



Individual A owns all 70 shares of stock of DC1, a domestic corporation. Individual B owns all 30 shares of stock of F1, a foreign corporation that is subject to tax as a resident of Country X. Pursuant to a reorganization described in Code §368(a)(1)(D), DC1 transfers all of its properties to F1 solely in exchange for 70 newly issued voting shares of F1 stock (DC1 acquisition) and distributes the F1 stock to Individual A in liquidation pursuant to section 361(c)(1). Pursuant to a plan that includes the DC1 acquisition, F2, a newly formed foreign corporation that is also subject to tax as a resident of Country X, acquires 100 percent of the stock of F1 solely in exchange for 100 newly issued shares of F2 stock (F1 acquisition). After the F1 acquisition, Individual A owns 70 shares of F2 stock, Individual B owns 30 shares of F2 stock, F2 owns all 100 shares of F1 stock, and F1 owns all the properties held by DC1 immediately before the DC1 acquisition. In addition, the form of the transaction is respected for U.S. federal income tax purposes.

The DC1 acquisition is a domestic entity acquisition, and F1 is a foreign acquiring corporation, because F1 directly acquires 100 percent of the properties of DC1. In addition, the 70 shares of F1 stock received by A pursuant to the DC1 acquisition in exchange for Individual A's DC1 stock are stock of a foreign corporation that is held by reason of holding stock in DC1. As a result, those 70 shares are included in both the numerator and the denominator of the ownership fraction when applying Code §7874 to the DC1 acquisition.

The DC1 acquisition is also an initial acquisition because it is a domestic entity acquisition that, pursuant to a plan that includes the F1 acquisition, occurs before the F1 acquisition (which, as described below, is a subsequent acquisition). Thus, F1 is the initial acquiring corporation.

The F1 acquisition is a subsequent acquisition because it occurs, pursuant to a plan that includes the DC1 acquisition, after the DC1 acquisition and, pursuant to the F1 acquisition, F2 acquires 100 percent of the stock of F1 and therefore is treated under Treas. Reg. §1.7874-2T(c)(4)(ii) (which applies the principles of Code §7874(a)(2)(B)(i) with certain modifications) as indirectly acquiring substantially all of the properties held directly or indirectly by F1. Thus, F2 is the subsequent acquiring corporation.

Under Treas. Reg. §1.7874-2T(c)(4)(i), the F1 acquisition is treated as a domestic entity acquisition, and F2 is treated as a foreign acquiring corporation. In addition, under Treas. Reg. §1.7874-2T(f)(1)(iv), the 70 shares of F2 stock received by Individual A (a former initial acquiring corporation shareholder) pursuant to the F1 acquisition in exchange for Individual A's F1 stock are stock of a foreign corporation that is held by reason of holding stock in DC1. As a result, those 70 shares are included in both the numerator and the denominator of the ownership fraction when applying Code §7874 to the F1 acquisition.