



US1 and US2, domestic corporations, own 60% and 40%, respectively, of the fair market value of UST, also a domestic corporation. US1 and US2 are not members of the same consolidated group and are unrelated. UST owns 100% of FC, a foreign corporation. In year 1, UST transfers 100% of the stock of FC to FA, a foreign corporation, in a reorganization described in section 368(a)(1)(A) after which US1 and US2 own 6% and 4%, respectively, of the stock of FA. At the time of the initial transfer, the section 1248 amount with respect to the FC stock is \$0. The notice requirement under Treas. Reg. §1.367(b)-1(c) is satisfied. Section 7874 does not apply to FA's acquisition of the stock of FC. US1 and US2 satisfy the conditions set forth in the second sentence of section 367(a)(5), including making appropriate basis adjustments. US1 enters into a gain recognition agreement ("GRA") to recognize its pro rata share of the gain realized but not recognized on UST's transfer of the stock of FC to FA, designates itself as a U.S. transferor and makes the election to include the gain in the year of the triggering event. US2 does not enter into a gain recognition agreement with respect to its pro rata share of the gain realized but not recognized on UST's transfer of the stock of FC to FA because US2 owns less than 5 percent of the stock of FA. In year 4, FA sells 30% of the FC stock for cash.

The transfer of the FC stock by UST to FA in the year 1 reorganization is not subject to section 367(a)(1). In addition, because FA partially disposes of the stock of FC in year 4, US1 must recognize 30% of its pro rata share of the gain realized but not recognized on the initial transfer of the FC stock to FA. The proportion of gain recognized by US1 is determined by reference to the relative fair market value of the UST stock owned by US1 at the time of the initial transfer. Thus, US1 must include 18% of the gain realized, but not recognized, on the initial transfer (the 30% of the transferred property that was disposed of multiplied by the amount of gain subject to the gain recognition agreement (corresponding to the 60% of the fair market value of UST stock that US1 held immediately before the initial transfer)), and pay any applicable interest.