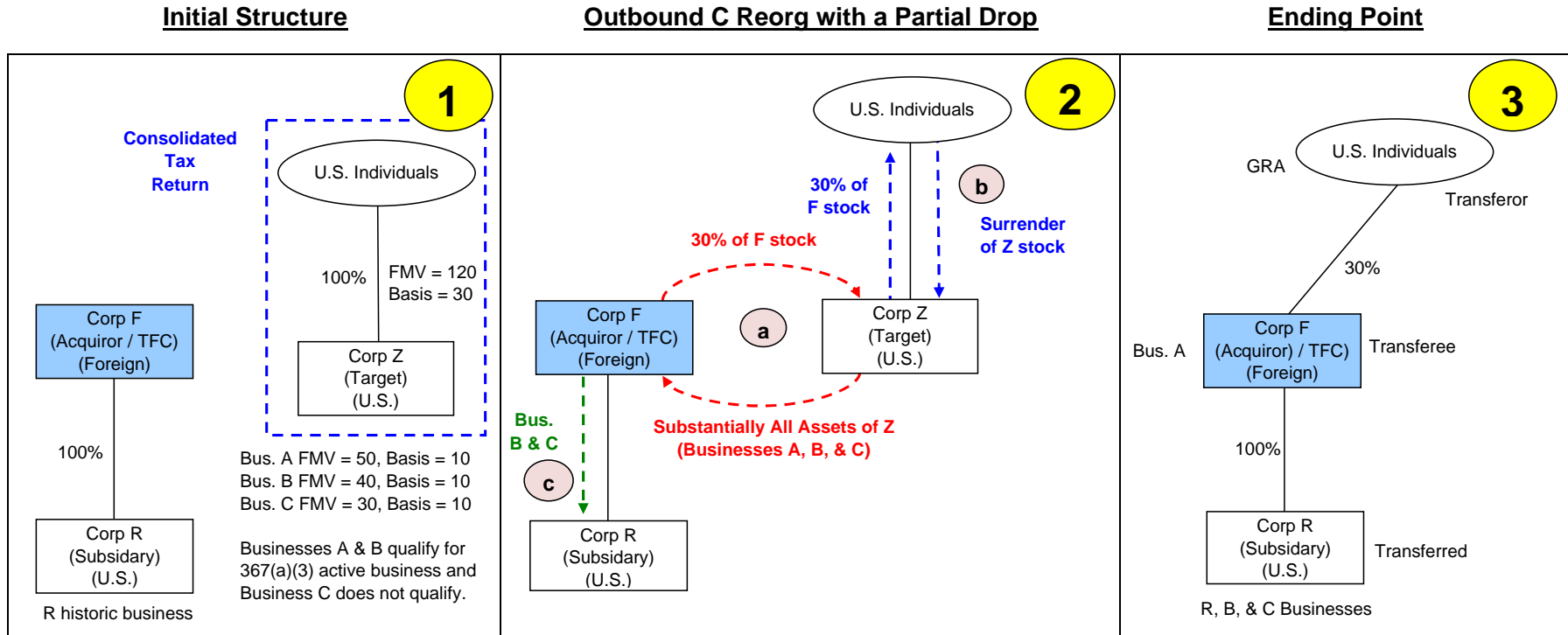


**Reg. 1.367(a)-3(d)(3), Example 6C
368(a)(1)(C) & 368(a)(2)(C)**

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

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F, a foreign corporation, owns all of the stock of R, a domestic corporation that operates an historical business. Z, a domestic corporation is owned by U.S. individuals, none of whom qualify as five-percent target shareholders with respect to Z. No U.S. persons that are either officers or directors of Z own any stock of F immediately after the transfer. F is engaged in an active trade or business outside the United States. 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. Assume that 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 the U.S. Individuals pursuant to a section 368(a)(1)(C) reorganization. F then contributes Businesses B and C to R in a controlled asset transfer.

The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules indirect stock transfer rules. However, the transfer of such assets is subject to gain recognition under section 367(a)(1), because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5). The Business B and C assets are part of an indirect stock transfer but must first be tested with respect to Z under section 367(a) and (d). The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Even though Z is not controlled within the meaning of section 368(c) by 5 or fewer domestic corporations, Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to §1.367(a)-3(d)(3)(vi)(B), the indirect transfer of Z stock satisfies the requirements of §1.367(a)-3(c)(1)(i), (ii), and (iv), and §1.367(a)-3(c)(6), and Z attaches a statement to its U.S. income tax return for the taxable year of the transfer. In general, the statement must contain a certification that, if F disposes of the stock of R (in a recognition or nonrecognition transaction) and a principal purpose of the transfer is the avoidance of U.S. tax that would have been imposed on Z on the disposition of the Business B and C assets transferred to R, then Z (or F on behalf of Z) will file a return (or amended return as the case may be) recognizing gain (\$50), as if, immediately prior to the reorganization, Z transferred the Business B and C assets to a domestic corporation in exchange for stock in a transaction treated as a section 351 exchange and immediately sold such stock to an unrelated party for its fair market value. A transaction is deemed to have a principal purpose of U.S. tax avoidance if F disposes of R stock within two years of the transfer, unless Z (or F on behalf of Z) can rebut the presumption to the satisfaction of the Commissioner. With respect to the indirect transfer of Z stock, assume the requirements of §1.367(a)-3(c)(1)(i), (ii), and (iv) are satisfied. Thus, assuming Z attaches the statement to its U.S. income tax return and satisfies the reporting requirements the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).