Individual A wholly owns DT, a domestic corporation. The stock of DT held by Individual A has a fair market value of $75x. Individual A also holds an obligation of DT with a value and face amount of $25x. DT holds property with a value of $100x, and the $25x obligation is associated with the property. FA, a newly formed foreign corporation, acquires the $100x of property from DT in exchange solely for 100 shares of FA stock. DT distributes 75 shares of FA stock to Individual A in exchange for Individual A's DT stock and transfers 25 shares of FA stock to Individual A in satisfaction of DT's obligation to Individual A, and liquidates.

The 25 shares of FA stock used to satisfy DT's obligation to Individual A after being transferred by FA to DT in exchange for the property of DT constitute disqualified stock described in Treas. Reg. §1.7874-4T(c)(1) by reason of Treas. Reg. §1.7874-4T(c)(1)(ii). Treas. Reg. §1.7874-4T(c)(2) does not reduce the amount of disqualified stock described in Treas. Reg. §1.7874-4T(c)(1)(ii) because the transfer of FA stock in exchange for the property of DT increases the fair market value of FA's assets by $100x (although the amount of disqualified stock is limited to 25 shares of FA stock in this case). Therefore, under Treas. Reg. §1.7874-4T(b), the 25 shares of FA stock that constitute disqualified stock are not included in the denominator of the ownership fraction. Accordingly, only 75 shares of FA stock are included in the ownership fraction, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.

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