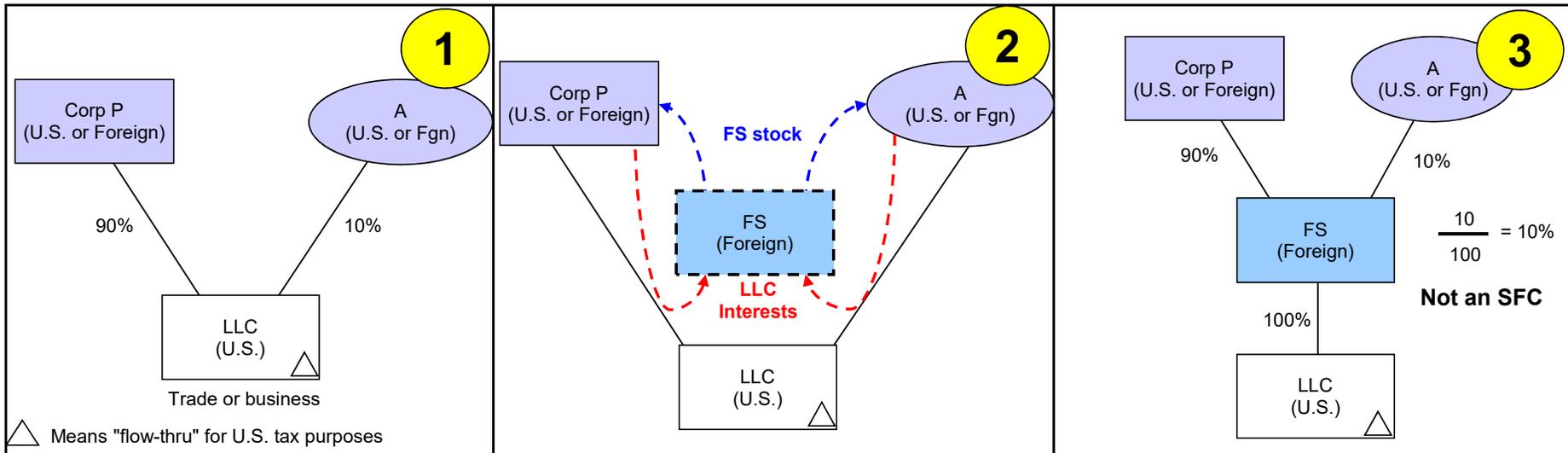


**Initial Structure**

**Outbound 351 of Stock**

**Ending Point**



LLC, a Delaware limited liability company, is engaged in the conduct of a trade or business. P, a corporation, holds 90 percent of the interests of LLC. A, a person unrelated to P, holds 10 percent of the interests of LLC. LLC has not elected to be treated as an association taxable as a corporation. P and A transfer their interests in LLC to FS, a newly formed foreign corporation, in exchange for 90 shares and 10 shares, respectively, of FS's stock, which are all of the outstanding shares of FS. Accordingly, LLC becomes a disregarded entity.

Prior to the FS's acquisition of the interests of LLC, LLC was a domestic partnership for Federal income tax purposes. FS has acquired substantially all the properties constituting a trade or business of LLC pursuant to a plan. After the acquisition, P holds 90 percent of FS's stock (by vote and value) by reason of holding a capital and profits interest in LLC, and A holds 10 percent of FS's stock (by vote and value) by reason of holding a capital and profits interest in LLC. The internal group restructuring exception under Reg. 1.7874-1(c)(2) applies, because before the acquisition, P held 80 percent or more of the capital and profits interest in LLC, and after the acquisition, P holds 80 percent or more of the stock (by vote and value) of FS. Under Reg. 1.7874-1(c)(1), the FS stock held by P is included in the denominator, but not the numerator, of the ownership fraction. Accordingly, the ownership fraction is 10/100. 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).