

**Reg. 1.367(a)-3(d)(3), Example 15
368(a)(1)(A)/(a)(2)(D)**

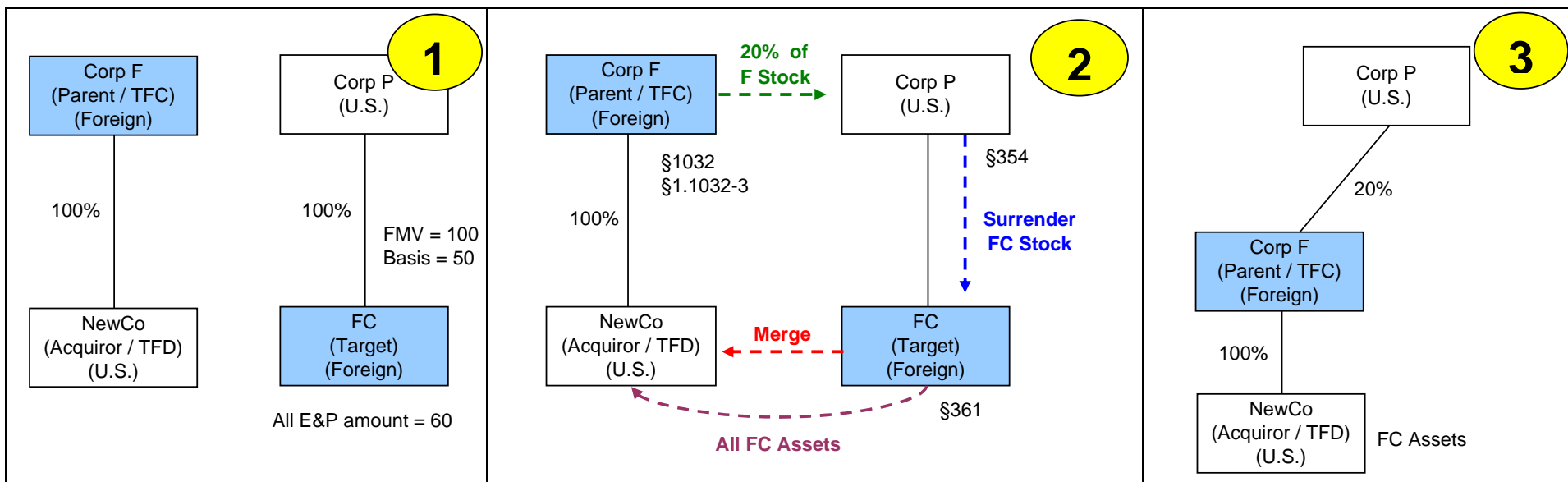
**Indirect Stock Transfer -
Forward Triangular Merger**

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Initial Structure

Forward Triangular Merger

Ending Point



F, a foreign corporation, owns all of the stock of Newco, a domestic corporation. P, a domestic corporation, owns all of the stock of FC, a foreign corporation. P's basis in the stock of FC is \$50 and the value of FC stock is \$100. The all earnings and profits amount with respect to the FC stock held by P is \$60. In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) ("Forward Triangular Merger"), Newco acquires all of the properties of FC, and P exchanges its stock in FC for 20 percent of the stock in F.

P's section 354 exchange is considered an indirect stock transfer. Because the earnings and profits amount with respect to the FC stock exchanged by P (\$60) is greater than the gain in such stock subject to section 367(a) (\$50), the section 367(b) rules (and not the section 367(a) rules) apply to the exchange. Under the rules of section 367(b), P must include in income the all earnings and profits amount of \$60 with respect to its FC stock. Alternatively, if P's all earnings and profits amount with respect to its FC stock were \$30 (which is less than the gain in such stock subject to section 367(a) (\$50)), section 367(b) and the regulations thereunder would not apply if there is gain recognition under section 367(a). Thus, if P failed to enter into a 5-year gain recognition agreement in accordance with §1.367(a)-8, then P would recognize \$50 of gain under section 367(a) and there would be no income inclusion under section 367(b). If, instead, P enters into a 5-year gain recognition agreement under §1.367(a)-8, thereby avoiding immediate gain recognition on the entire \$50 of section 367(a) gain, P is required to include in income the all earnings and profits amount of \$30. In such a case, P will adjust its basis in the FC stock pursuant to §1.367(b)-2(e)(3)(ii) and enter into a gain recognition agreement in the amount of \$20.