The transaction generally involves four parties: Seller, Buyer, Intermediary, and Target. Pursuant to a prearranged plan, the parties undertake the following steps. Seller purports to sell the stock of Target to Intermediary. Intermediary then makes an election under section 338, providing Target with a stepped-up basis in its assets. Intermediary then makes an election under §301.7701-3 to treat Target as a disregarded entity. As a result of the deemed liquidation, Intermediary inherits Target's assets with a stepped-up basis. Shortly thereafter, pursuant to the prearranged plan, Buyer purchases all or substantially all of Target's assets and Target pays a dividend to Intermediary. There are several variations on this general theme.

In step 3 above, the asset sale generates taxable income for foreign tax purposes (but not for U.S. tax purposes) and Intermediary claims a credit under section 901 with respect to the foreign income tax imposed on the asset sale. The Service has indicated that it will challenge this type of transaction under various theories, including the step transaction doctrine, the substance over form doctrine, section 269 (acquisitions made with the principal purpose of evading or avoiding income tax), or by applying agency principles.

This type of transaction is a listed transaction under Reg. 1.6011-4.