F, a foreign corporation, owns all of the stock of R, 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 $90, 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. R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in a controlled asset transfer.

Sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R, because such assets are re-transferred to M, a domestic corporation, provided that the basis of the Business A assets in the hands of M is no greater than the basis of the assets in the hands of Z, and certain other requirements are satisfied. Because Z is controlled (within the meaning of section 368(c)) by V, a domestic corporation, appropriate basis adjustments must be made pursuant to section 367(a)(5) to the stock of F held by V. Section 367(a)(1) does not apply to Z's transfer of its Business B assets to R (which are not re-transferred to M) because such assets qualify for an exception to gain recognition under section 367(a)(3), subject to section 367(a)(5). V is generally deemed to transfer the stock of a foreign corporation to F in a section 354 exchange including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of § 1.367(a)-8. To the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange. Thus, with respect to V's indirect transfer of Z stock to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of §1.367(a)-3(c) are satisfied, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of §1.367(a)-8. The transferee foreign corporation is F and the transferred corporation is M. A disposition by F of the stock of R, or a disposition by R of the stock of M, will trigger the gain recognition agreement. To determine whether there is a triggering event under §1.367(a)-8T(d)(2), both the Business A assets in M and the Business B assets in R must be considered.

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