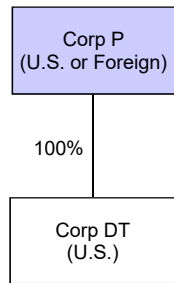


**Disqualified Stock Interaction with
Loss of Control Rule (No Loss of Control)**

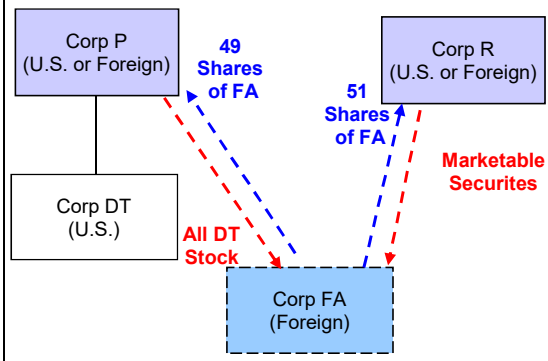
Initial Structure

1



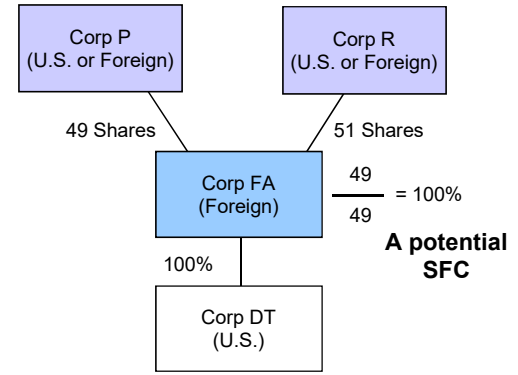
Stock Transfers

2



Ending Point

3



P, a corporation, wholly owns DT, a domestic corporation. P transfers all of its shares of DT stock to FA, a newly formed foreign corporation, in exchange for 49 shares of FA stock, and R, a corporation, transfers marketable securities (within the meaning of Treas. Reg. §1.7874-4T(i)(6)) to FA in exchange for the remaining 51 shares of FA stock.

Under Treas. Reg. §§1.7874-4T(i)(6) and (i)(7)(ii), the marketable securities constitute nonqualified property. Accordingly, the shares of FA stock transferred by FA to R 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. Therefore, under Treas. Reg. §1.7874-4T(b), the shares of FA stock transferred to R are not included in the denominator of the ownership fraction. Although under Treas. Reg. §1.7874-4T(b) R's shares of FA stock are excluded from the denominator of the ownership fraction, under Treas. Reg. §1.7874-4T(h) such stock is taken into account for purposes of determining whether P or R is a member of the expanded affiliated group that includes FA. Because P holds 49% of the shares of FA stock (49/100), P is not a member of the expanded affiliated group that includes FA, and P's FA stock is included in both the numerator and the denominator of the ownership fraction. Because R holds 51% of the shares of FA stock (51/100), R is a member of the expanded affiliated group that includes FA and, before taking into account Treas. Reg. §1.7874-1(c), R's FA stock would be excluded from the numerator and denominator of the ownership fraction under Code §7874(c)(2)(A) and Treas. Reg. §1.7874-1(b). However, the acquisition results in a loss of control described in Treas. Reg. §1.7874-1(c)(2) because P does not hold, in the aggregate, directly or indirectly, more than 50% of the shares of FA stock (by vote or value) of R, FA, or DT after the acquisition. Accordingly, the FA stock held by R would be included in the denominator of the ownership fraction under Treas. Reg. §1.7874-1(c)(1). Nevertheless, the FA stock held by R is excluded from the denominator of the ownership fraction under Treas. Reg. §§1.7874-4T(b) and (h). Thus, the ownership fraction is 49/49.