DX's sale of FY stock to FX is a section 304 transaction. DX is deemed to have contributed the FY stock to FX in a section 351 exchange, and then FX is deemed to have redeemed the FX shares which were treated as issued to DX on the fictional 351 exchange.

The 200 received by DX is treated as a distribution in redemption of the stock of FX. Because DX owns 100% of FX before and after the redemption (via attribution), the redemption is treated as a 301 distribution. The 301 distribution is a dividend first to the extent of FX's E&P and then to FY's E&P. Section 304(b)(2). Thus, the distribution is treated as a dividend of 90 out of FX and a dividend of 110 out of FY. In addition, DX is deemed to own at least 10% of the voting stock of FY and FX for purposes of section 902. Therefore, DX may compute foreign taxes deemed paid with respect to FX (20) and with respect to FY (25).

DX is considered to have transferred FY stock to FX in a section 351 exchange (the ruling states that it is a capital contribution, but section 304 was amended in 1997 to make it a deemed section 351 exchange). Because DX is a U.S. person and FX is a foreign corporation, the transfer under section 351 is subject to section 367(a). P may need to enter into a gain recognition agreement ("GRA") for DX to avoid recognizing gain on the transaction. See generally the section 367(a) regulations.

FX would have a basis of 100 in the stock of FY (Section 362(a)). P's basis in the stock of FX would increase by 100. Reg. 1.302-2(c), Example 2.

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