

**Reg. 1.367(a)-3(d)(3), Example 10  
368(a)(1)(A) & 368(a)(2)(D)**

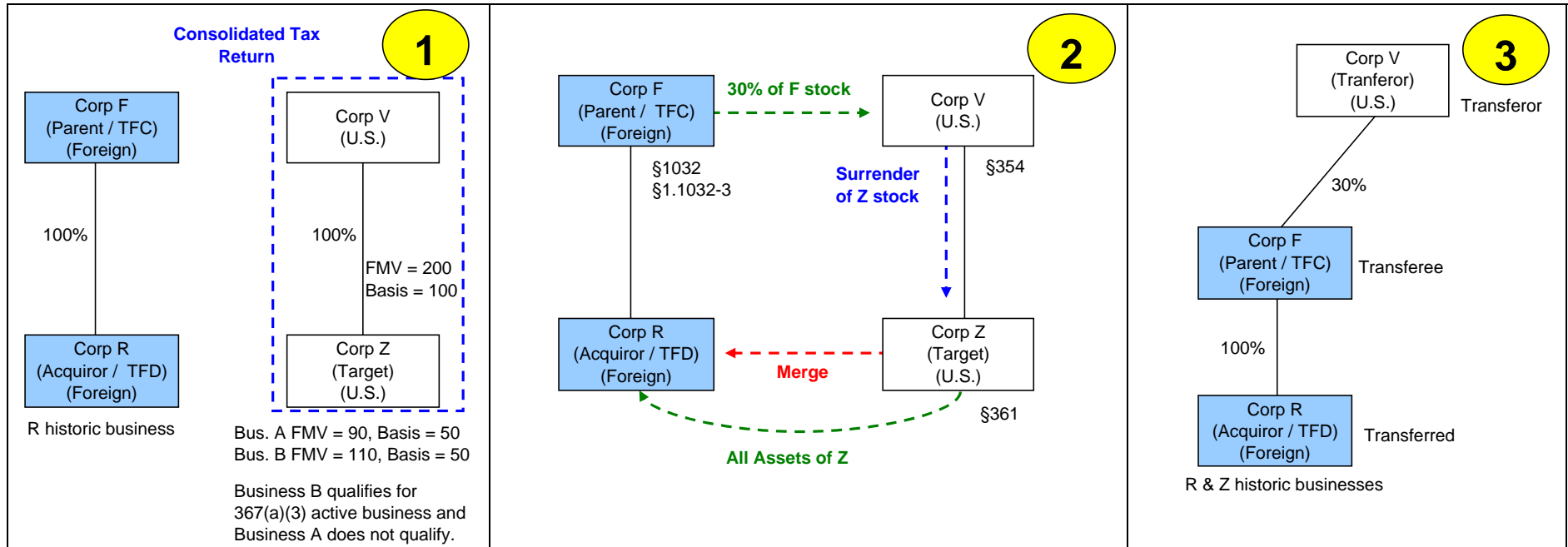
**Indirect Stock Transfer -  
Outbound Forward Triangular Merger**

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**Initial Structure**

**Forward Triangular Merger**

**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 does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). 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. R acquires all of the assets of Z in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) ("Forward Triangular Merger"). Pursuant to the reorganization, V receives 30 percent of the stock of F in a section 354 exchange.

The assets of Businesses A and B that are transferred to R must be tested under section 367(a) and (d) prior to the consideration of the indirect stock transfer rules. The Business B assets qualify for the active trade or business exception under section 367(a)(3), subject to section 367(a)(5). Because the Business A assets do not qualify for the exception, Z must recognize \$40 of gain under section 367(a) on the transfer of Business A assets to R. Further, because V and Z file a consolidated return, V's basis in the stock of Z is increased 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. V's indirect transfer of foreign stock will be taxable under section 367(a) unless V enters into a gain recognition agreement in the amount of \$60 (\$200 value of Z stock less \$140 adjusted basis).