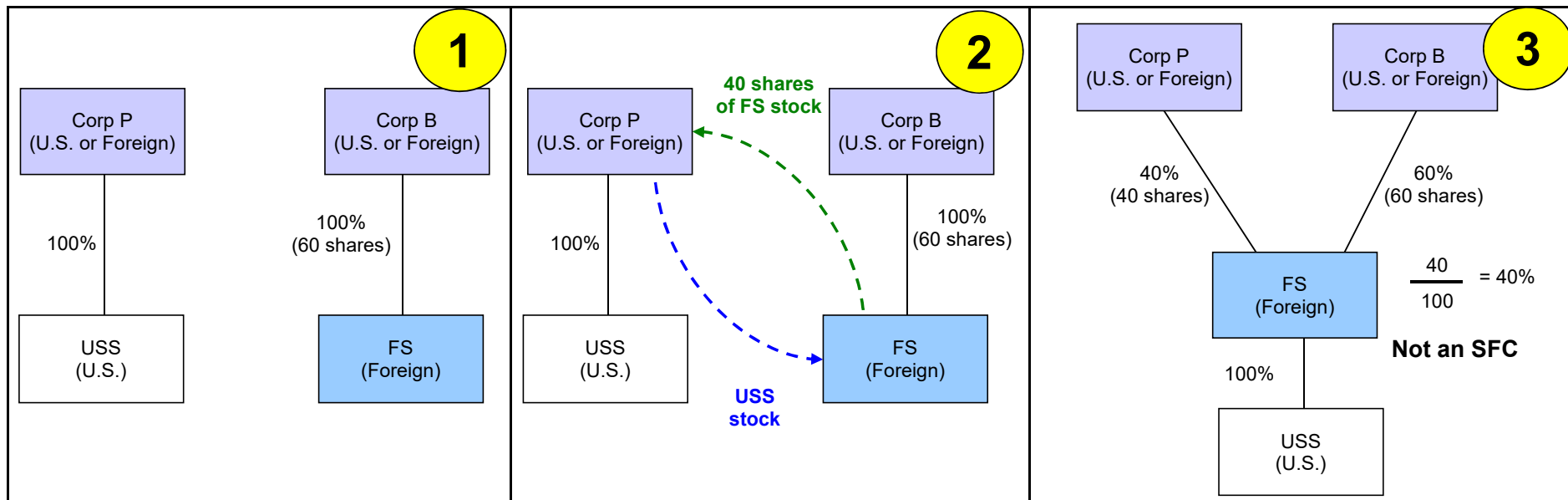


Loss of Control in Outbound B Reorganization

Initial Structure

Outbound B Reorganization

Ending Point



P, a corporation, holds all the outstanding stock of USS, a domestic corporation. B, a corporation unrelated to P, holds all 60 outstanding shares of FS, a foreign corporation. P transfers to FS all the outstanding stock of USS in exchange for 40 newly issued shares of FS.

FS has indirectly acquired substantially all the properties held directly or indirectly by USS pursuant to a plan. After the acquisition, B holds 60 percent of the outstanding shares of the FS stock. Accordingly, B, FS and USS are members of an EAG. After the acquisition, P does not hold directly or indirectly more than 50 percent of the stock (by vote or value) of any member of the EAG and, thus, the acquisition results in a loss of control described in Reg. 1.7874-1(c)(3). Accordingly, under Reg. 1.7874-1(c)(1), the FS stock owned by B is included in the denominator, but not in the numerator, of the ownership fraction. Therefore, the ownership fraction is 40/100. FS is not a surrogate foreign corporation. The analysis is limited to a discussion of issues under section 7874, even though the example may raise other issues (for example, under section 367).