There were no U.S. transferors. Therefore, the exchange is not subject to section 367(a). The exchange is subject to section 367(b) because it is described in section 354 and the status of foreign corporations (FC2 & FC3) as corporations are relevant in determining tax attributes. The general rule of section 367(b) is that a foreign corporation is considered to be a corporation except to the extent provided in the regulations.

If, after the reorganization, FC3 is a CFC and DC2 is a section 1248 shareholder of FC3 (FC1 owns >10% of the stock of FC3), then there are no exceptions to corporate treatment and no income inclusion is required under section 367(b). If, however, FC3 is not a CFC or DC2 is not a section 1248 shareholder with respect to FC3, then FC1 must include in income as a deemed dividend the section 1248 amount attributable to the FC2 stock. The deemed dividend is not treated as FPHC income.