



DC1 is a domestic corporation. Pursuant to a plan, DC1 and individual B organize a limited liability company (HPS) under the law of Country A. DC1 owns 90% of the membership interests in HPS, and B owns 10% of the membership interests in HPS. HPS is a foreign eligible entity under Treas. Reg. §301.7701-2, and DC1 and B make an election under Treas. Reg. §301.7701-3 to treat HPS as a partnership for Federal tax purposes as of the date of the formation of HPS. HPS forms DC2, a domestic corporation. One day after the formation of HPS, DC2 merges with and into DC1. Pursuant to the merger agreement, the DC1 shareholders exchange their DC1 stock solely for membership interests in HPS. After the merger HPS wholly owns DC1, and the former domestic entity shareholders of DC1 own a greater than 80% interest in HPS by reason of holding stock of DC1. Public trading of the HPS ownership interests begins the day after the date on which the merger is completed. HPS is not treated as a corporation under Code §7704(a) by reason of Code §7704(c). If HPS were a corporation, the condition of Code §7874(a)(2)(B)(iii) would be satisfied.

HPS is a publicly traded foreign partnership that is described in Treas. Reg. §1.7874-2(g)(2). Therefore, under Treas. Reg. §1.7874-2(g)(1), for purposes of Code §7874, HPS is treated as a foreign corporation organized under the law of Country A and the membership interests in HPS are treated as stock of the foreign corporation. The foreign corporation is treated as a surrogate foreign corporation under Code §7874(a)(2)(B) because, pursuant to the merger, HPS acquired substantially all of the properties held by DC1, the former domestic entity shareholders of DC1 hold at least 60% of the stock of the foreign corporation by reason of holding stock of DC1, and the expanded affiliated group that includes the foreign corporation does not have substantial business activities in Country A when compared to the total business activities of the expanded affiliated group. Further, because the former domestic entity shareholders of DC1 hold at least 80% of the stock of the foreign corporation by reason of holding stock of DC1, Code §7874(b) applies to the surrogate foreign corporation, and therefore HPS is treated as a domestic corporation for purposes of the Code.

Under Treas. Reg. §1.7874-2(g)(6), except for purposes of determining whether HPS is a surrogate foreign corporation, at the end of the day immediately preceding the date of the merger of DC2 with and into DC1, HPS is treated as transferring all of its assets and liabilities to a new domestic corporation in exchange solely for stock of the domestic corporation. HPS is then treated as proportionately distributing such stock to its membership interest holders in liquidation of the partnership. In addition, as a result of the merger of DC2 with and into DC1, the former domestic entity shareholders of DC1 shall be treated as receiving stock of a domestic corporation in exchange for their DC1 stock.