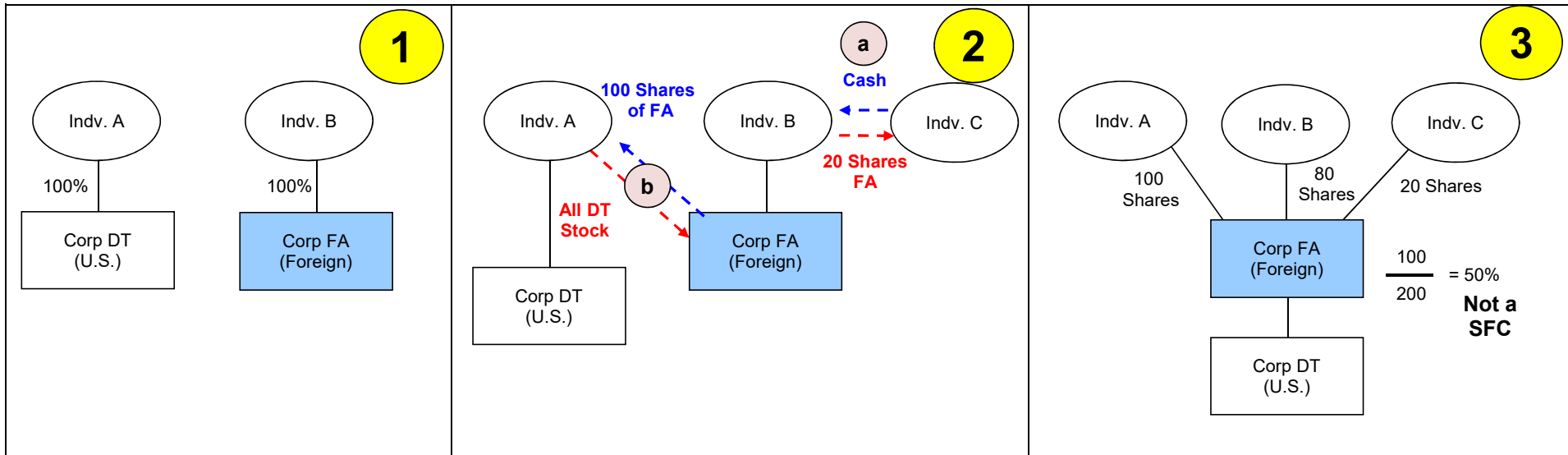


Initial Structure

Stock Transfers

Ending Point



Individual A wholly owns DT, a domestic corporation. Individual B holds all 100 outstanding shares of FA, a foreign corporation. Individual C acquires 20 shares of FA stock from Individual B for cash, and then FA acquires all of the stock of DT, a domestic corporation, from Individual A in exchange solely for 100 shares of FA stock.

Under Treas. Reg. §1.7874-4T(i)(7)(i), cash constitutes nonqualified property. Accordingly, absent the application of Treas. Reg. §1.7874-4T(c)(2), the 20 shares of FA stock transferred by Individual B to Individual C in exchange for cash would constitute disqualified stock described in Treas. Reg. §1.7874-4T(c)(1) by reason of Treas. Reg. §1.7874-4T(c)(1)(i). Nevertheless, because Individual B's sale of FA stock neither increases the assets of FA nor decreases the liabilities of FA, such FA stock is not disqualified stock by reason of Treas. Reg. §1.7874-4T(c)(2). Accordingly, Treas. Reg. §1.7874-4T(b) does not apply to Individual B's sale of the 20 shares of FA stock to Individual C, and that FA stock is included in the denominator of the ownership fraction. The 100 shares of FA stock received by Individual A are the only shares included in the numerator of the ownership fraction. Thus, the ownership fraction is 100/200.