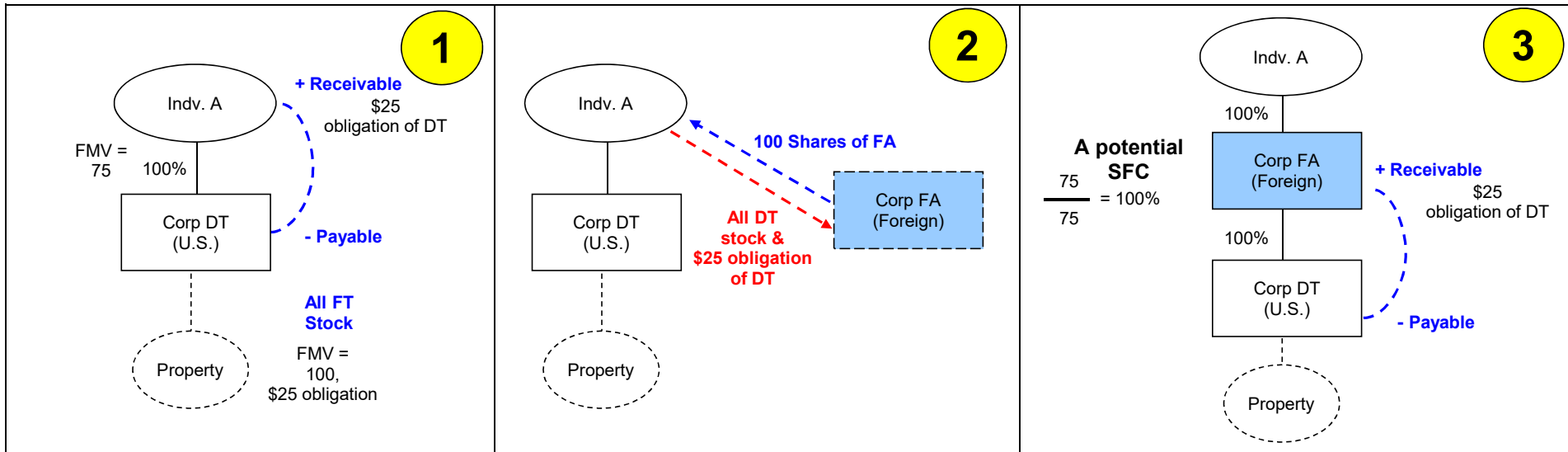


Initial Structure

Stock Transfer

Ending Point



Individual A wholly owns DT, a domestic corporation. The stock of DT held by Individual A has a fair market value of \$75x. Individual A also holds an obligation of DT with a value and face amount of \$25x. DT holds property with a value of \$100x, and the \$25x obligation is associated with the property. FA, a newly formed foreign corporation, transfers 100 shares of FA stock to Individual A in exchange for all the DT stock and the \$25x obligation of DT.

Under Treas. Reg. §1.7874-4T(i)(7)(iii)(A), the \$25x obligation of DT constitutes nonqualified property because DT is a member of the expanded affiliated group that includes FA. Thus, the shares of FA stock transferred by FA to Individual A in exchange for the obligation of DT constitute disqualified stock described in Treas. Reg. §1.7874-4T(c)(1)(i). Under Treas. Reg. §1.7874-2(f)(2), Individual A is treated as receiving 75 shares of FA stock in exchange for the DT stock ($100 \times \$75x/\$100x$) and 25 shares of FA stock in exchange for the obligation of DT ($100 \times \$25x/\$100x$). Thus, 25 shares of FA stock 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 for the \$25x obligation increases the fair market value of FA's assets by \$25x. Therefore, under Treas. Reg. §1.7874-4T(b), the 25 shares of FA stock transferred to Individual A in exchange for the obligation of DT are not included in the denominator of the ownership fraction. Accordingly, the only FA stock included in the ownership fraction is the 75 shares of 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.