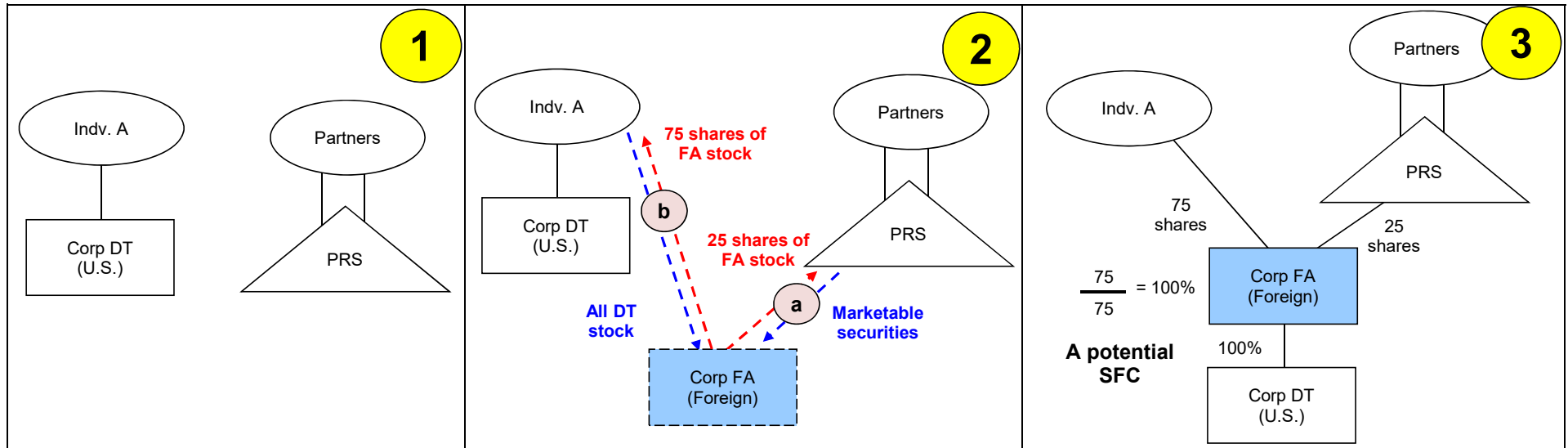


Initial Structure

Stock Acquisition

Ending Point



Individual A wholly owns DT, a domestic corporation. PRS, a partnership with individual partners, transfers marketable securities (within the meaning of Treas. Reg. §1.7874-4T(i)(6)) to FA, a newly formed corporation, in exchange solely for 25 shares of FA stock. Then Individual A transfers all the DT stock to FA in exchange solely for 75 shares of FA stock.

Under Treas. Reg. §§1.7874-4T(i)(6) and (i)(7)(ii), the marketable securities constitute nonqualified property. Accordingly, the 25 shares of FA stock transferred by FA to PRS in exchange for the marketable securities constitute disqualified stock described in Treas. Reg. §1.7874-4T(c)(1) by reason of Treas. Reg. §1.7874-4T(c)(1)(i). Treas. Reg. §1.7874-4T(c)(2) does not reduce the amount of disqualified stock described in Treas. Reg. §1.7874-4T(c)(1)(i) because the transfer of FA stock in exchange for the marketable securities increases the fair market value of the assets of FA by the fair market value of the marketable securities transferred. Under Treas. Reg. §1.7874-4T(b), the 25 shares of FA stock transferred to PRS are not included in the denominator of the ownership fraction. Accordingly, the only FA stock included in the ownership fraction is the FA stock transferred to Individual A in exchange for the DT stock, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.