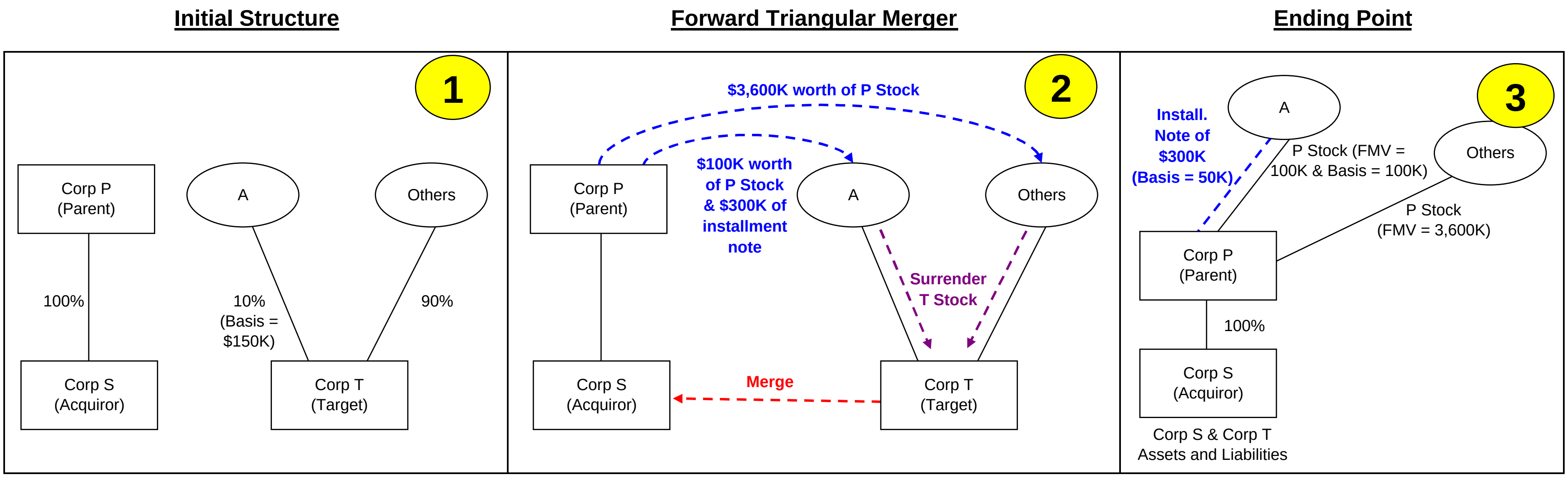
Prop. Reg. 1.453-1(f)(2)(iv), Example 1

Installment Obligation Received in Forward Triangular Merger



T corporation and P corporation are unrelated closely held corporations. A owns 10% of the stock of T. A is not related to any other T stockholder or to any P stockholder. S corporation is a wholly-owned subsidiary of P. Pursuant to a plan of reorganization, T merges with and into S. In the merger, the T shares held by A are exchanged for shares of P worth $100,000 and a $300,000 installment obligation (bearing adequate interest) issued by P. In the merger the other stockholders of T exchange their T shares solely for P shares worth, in the aggregate, $3,600,000. The merger is a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) [forward triangular merger], and T, S, and P each is a party to the reorganization under section 368(b). P is a qualifying corporation and A is party to a section 356(a)(1) exchange in which receipt by A of the installment obligation will not be treated as a dividend to A. Because, for purposes of section 453(f)(6), this transaction is treated as a direct exchange between P and A, no gain or loss is recognized by S with respect to the P obligation.

Assume A's basis in the T shares exchanged by A was $150,000. A's basis is allocated first to the permitted property (P shares) received, up to the fair market value of $100,000. A's excess basis is $50,000 ($150,000 - $100,000). Since the installment obligation is the only boot received by A in the exchange, the entire excess basis of $50,000 is allocable to it. Under the installment method, the contract price is $300,000 (face amount of the installment obligation), the gross profit is $250,000 (contract price less $50,000 excess basis allocated to the installment obligation), and the gross profit ratio is 5/6($250,000/$300,000). A recognizes no gain until payments are received on the installment obligation. As A receives payments (exclusive of interest) on the installment obligation, 5/6ths of each payment will be gain attributable to the exchange and 1/6th of each payment will be recovery of basis. A will hold the permitted property (P stock) received in the exchange at a basis of $100,000.