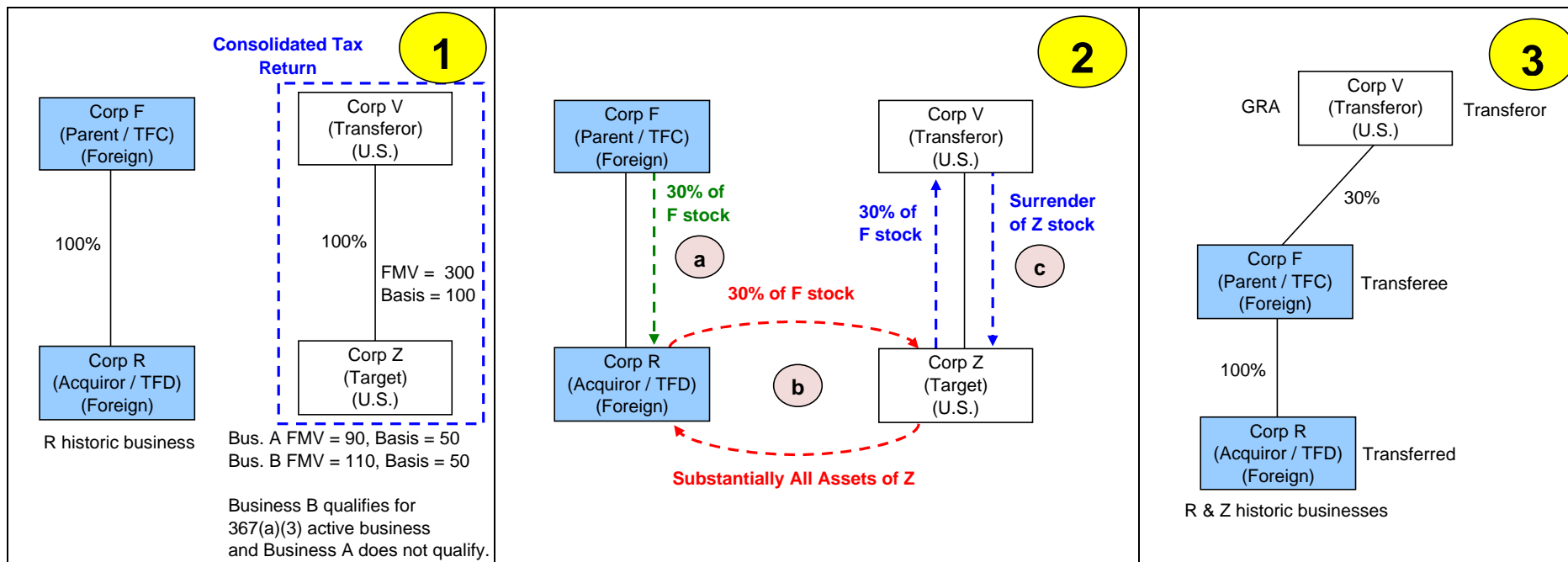
**Indirect Stock Transfer -
 Outbound Triangular C Reorg**

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Initial Structure

Outbound Triangular C Reorg

Ending Point



F, a foreign corporation, owns all of the stock of R, a foreign corporation that operates an historical business. V, a domestic corporation, owns all of the stock of Z, also a domestic corporation. V and Z file a consolidated return for Federal income tax purposes. The properties of Z consist of Business A assets, with an adjusted basis of \$50 and fair market value of \$90, and Business B assets, with an adjusted basis of \$50 and a fair market value of \$110. Assume that the Business A assets do not qualify for the active trade or business exception under section 367(a)(3), but that the Business B assets do qualify for the exception. V's basis in the Z stock is \$100, and the value of such stock is \$200. V does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C), R acquires all of the assets of Z, and V receives 30% of the voting stock of F.

The assets of Businesses A and B that are transferred to R must be tested under sections 367(a)(3) and (a)(5) prior to consideration of the indirect stock transfer rules. Thus, Z must recognize \$40 of income under section 367(a)(1) on the outbound transfer of Business A assets. Under §1.1502-32, because V and Z file a consolidated return, V's basis in its Z stock increases from \$100 to \$140 as a result of Z's \$40 gain. V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange and therefore must enter into a gain recognition agreement in the amount of \$60 (the gain realized but not recognized by V in the stock of Z after the \$40 basis adjustment). If F sells a portion of its stock in R during the term of the agreement, V will be required to recognize a portion of the \$60 gain subject to the agreement. To determine whether R disposes of substantially all of its assets (under §1.367(a)-8T(d)(2)), only the Business B assets will be considered (because the transfer of the Business A assets was taxable to Z under section 367).