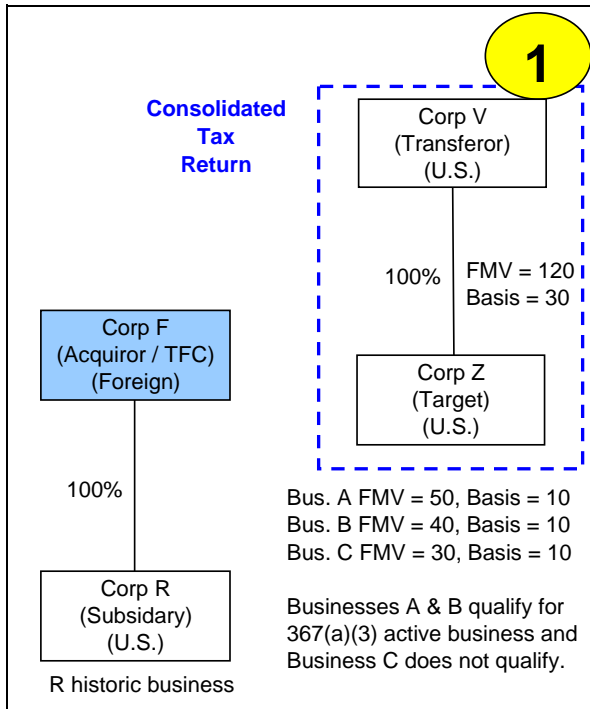


**Reg. 1.367(a)-3(d)(3), Example 6B
368(a)(1)(C) & 368(a)(2)(C)**

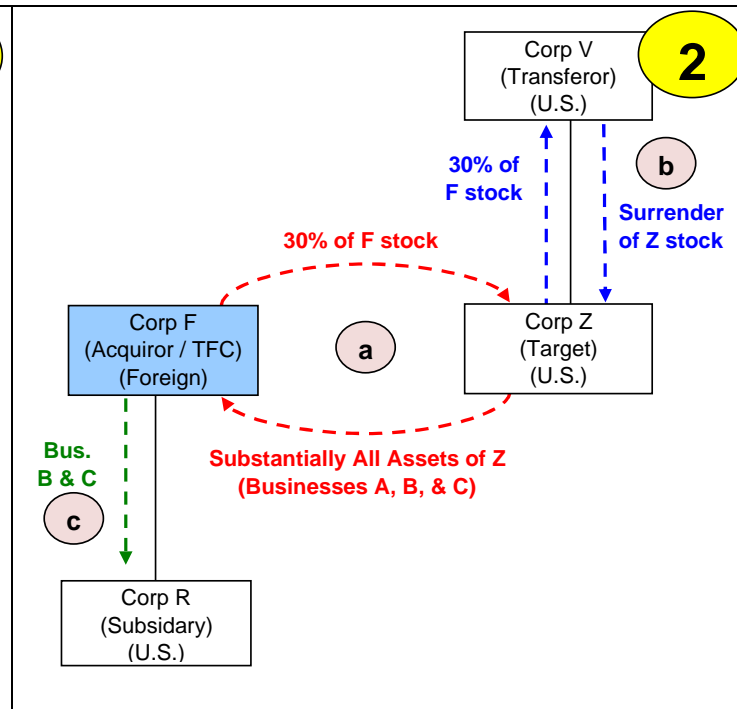
**Indirect Stock Transfer -
Outbound C Reorg with Partial Drop**

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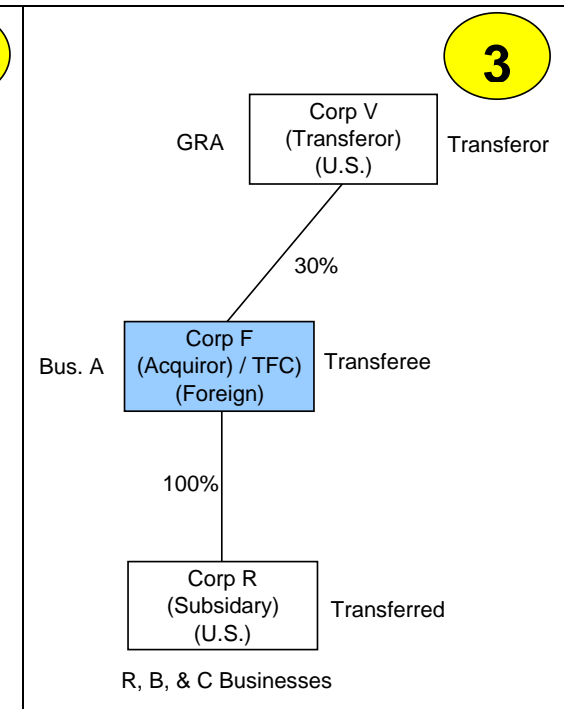
Initial Structure



Outbound C Reorg with a Partial Drop



Ending Point



F, a foreign corporation, owns all of the stock of R, a domestic corporation that operates an historical business. V, a domestic corporation, owns all of the stock of Z, also a domestic corporation. V does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). Z has 3 businesses: Business A with a basis of \$10 and a value of \$50, Business B with a basis of \$10 and a value of \$40, and Business C with a basis of \$10 and a value of \$30. V and Z file a consolidated Federal income tax return and V has a basis of \$30 in the Z stock, which has a value of \$120. Businesses A and B consist solely of assets that will satisfy the section 367(a)(3) active trade or business exception; none of Business C's assets will satisfy the exception. Z transfers all 3 businesses to F in exchange for 30 percent of the F stock, which Z distributes to V pursuant to a section 368(a)(1)(C) reorganization. F then contributes Businesses B and C to R in a controlled asset transfer.

As in Example 6A, the outbound transfer of the Business A assets to F is subject to the general rules under section 367. However, subject to section 367(a)(5), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a). The Business B and C assets are part of an indirect stock transfer, but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is no greater than the basis of the assets in the hands of Z, and appropriate basis adjustments are made pursuant to section 367(a)(5) to the stock of F held by V. V also is deemed to make an indirect transfer of Z stock to the extent the assets are transferred to R. To preserve non-recognition treatment under section 367(a), and assuming the other requirements of §1.367(a)-3(c) are satisfied, V must enter into a 5-year gain recognition agreement in the amount of \$50, the amount of the appreciation in the Business B and C assets, as the transfer of such assets by Z was not taxable under section 367(a)(1) and constituted an indirect stock transfer.