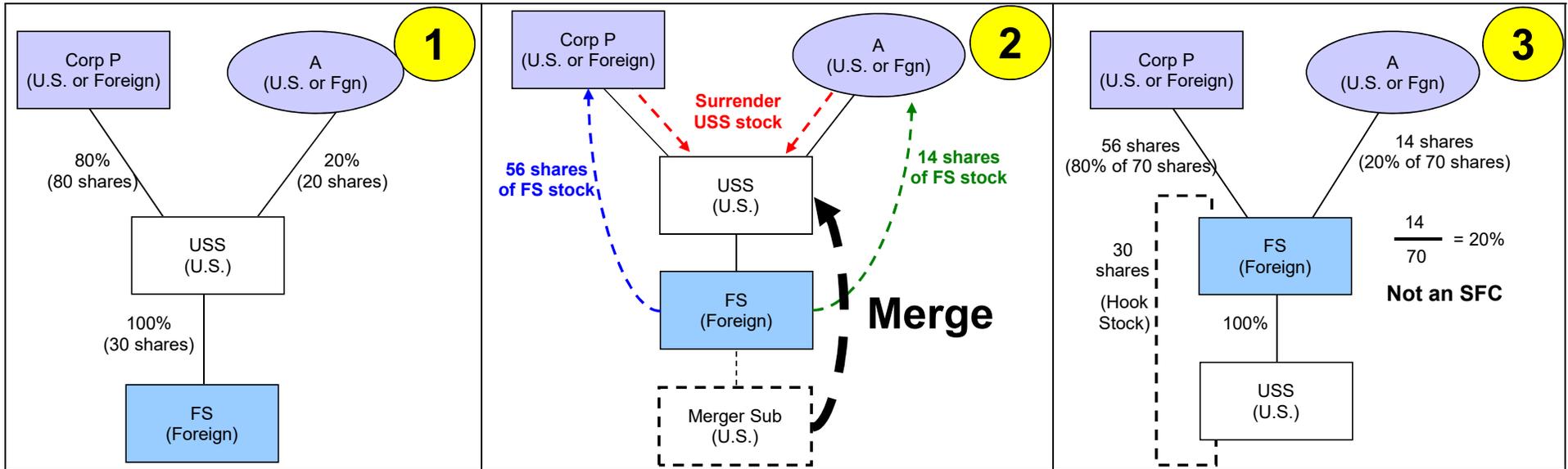


Outbound Reorganization as an Internal Group Restructuring (Hook Stock)

Initial Structure

Outbound 351 of Stock

Ending Point



USS, a domestic corporation, has 100 shares of stock outstanding. P, a corporation, holds 80 shares of USS stock. The remaining 20 shares of USS stock are held by A, a person unrelated to P. USS owns all 30 outstanding shares of FS, a foreign corporation. Pursuant to a plan, FS forms Merger Sub, a domestic corporation. Under a merger agreement and state law, Merger Sub merges into USS, with USS surviving the merger as a subsidiary of FS. In exchange for their USS stock, P and A, the former shareholders of USS, respectively receive 56 and 14 shares of FS stock. USS continues to hold 30 shares of FS stock.

FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. Under Reg. 1.7874-1(b), the shares of FS stock held by P and USS, both of which are members of the EAG, are not included in either the numerator or denominator of the ownership fraction, unless the acquisition results in an internal group restructuring or loss of control of USS such that the exception of Reg. 1.7874-1(c)(1) applies. In determining whether the acquisition of USS is an internal group restructuring, under Reg. 1.7874-1(d)(2), the FS stock held by USS is disregarded. Because P held directly or indirectly 80 percent or more of the stock (by vote and value) of USS before the acquisition, and after the acquisition P holds directly or indirectly 80 percent or more of the stock (by vote and value) of FS (when disregarding the FS stock held by USS), the acquisition is an internal group restructuring and the exception of Reg. 1.7874-1(c)(1) applies. Accordingly, when determining whether FS is a surrogate foreign corporation, the FS stock held by P is included in the denominator, but not the numerator of the ownership fraction. However, under Reg. 1.7874-1(b), the FS stock held by USS is not included in either the numerator or denominator of the ownership fraction. Accordingly, the ownership fraction is 14/70, or 20 percent, since only the stock held by A is included in the numerator, and the stock held by both P and A is included in the denominator. Accordingly, FS is not a surrogate foreign corporation. The analysis is limited to a discussion of issues under section 7874, even though the example may raise other issues (for example, under section 367).