

Reg. 1.367(a)-3(d)(3), Example 13
(formerly Example 10)

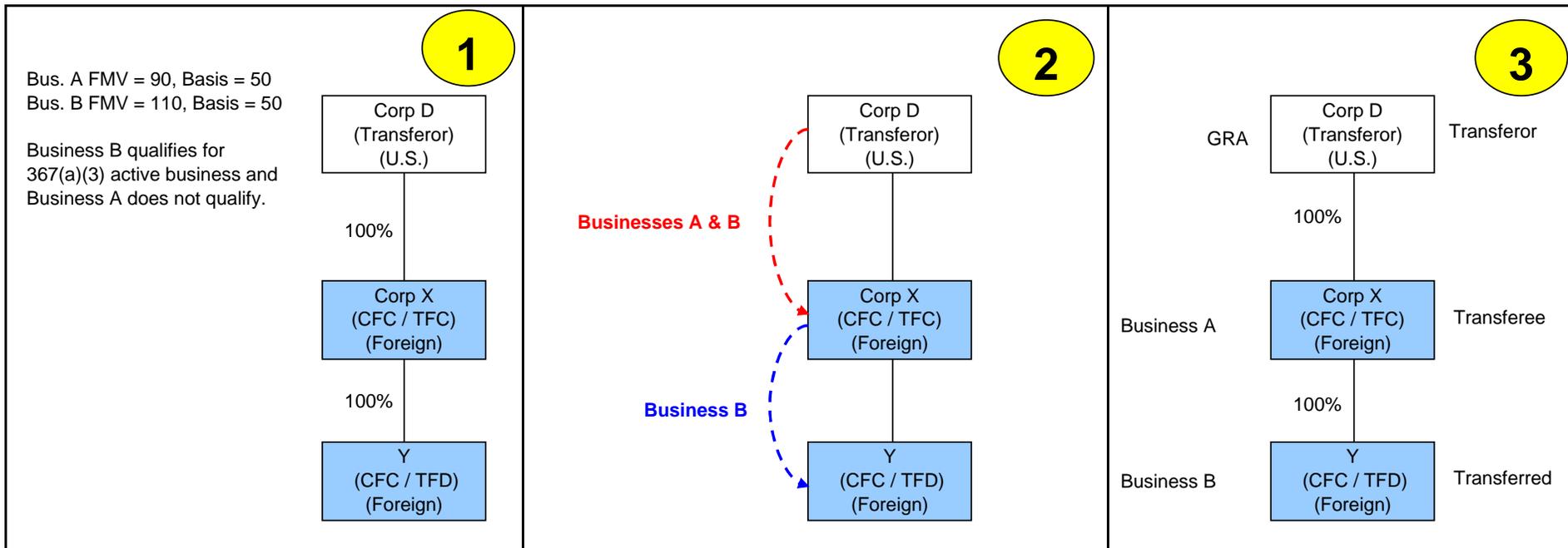
**Indirect Stock Transfer -
Successive 351 Exchanges**

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Initial Structure

Successive 351 Exchanges

Ending Point



D, a domestic corporation, owns all the stock of X, a controlled foreign corporation that operates an historical business, which owns all the stock of Y, a controlled foreign corporation that also operates an historical business. The properties of D consist of Business A assets, with an adjusted basis of \$50 and a 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 B assets qualify for the exception under section 367(a)(3) and §1.367(a)-2T(c)(2), but that the Business A assets do not qualify for the exception. In an exchange described in section 351, D transfers the assets of Businesses A and B to X, and, in connection with the same transaction, X transfers the assets of Business B to Y in another exchange described in section 351.

This transaction is treated as an indirect stock transfer for purposes of section 367(a), but the transaction is not recharacterized for purposes of section 367(b). Moreover, the assets of Businesses A and B that are transferred to X must be tested under section 367(a)(3). The Business A assets, which were not transferred to Y, are subject to the general rules of section 367(a), and not the indirect stock transfer rules. D must recognize \$40 of income on the outbound transfer of Business A assets. The transfer of the Business B assets is subject to both the asset transfer rules (under section 367(a)(3)) and the indirect stock transfer rules. Thus, D's transfer of the Business B assets will not be subject to section 367(a)(1) if D enters into a five-year gain recognition agreement with respect to the stock of Y. X will be treated as the transferee foreign corporation and Y will be treated as the transferred corporation for purposes of applying the terms of the agreement. If X sells all or a portion of the stock of Y during the term of the agreement, D will be required to recognize a proportionate amount of the \$60 gain that was realized by D on the initial transfer of the Business B assets.