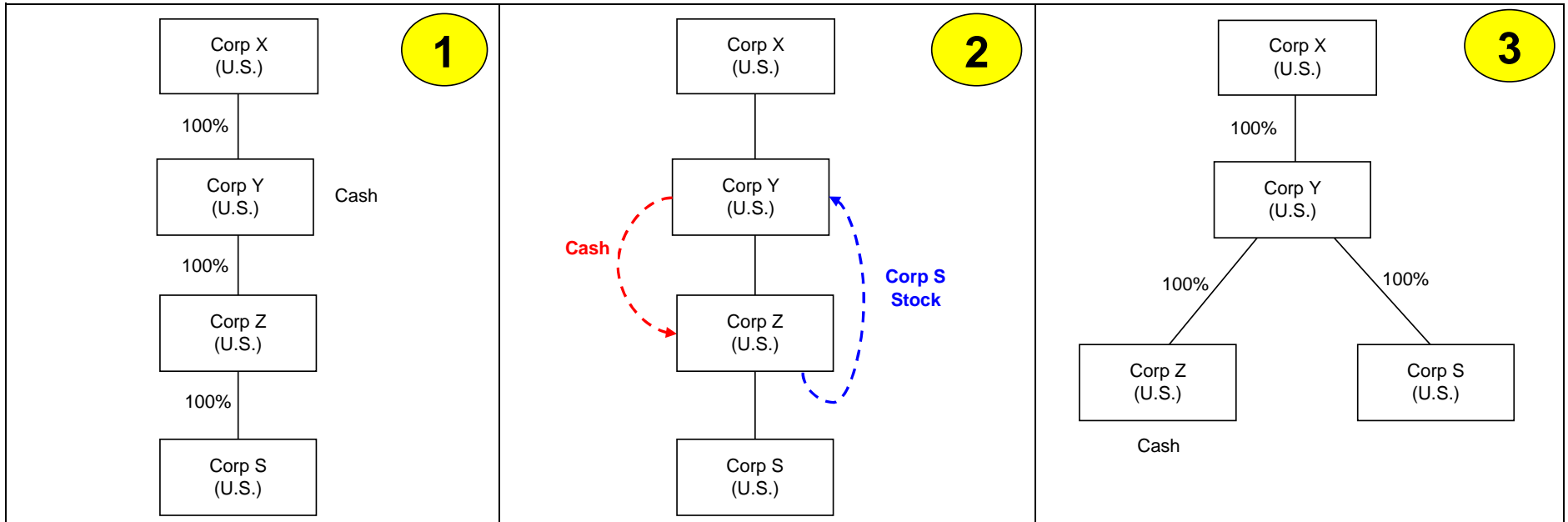


**Upstream Stock Sale is Not a 304 Transaction**

**Initial Structure**

**Upstream Sale**

**Ending Point**



Corp X owns 100% of Corp Y and Y owns 100% of Corp Z. Y purchased all of Corp S, a wholly owned subsidiary of Z, for cash. Section 304(a)(1) provides if one or more persons are in control of each of two corporations and, in return for property, one of the corporations acquires stock in the other corporation from the person so in control, then such property will be treated as a distribution in redemption of the stock of the corporation acquiring such stock. Section 304(c)(1) provides that for purposes of section 304, "control" means the ownership of stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote, or at least 50% of the total value of shares of all classes of stock.

[The following is simplified - see statute] Section 318(a)(2)(C) provides that if stock in a corporation is owned by a person, the person will be considered as owning the stock owned by the corporation. Section 318(a)(3)(C) provides that if stock in a corporation is owned by any person, the corporation will be considered as owning the stock owned by the person. Section 318(a)(5)(A) provides that stock constructively owned will be considered as actually owned. Reg. 1.318-1(b)(1) provides that to determine the stock ownership, a corporation will not be considered to own its own stock by reason of section 318(a)(3)(C).

Under section 318(a)(2)(C), X is considered as owning Z. Under section 318(a)(3)(C), Z is considered as owning Y. This would result in the above purchase being within the terms of section 304(a)(1), since Z would be in control of Y. However, if Z were considered as owning Y, it would own the stock owned by Y, which would include its own stock. Reg. 1.318-1(b)(1) is applicable since sections 318(a)(5)(A) and 318(a)(2)(C) would apply to make Z the owner of its own stock. As a result, Z cannot be considered as owning Y. However, Z would be considered as owning other corporations owned by X.

Accordingly, section 304(a)(1) is not applicable to the purchase by Y of the S stock from Z because Z is not in control of Y. Gain or loss is recognized to Z upon the sale of S to Y.