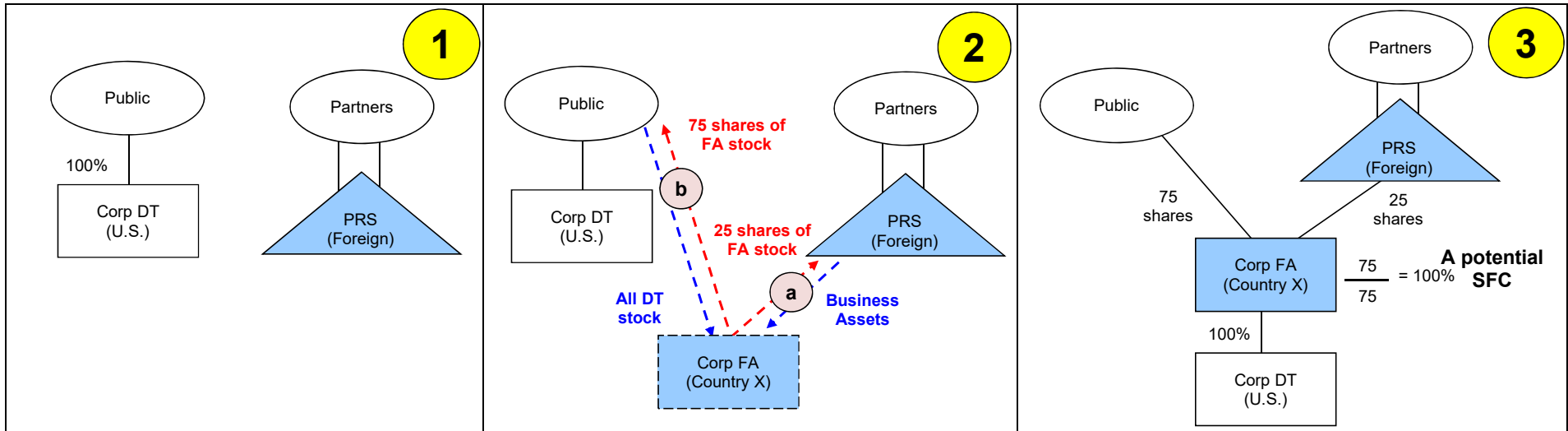


**Initial Structure**

**Formation of Corp FA**

**Ending Point**



DT is a publicly traded domestic corporation. PRS, a foreign partnership with individual partners, is unrelated to DT. PRS transfers certain business assets (PRS properties) to FA, a newly formed foreign corporation, in exchange solely for 25 shares of FA stock. The shareholders of DT transfer all of their DT stock to FA in exchange solely for the remaining 75 shares of FA stock. None of the PRS properties is property described in Treas. Reg. §1.7874-4T(i)(7)(i) through (iii) (nonqualified property), but FA acquires the PRS properties with a principal purpose of avoiding the purposes of Code §7874.

Under Treas. Reg. §1.7874-4T(i)(7)(iv), the PRS properties transferred to FA constitute nonqualified property, because FA acquires the PRS properties in a transaction related to the acquisition of the DT stock with a principal purpose of avoiding the purposes of Code §7874. Accordingly, the 25 shares of FA stock transferred by FA to PRS in exchange for the PRS properties constitute disqualified stock described in Treas. Reg. §1.7874-4T(c)(1)(i). Treas. Reg. §1.7874-4T(c)(2) does not apply to reduce the amount of disqualified stock described in Treas. Reg. §1.7874-4T(c)(1)(i) because the transfer of FA stock in exchange for the PRS properties increases the fair market value of FA's assets by the fair market value of the PRS properties. Accordingly, pursuant to Treas. Reg. §1.7874-4T(b), the 25 shares of FA stock transferred to PRS in exchange for the PRS properties are not included in the denominator of the ownership fraction. Furthermore, even in the absence of Treas. Reg. §1.7874-4T(i)(7)(iv), the transfer of the PRS properties to FA would be disregarded pursuant to Code §7874(c)(4). Therefore, the only FA stock included in the ownership fraction is the FA stock transferred to DT's former shareholders in exchange for their DT stock, and that FA stock is included in both the numerator and the denominator of the ownership fraction. Thus, the ownership fraction is 75/75.