



LB&I International Practice Service Transaction Unit

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Unit Name	Foreign-To-Foreign Transactions – IRC 367(b) Overview
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Issue and Transaction Overview

Foreign-To-Foreign Transactions – IRC 367(b) Overview

- In general, U.S. corporate shareholders (S/H) of Controlled Foreign Corporations (CFC) are not subject to current U.S. taxation on the CFC's earnings and profits (E&P) unless the CFC earns certain passive or "mobile" types of income (i.e., subpart F income). This S/H level of U.S. taxation is deferred until the CFC repatriates its E&P or there is a disposition of the S/H's interest in the CFC. If the E&P repatriation is in the form of cash or property, then the U.S. S/H is taxed on such distribution under Internal Revenue Code (IRC) 301. If the U.S. S/H disposes of its interest in the CFC, it is treated as receiving a dividend out of the CFC's untaxed accumulated earnings and profits under IRC 1248.
- A transfer of property by a CFC to a Foreign Corporation (FC) under a wide variety of nonrecognition transactions such as capital contributions, corporate liquidations, and reorganizations (e.g., IRC 332, 351, 354, 355, 356, or 361) could receive tax-free treatment. However, when such nonrecognition transactions result in the transfer of property from a CFC to another FC, IRC 367(b) may cause the S/H to recognize dividend income, as described below. The principal purpose of IRC 367(b) is to preserve the application of the principles of IRC 1248 with respect to the untaxed accumulated E&P of a CFC to the U.S. S/H at the time of the stock or asset transfer if such transaction qualifies as an IRC 351 exchange or a reorganization described in IRC 368(a)(1).
- In a foreign-to-foreign (F-to-F) transaction, IRC 367(b) generally focuses on whether an exchanging S/H loses its IRC 1248 S/H status as a result of the IRC 367(b) exchange. If the status is lost, then the exchanging S/H generally must include in income as a deemed dividend an amount equal to the lesser of the gain realized or the CFC's "Section 1248 Amount" attributed to such stock exchanged.
- One of the primary purposes of IRC 367(b) is to ensure that U.S. taxation is imposed at the exchanging S/H's level on the CFC's "IRC 1248 E&P" for certain outbound transfers of CFC stock or F-to-F nonrecognition transactions that were previously afforded deferral treatment in the U.S. in order to preserve the application of the policies of IRC 1248.

Issue and Transaction Overview (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

- This Practice Unit provides a general overview of potential tax effects of certain F-to-F transactions to the exchanging S/H and whether IRC 367(b) may be applicable to the transaction. This Practice Unit will focus on the most common IRC 367(b) Foreign-to-Foreign (F-to-F) transaction between two foreign corporations and whether an income inclusion is required due to the fact that the exchanging S/H has lost its IRC 1248 S/H status or there is a loss of CFC status. Similar results may exist for a stock transfer of a CFC to a FC pursuant to an IRC 368(a)(1)(B) stock reorganization or IRC 351 exchange, the receipt of preferred stock in certain exchanges, or certain recapitalizations.
- The examiner should determine if a F-to-F transaction has occurred involving a CFC and whether an income inclusion should be reported by the exchanging S/H pursuant to IRC 367(b).
- See related Practice Unit, “Inbound Liquidation of Foreign Corporation into a U.S. Corporate Shareholder – Under IRC 367(b),” DCN: ISO/9411.08_02(2013) for more information on an inbound (I/B) transaction from a FC to a U.S. Corporation covered by IRC 367(b).
- See related Practice Unit, “Outbound Transfer of CFC Stock – Interplay IRC 367(b) with IRC 367(a)”, (to be developed) for more details on the outbound (O/B) transfers of CFC stock that may require possible income recognition under IRC 367(b) regardless of the ability to file a Gain Recognition Agreement (GRA) under IRC 367(a).

Transaction and Fact Pattern

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Diagram of Transaction	Facts
<p>The diagram illustrates the transaction flow between four entities: USP (U.S. Parent), CFC (Controlled Foreign Corporation), Unrelated FP (Unrelated Foreign Parent), and FC (Foreign Corporation). USP and CFC are connected by a vertical line, and Unrelated FP and FC are connected by a vertical line. Green arrows indicate the following transactions: 1. CFC transfers all its assets and liabilities to FC in exchange for 40% of FC voting stock. 2. CFC distributes the FC stock to USP, and the CFC stock held by USP is canceled. 3. CFC liquidates as part of this asset reorganization. Labels include '40% FC Stock' for the stock transfers and 'CFC Assets' for the asset transfer.</p>	<p>Facts:</p> <ul style="list-style-type: none"> ▪ U.S. Parent (USP) owns 100% of Controlled Foreign Corporation (CFC), since CFC's incorporation. ▪ USP is an IRC 1248 S/H of CFC ▪ USP's basis in CFC stock = \$5 M ▪ CFC has a fair market value (FMV) = \$10M ▪ CFC has undistributed E&P of \$8M ▪ Unrelated Foreign Parent (FP) owns 100% of a Foreign Corporation (FC). ▪ In a transaction, the following steps occurred: <ul style="list-style-type: none"> – Step 1: CFC (transferor) transfers all of its assets and liabilities to FC (transferee) in exchange for 40% of FC voting stock. – Step 2: CFC distributes the FC stock to USP, and the CFC stock held by USP is canceled. CFC liquidates as part of this asset reorganization.

Transaction and Fact Pattern (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Diagram of Transaction	Facts
<p style="text-align: center;">After Transaction</p> <pre> graph TD USP[USP] --- P1[40%] UnrelatedFP[Unrelated FP] --- P2[60%] P1 --- FC[FC w/CFC Assets] P2 --- FC </pre>	<p>Resulting Organizational Structure:</p> <ul style="list-style-type: none"> ▪ CFC (transferor) ceases to exist. ▪ USP owns 40% of FC (transferee), which owns all of CFC's assets. ▪ The unrelated FP owns a controlling 60% interest of FC. <p>Alternative Facts: In lieu of the direct F-to-F asset transfer as depicted in this Illustration, if USP transferred CFC's stock to FC in exchange for FC stock and CFC made a check-the-box (CTB) election to be treated as a disregarded entity (DE) of FC immediately after the stock transfer, the transaction would also be subject to IRC 367(b) treatment. The O/B transfer of CFC stock would mostly likely be stepped together with the CTB election (deemed liquidation of CFC into FC) and treated as a "deemed" F-to-F asset reorganization subject to IRC 367(b) pursuant to Treas. Reg. 301.7701-3(g)(1)(iii) and Rev. Rul. 67-274.</p> <ul style="list-style-type: none"> ▪ This alternative fact pattern is beyond the scope of this Unit and will not be covered here. See related Practice Unit, "Outbound Transfer of Foreign Stock Followed by CTB Election," DCN:ISO/9411.08_05(2014) for further details.

Effective Tax Rate Overview

Foreign-To-Foreign Transactions – IRC 367(b) Overview

ETR of Company

- Generally, the effective tax rate (ETR) of a U.S.-parented group of companies that conducts foreign operations through a CFC rather than a branch is lower for financial accounting purposes as the CFC's earnings are deferred from U.S. taxation, especially if the taxpayer has asserted that the CFC's earnings are permanently reinvested income (PRI), which is not taken into account in determining a group's income tax provision. Nevertheless, the ETR of the company may show an increase in the year that the CFC's IRC 1248 earnings are included by its S/H under IRC 367(b). Normally, an exchange of the foreign corporation's stock or assets for stock of the foreign transferee corporation may receive non-taxable treatment in a nonrecognition transaction such as an IRC 368(a)(1) reorganization or a IRC 351 exchange. However, if a FC's stock is involved at the exchanging S/H level, then IRC 367(b) may apply to the transaction requiring the recognition of deemed dividend income at the exchanging S/H level, thereby resulting in an increase in ETR. The increase in ETR may be offset by any related foreign tax credit (FTC) attributable to the "deemed" dividend.

ETR Impact of Adjustment

- Upon certain F-to-F reorganizations or IRC 351 exchanges, USP must include in income a "deemed dividend" equal to the lesser of the gain realized or its share of the CFC's positive "IRC 1248 E&P" resulting in an increase to ETR for financial accounting purposes. To the extent that a deemed dividend is received, USP may also be allowed related FTC, which may minimize the impact of the "deemed dividend" income inclusion to USP's ETR.

Summary of Potential Issues

Foreign-To-Foreign Transactions – IRC 367(b) Overview

<u>Issue 1</u>	Whether IRC 367(b) applies to the transaction.
<u>Issue 2</u>	Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.
<u>Issue 3</u>	Whether the exchanging shareholder shall include in income as a deemed dividend the lesser of the realized gain on the exchange or the IRC 1248 amount attributable to the stock that it exchanges.

All Issues, Step 1: Initial Factual Development

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Generally, the regulations under IRC 367(b) provide that if an exchanging S/H loses its status as a "section 1248 S/H" of the corporation when the stock or assets of the foreign corporation are transferred in connection with the transaction, then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the gain realized on the exchange or the CFC's "IRC 1248 Amount".

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Confirm USP's ownership percentage in CFC before the transaction. <ul style="list-style-type: none"> - Does USP own 10% or more of the total combined voting power of all classes of stock of CFC immediately before the transaction? - Apply constructive ownership rules of IRC 958(b) 	<ul style="list-style-type: none"> ▪ Organizational Chart ▪ Final Form 5471 ▪ Form 5471, Sch O ▪ Stock Register or Other Documents to verify ownership structure of CFC, if needed 	

All Issues, Step 1: Initial Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Generally, the regulations under IRC 367(b) provide that if an exchanging S/H loses its status as a "section 1248 S/H" of the corporation when the stock or assets of the foreign corporation are transferred in connection with the transaction, then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the gain realized on the exchange or the CFC's "IRC 1248 Amount".

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Confirm if CFC was a CFC at the time of the transaction. <ul style="list-style-type: none"> – Immediately before the transaction, was more than 50% of the combined voting power of all classes of stock entitled to vote or the value of CFC owned by U.S. S/Hs (constructive ownership rules of IRC 958(b) apply)? – If not, was CFC a CFC at any time within the 5 years prior to the date of the transaction? ▪ Does CFC own any other entities, e.g., lower-tier CFCs? 	<ul style="list-style-type: none"> ▪ Organizational Chart ▪ Final Form 5471 ▪ Form 5471, Sch O ▪ Stock Register or Other Documents to verify ownership structure of CFC, if needed 	

All Issues, Step 1: Initial Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Generally, the regulations under IRC 367(b) provide that if an exchanging S/H loses its status as a "section 1248 S/H" of the corporation when the stock or assets of the foreign corporation are transferred in connection with the transaction, then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the gain realized on the exchange or the CFC's "IRC 1248 Amount".

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Determine the type of transaction that occurred which involves a transfer of property from CFC to FC. <ul style="list-style-type: none"> - Did FC acquire CFC's assets or stock in a transaction governed by a non-recognition provision? - Did CFC transfer its assets to FC (transferee) in a foreign-to-foreign (F-to-F) asset transfer pursuant to an asset reorganization? - After the transaction, did CFC cease to exist? 	<ul style="list-style-type: none"> ▪ Step plan of the transaction ▪ Tax Opinions, if any ▪ IRC 368 Return Disclosures ▪ Organizational Chart ▪ Final Form 5471 ▪ Form 5471, Sch O ▪ Plan of reorganization ▪ Shareholders' agreements ▪ Board minutes and corporate resolutions ▪ Public internet information on USP and/or CFC ▪ Securities and Exchange Commission (SEC) reports 	

All Issues, Step 1: Initial Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Generally, the regulations under IRC 367(b) provide that if an exchanging S/H loses its status as a "section 1248 S/H" of the corporation when the stock or assets of the foreign corporation are transferred in connection with the transaction, then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the gain realized on the exchange or the CFC's "IRC 1248 Amount".

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Based upon initial preliminary review of the U.S. return, confirm if USP, the exchanging S/H, has a potential built-in gain on the exchange of CFC stock (canceled) for stock in FC. <ul style="list-style-type: none"> – What is the FMV of FC stock at the time of the transaction? – What is USP's basis in CFC stock? ▪ NOTE: A realized gain at the exchanging S/H's (USP) level is required in order for the potential income recognition rule to apply under IRC 367(b) ▪ Further analysis of gain computation will be completed in Issue 3. 	<ul style="list-style-type: none"> ▪ IRC 351 or IRC 368 Disclosures ▪ Form 5471 of CFC, Sch F Balance Sheet and Sch O 	

All Issues, Step 1: Initial Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Generally, the regulations under IRC 367(b) provide that if an exchanging S/H loses its status as a "section 1248 S/H" of the corporation when the stock or assets of the foreign corporation are transferred in connection with the transaction, then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the gain realized on the exchange or the CFC's "IRC 1248 Amount".

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Confirm FC status immediately after the transfer. <ul style="list-style-type: none"> – Did USP receive more than 10% of FC? – Was FC a CFC? – Is FC reported as a CFC owned by USP immediately after the transfer? – Was a Form 5471 filed for FC? <ul style="list-style-type: none"> ▪ If so, review Sch B for ownership percentage by USP 	<ul style="list-style-type: none"> ▪ IRC 368 Disclosure Relating CFC's transaction ▪ Form 5471 & Sch. O of CFC ▪ Form 5471 & Sch. O of FC, if any. 	

Issue 1, Step 2: Review Potential Issues

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Generally, IRC 367(b) allows the nonrecognition of gain when a FC transfers property in an otherwise nontaxable exchange (such as IRC 332, 351, 354, 355, 356, or 361) that is <u>not</u> an outbound transfer subject to IRC 367(a)(1). However, IRC 367(b) regulations may require immediate taxation at the exchanging S/H's level on its respective share of the undistributed E&P of the CFC that has previously been deferred from U.S. taxation. ▪ Generally, IRC 367(b) covers the following types of transactions: <ul style="list-style-type: none"> - Inbound (I/B) transaction from a FC to a U.S. corporation - Foreign-to-Foreign (F-to-F) transaction between two FCs - Outbound (O/B) transfers of CFC stock to a FC ▪ This Practice Unit will focus on only IRC 367(b) F-to-F transactions. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-1 – General rules of IRC 367(b) and notice reporting requirements ▪ Treas. Reg. 1.367(b)-2 – Definitions for IRC 367(b) transactions ▪ Treas. Reg. 1.367(b)-4 – <i>Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions</i>

Issue 1, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ The general rule of IRC 367(b) allows the exchange to receive non-taxable treatment unless the regulations provide otherwise. As a result, you must look to the regulations to determine whether taxation is required at the exchanging S/H's level. ▪ In this Practice Unit, we are focusing on the application of IRC 367(b) to F-to-F transactions. A F-to-F transaction may include: <ul style="list-style-type: none"> – A transaction when a FC acquires the stock or assets of another FC in an IRC 351 exchange or an IRC 368(a)(1) reorganization. <ul style="list-style-type: none"> ▪ Includes an O/B transfer of CFC stock by a U.S. S/H to another FC ▪ Deemed F-to-F asset reorganization – O/B stock transferred followed by a check-the-box (CTB) election of target FC to be a DE of acquiring FC. – F-to-F IRC 332 liquidation of a lower-tier FC into its upper-tier FC (not covered in this unit) 	<ul style="list-style-type: none"> ▪ <i>IRC 332 – Nontaxable liquidation of certain subsidiaries</i> ▪ <i>IRC 351 - Transfer to corporation controlled by transferor</i> ▪ <i>IRC 368 – Corporate Reorganizations</i> ▪ <i>IRC 367(b)</i> ▪ <i>Treas. Reg. 1.367(b)-1 – General rules of IRC 367(b) and notice reporting requirements</i> ▪ <i>Treas. Reg. 1.367(b)-2 – Definitions for IRC 367(b) transactions</i> ▪ <i>Treas. Reg. 1.367(b)-4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions</i>

Issue 1, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ If the transaction is not specifically addressed in the IRC 367(b) regulations, the treatment of the F-to-F transaction will default to the general rule of IRC 367(b) and receive non-taxable treatment.▪ Although, all of the above F-to-F transactions may qualify as a transaction subject to IRC 367(b), this Unit is illustrating only the Foreign-to-Foreign (F-to-F) asset reorganization transaction between CFC and FC. See Fact Pattern of Transaction.	<ul style="list-style-type: none">▪ IRC 1248 – Attribution principles to S/H ownership

Issue 1, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ The IRC 367(b) regulations regarding F-to-F transactions are designed to preserve the application of the principles of IRC 1248 for future U.S. taxation of the previously untaxed E&P of a CFC, as long as such E&P remains in the CFC. ▪ When the assets or stock of a CFC are transferred in a nonrecognition transaction to another FC (transferee), the transaction will be considered as nontaxable if the transferee FC itself is a CFC or becomes a CFC as a result of the transfer and the exchanging S/H of the CFC remains as a IRC 1248 S/H in the acquiring FC immediately after the transaction. In such a case, IRC 367(b) will not cause the exchanging S/H to recognize dividend income with respect to its share of the previously untaxed E&P of a CFC. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – <i>Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions</i>

Issue 1, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ On the other hand, if the transfer consists of the transfer of assets or stock of CFC to FC that is not a CFC immediately after the transaction (or even if it is a CFC, the exchanging S/H of the transferred CFC is not an IRC 1248 S/H of the transferee FC), then the IRC 367(b) regulations require the exchanging S/H to include in income a deemed dividend equal to the lesser of the realized gain on the exchange or its share of the IRC 1248 E&P amount of the corporation whose stock or assets are transferred. ▪ In such case, the transaction is the last opportunity to tax CFC's E&P in the U.S. with respect to the exchanging S/H. ▪ In such case, under IRC 367(b) possible taxation may be required. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – <i>Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions</i> ▪ IRC 1248(a)

Issue 1, Step 3: Additional Factual Development

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Confirm FP’s ownership of FC immediately before the reorganization. <ul style="list-style-type: none"> – Was FP publicly held? – If not, was FP (thus FC indirectly), controlled by foreign or U.S. persons? ▪ If U.S. persons own FP, what is the total percentage of ownership by U.S. shareholders? ▪ Constructive ownership rules apply ▪ Note that IRC 367(b) can apply to certain transactions where FC’s shareholders are foreign corporations with U.S. shareholders. 	<ul style="list-style-type: none"> ▪ Ownership structure chart ▪ Financial statement of FC ▪ Stock Register ▪ Public internet websites of FC 	

Issue 1, Step 4: Develop Arguments

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ IRC 367(b) governs transfers of property in a nonrecognition transaction (IRC 332, 351, 354, 355, 356, or 361) involving a FC that generally is not a transaction covered by IRC 367(a)(1) (O/B transfer of property by a U.S. person to a FC). ▪ For the fact pattern in our Illustration, you must determine if CFC’s transfer of assets initially qualified as an IRC 351 exchange or an IRC 368(a)(1) reorganization and whether IRC 367(b) applies to the transaction. ▪ Factors to consider: <ul style="list-style-type: none"> – Does IRC 351 or a reorganization provision under IRC 368(a)(1) apply? – What type of stock was received in the exchange by USP, i.e., the exchanging S/H? Was it CFC stock, non-CFC stock, or preferred stock? 	<ul style="list-style-type: none"> ▪ Corporate Organization Chart ▪ Form 5471 and Schedule O ▪ IRC 351 or 368 Disclosure Statements attached to the Form 1120 ▪ Step plan or plan of reorganization ▪ Tax opinions, if any ▪ Board of director minutes ▪ Any related agreements between USP, FC and/or foreign parent ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions 	

Issue 1, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Adjustment	Resources	6103 Protected Resources
 CONSULTATION: A consultation with local Counsel is advisable if there is a question on whether the transfer is subject to IRC 367(b).		

Issue 1, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Adjustment	Resources	6103 Protected Resources
<p> DECISION POINT: Based upon your analysis, you have determined that the transaction qualified as a F-to-F asset reorganization under IRC 368(a)(1)(C) for the fact pattern in our Illustration pursuant to a plan of reorganization that is subject to IRC 367(b).</p> <ul style="list-style-type: none"> ▪ Proceed to Issue #2 to continue the IRC 367(b) analysis on the transaction for possible taxation to USP. For example, if USP lost its IRC 1248 S/H status, then USP may be required to include a deemed dividend of its share of CFC's positive IRC 1248 earnings and profits (E&P). ▪ If you determined that this transaction is not subject to IRC 367(b), no further analysis under IRC 367(b) is required. You should consider other applicable code sections for possible taxation. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions 	

Issue 1, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Adjustment	Resources	6103 Protected Resources
 <p>DECISION POINT: IRC 367(a) applies to an O/B transfer of foreign stock by a U.S. person to a FC. An O/B transfer of CFC stock may also fall within the scope of Treas. Reg. 1.367(b)-4 since a FC is acquiring foreign stock in certain nonrecognition transactions. This IRC 367(b) regulation does not distinguish from where the FC acquired the stock (foreign or domestic transferor). As a result, IRC 367(a) may require a gain recognition agreement (GRA) in order to avoid gain recognition under IRC 367(a); however, immediate taxation may be required under IRC 367(b).</p>	<ul style="list-style-type: none"> ▪ IRC 367(a) ▪ IRC 367(b) ▪ Treas. Reg. 1.367(a)-3(b)(2) – Stock transfers subject to sections 367(a) and (b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions 	

Issue 1, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 1

Whether IRC 367(b) applies to the transaction.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ A future Practice Unit will be developed to address the concurrent application of IRC 367(a) and 367(b) to O/B transfers of CFC stock.▪ This Practice Unit only addresses the IRC 367(b) implications for our Fact Pattern on a F-to-F asset transaction (which is not an O/B stock transfer) and you should proceed to Issue 2.		

Issue 2, Step 2: Review Potential Issues

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Based upon your conclusion in Issue 1, you have determined that the F-to-F asset reorganization of CFC into FC is subject to IRC 367(b). ▪ In general IRC 367(b) does not require recognition of income, unless prescribed in the regulations. Treas. Reg. 1.367(b)-4 provides such an income recognition rule for certain F-to-F transactions. ▪ This regulation focuses on the acquisition of foreign stock or assets by a FC in certain nonrecognition transactions. If a FC acquires foreign corporate assets or foreign stock in: <ul style="list-style-type: none"> – An IRC 351 exchange or – An IRC 368(a)(1) reorganization ▪ then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the realized gain on the exchange or the CFC’s “IRC 1248 E&P amount”. The regulations require certain criteria to be met for income recognition at the exchanging S/H level. As a result, if the transaction does not meet the scope and criteria of the regulations, then the transaction will default to the “general” rule of IRC 367(b) and receive non-taxable treatment. 	<ul style="list-style-type: none"> ▪ IRC 351 ▪ IRC 368 ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Under Treas. Reg. 1.367(b)-4, an exchanging S/H will be required to include in income as a deemed dividend the IRC 1248 E&P amount (limited to realized gain) attributable to the foreign stock exchange if: <ul style="list-style-type: none"> – The exchange results in the loss of IRC 1248 S/H status (or CFC status), – Preferred or other stock in certain exchanges is received, or – Certain exchanges involving recapitalizations occur. ▪ An IRC 1248 S/H is any U.S. S/H that owns 10 percent or more of the total combined voting power of all classes of voting stock of CFC at any time during the 5-year period ending on the date of the sale or exchange. ▪ The exchanging S/H that may be subject to taxation under IRC 367(b) includes: <ul style="list-style-type: none"> – A U.S. person that is a IRC 1248 S/H of the acquired FC or – A FC that has a U.S. person that is a IRC 1248 S/H of such FC and the acquired FC. 	<ul style="list-style-type: none"> ▪ IRC 1248(a)(2) – IRC 1248 S/H defined ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status ▪ Treas. Reg. 1.367(b)-4(b)(2) – Criteria for income recognition – Receipt of preferred stock ▪ Treas. Reg. 1.367(b)-4(b)(3) – Criteria for income - Recapitalizations ▪ Treas. Reg. 1.367(a)-3(b)(2) – Stock transfers subject to sections 367(a) and 367(b)

Issue 2, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ For example, when CFC's assets or stock are acquired by another FC in an otherwise nonrecognition transaction, the transaction will be considered taxable if the exchanging S/H who was an IRC 1248 S/H of the CFC immediately before the transaction receives stock in a FC that is not a CFC with respect to which S/H is not a IRC 1248 S/H immediately after the exchange. ▪ In our Fact Pattern, the following steps occurred: <ul style="list-style-type: none"> – CFC (the acquired FC) transfers all of its assets (and liabilities) to FC (transferee) in exchange for 40% of FC voting stock, – CFC distributes the FC voting stock to USP, its IRC 1248 S/H, and – USP exchanges its CFC stock (cancelled) for FC stock (acquiring FC) under IRC 354 as part of the asset reorganization. – CFC liquidates as part of the asset reorganization. ▪ This transaction qualifies as a foreign-to-foreign "C" reorganization under IRC 368, therefore Treas. Reg. 1.367(b)-4 must be considered since FC acquired CFC's assets in a reorganization, an otherwise nonrecognition transaction. 	<ul style="list-style-type: none"> ▪ IRC 354 – S/H exchange in a reorganization ▪ IRC 368 – <i>Definitions relating to Corporate Reorganizations</i> ▪ IRC 1248 – Ownership criteria for an IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ In our Fact Pattern, USP was an IRC 1248 S/H of CFC immediately before the transaction since USP wholly owned CFC. The question that must be answered under IRC 367(b) is whether USP is an IRC 1248 S/H in FC, the acquiring corporation, immediately after the exchange. Did USP lose its 1248 S/H status? In order for IRC 1248 S/H status to be retained, FC, the acquiring corporation, must be a CFC to which USP owns at least 10% of such FC. ▪ If not, USP, as exchanging S/H, may be required, pursuant to Treas. Reg. 1.367(b)-4, to pick up income as a result of the F-to-F asset reorganization. If IRC 1248 S/H status of USP is maintained, no income recognition is required and the transaction defaults to the general rule of IRC 367(b). 	<ul style="list-style-type: none"> ▪ IRC 354 – S/H exchange in a reorganization ▪ IRC 368 – <i>Definitions relating to Corporate Reorganizations</i> ▪ IRC 1248 – Ownership criteria for an IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Even if the F-to-F transaction does not result in an income inclusion under Treas. Reg. 1.367(b)-4, the hovering deficit rule of Treas. Reg. 1.367(b)-7 needs to be considered. The hovering deficit rule generally provides that if a foreign corporation acquires the assets of another foreign corporation in a transaction described in IRC 381, a deficit in earnings and profits of the distributor, transferor, or acquiring corporation (i.e., the transferee) can be used only to offset earnings and profits accumulated after the date of the transfer. In the example, if either CFC (the transferor) or FC (the transferee) had a deficit in earnings and profits when CFC transferred its assets and liabilities to FC, then the deficit in earnings and profits could be used only to offset the earnings and profits accumulated after the date of the transfer. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ IRC 381(c)(2)(B) – Carryover of E&P ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status ▪ Treas. Reg. 1.367(b)-7 – <i>Carryover of E&P and foreign taxes in certain F-to-F nonrecognition transactions</i> ▪ Treas. Reg. 1.367(b)-9 – Special rule - carryover of E&P and foreign taxes for “F” reorgs and similar transactions

Issue 2, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Issue	Resources
 <p>CAUTION: Although not depicted in the fact pattern in this Practice Unit, it should be noted that an exchanging S/H may be a FC (that has a U.S. person that is a IRC 1248 S/H of such FC and the acquired FC) and may be subject to the rules previously described. If a CFC sells or exchanges stock in any other FC (e.g., a lower-tier FC of the CFC), then gain recognized on such sale or exchange shall be included in the gross income of the CFC as a dividend to the same extent that it would have been so included under IRC 1248(a) (i.e., if such exchanging CFC S/H, instead, was a U.S. person).</p>	<ul style="list-style-type: none"> ▪ <i>IRC 964(e) – Gain on certain stock sales by CFCs treated as dividends</i> ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status ▪ Treas. Reg. 1.367(b)-4(c) – exclusion of deemed dividend from FPHCI

Issue 2, Step 3: Additional Factual Development

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Confirm what CFC received in the exchange for the transfer of all of its assets and liabilities to FC. <ul style="list-style-type: none"> – Did CFC receive only voting stock in FC? – What is CFC’s ownership percentage of FC immediately after the transfer? – Did CFC receive additional consideration, such as boot (i.e., cash/notes)? – Did CFC receive stock in FP, the parent of FC (i.e., the acquiring corporation)? If so, a possible triangular reorganization is in play (and special rules apply). – Did CFC receive any preferred stock of FC in the exchange? 	<ul style="list-style-type: none"> ▪ Step Plan ▪ Plan of reorganization ▪ Tax Opinions ▪ Stock certificates, stock register ▪ Form 5471 Schedule O – Description of the transfer. ▪ IRC 368 and 367(b) Disclosures ▪ Documentation of boot received, if any 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Determine USP’s ownership percentage in FC (transferee) stock after the transaction. <ul style="list-style-type: none"> – Immediately after the transaction, did USP own 10% or more of the total combined voting power of all classes of stock of FC? – Immediately after the transaction, is FC a CFC? <ul style="list-style-type: none"> ▪ Was more than 50% of the combined voting power of all classes of FC stock entitled to vote owned by US shareholders? ▪ Alternatively, was more than 50% of the total value of FC owned by US shareholders? ▪ Note that constructive ownership rules apply. 	<ul style="list-style-type: none"> ▪ IRC 368 Disclosure ▪ Form 5471 & Sch. O ▪ Final 5471 of CFC, Sch O ▪ FC Financial Statements, if available ▪ Valuation Study of CFC, if any, in comparison to FMV of FC stock received ▪ Plan of reorganization ▪ Shareholders agreements ▪ Stock Ownership Documentation ▪ Public internet websites on FC 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ The determination of whether FC is a CFC with respect to which USP, the exchanging S/H, is an IRC 1248 S/H immediately after the transfer is key in the IRC 367(b) treatment of the transaction.		

Issue 2, Step 4: Develop Arguments

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Based upon your analysis in Issue #1, you have determined that the transaction qualifies as a reorganization under IRC 368(a)(1)(C) pursuant to a plan of reorganization subject to IRC 367(b). ▪ Under Issue # 2, you now must determine whether or not the transaction falls under the scope of Treas. Reg. 1.367(b)-4 that would require possible income recognition. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ IRC 957(a) – Determination of CFC ▪ IRC 1248(a)(2) – IRC 1248 S/H defined 	

Issue 2, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Under the analysis of Issue #2, you have concluded and verified the following facts: <ul style="list-style-type: none"> - USP was an IRC 1248 S/H of CFC immediately before the transaction (100%). - FC acquired CFC's assets in a reorganization. - CFC received 40% of voting stock of FC in exchange for its assets. - FC is not a CFC, but is controlled by FP immediately after the transaction (60%). - USP exchanged its CFC's stock for 40% of FC's voting stock as part of this transaction. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ IRC 957(a) – Determination of CFC ▪ IRC.1248(a)(2) - IRC 1248 S/H defined 	

Issue 2, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 2

Whether Treas. Reg. 1.367(b)-4 applies in a foreign-to-foreign transaction in order to require a potential income inclusion.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ As a result, you have concluded that this F-to-F asset reorganization falls under the scope of Treas. Reg. 1.367(b)-4. USP, the exchanging S/H, was an IRC 1248 S/H of CFC immediately before the transaction. USP received stock in a FC in the transaction; however, FC does not qualify as a CFC. Since FC is not a CFC, USP did not maintain its IRC 1248 S/H status in FC. Therefore, IRC 1248 S/H status was lost as well as CFC status. ▪ Under Treas. Reg. 1.367(b)-4(b), USP, as the exchanging S/H, may be subject to income recognition equal to the IRC 1248 E&P of CFC attributable to the stock exchanged due to the loss of IRC 1248 S/H status. ▪ Proceed to Issue # 3 to determine the amount of the income inclusion. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ IRC 957(a) – Determination of CFC ▪ IRC 1248(a)(2) – IRC 1248 S/H defined 	

Issue 3, Step 2: Review Potential Issues

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ The primary purpose of IRC 367(b) is to preserve the ability to tax previously untaxed accumulated E&P of a CFC at the S/H level. This is accomplished in two ways: <ul style="list-style-type: none"> – Nontaxable treatment is allowed when the stock or assets of a CFC are transferred to another CFC and IRC 1248 S/H is maintained since there is still an opportunity to tax the E&P of the CFC in the future. – Taxation may be required when the acquiring FC is not a CFC (or even if it is a CFC but 1248 S/H status is not maintained) since the transaction may be the last opportunity to possibly tax the exchanging S/H of the CFC (here USP) on the undistributed E&P of the acquired CFC. ▪ The transactions that are subject to possible income inclusion equal to the IRC 1248 deemed dividend (limited to gain) to the exchanging S/H include: <ul style="list-style-type: none"> – Loss of IRC 1248 S/H or CFC status (most common scenario) – Receipt by domestic corporation of preferred or other stock in certain instances – Certain exchanges involving recapitalizations. ▪ You are charged with determining whether an income inclusion is required and what is the proper amount. 	<ul style="list-style-type: none"> ▪ IRC 367(b) ▪ IRC 1248(a)(2) – IRC 1248 S/H defined ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-4(a) – <i>Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions</i> ▪ Treas. Reg. 1.367(b)-4(b) – Deemed dividend inclusion of Section 1248 amount ▪ Treas. Reg. 1.367(b)-2(b) - Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4(b)(1)(iii), Example (1)

Issue 3, Step 2: Review Potential Issues (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ The term " section 1248 amount", which is defined in Treas. Reg. 1.367(b)-2(c), means the net positive E&P earned while such FC was a CFC which would have been attributable under IRC 1248 to the stock of the CFC transferred. ▪ Such IRC 1248 deemed dividend amount is limited to the gain that the exchanging S/H would have been required to include in income if it sold the stock in an arms-length, taxable transaction. Any excess IRC 1248 E&P of the CFC over the amount of gain realized in the transaction is not taxed. ▪ NOTE: The IRC 1248 E&P amount will include any IRC 1248 E&P of lower-tier CFCs of the acquired CFC. ▪ The deemed dividend would be foreign sourced pursuant to the look-through rules and bring with it any related foreign tax credit (FTC) under IRC 902. 	<ul style="list-style-type: none"> ▪ IRC 1248(a)(2) – IRC 1248 S/H defined ▪ IRC 1248(c)(2) – E&P determination (including lower-tier CFCs) ▪ IRC 958(a) - Rules for determining stock ownership ▪ Treas. Reg. 1.367(b)-2(b) – Defines IRC 1248 S/H for IRC 367(b) purposes ▪ Treas. Reg. 1.367(b)-2(c) – Defines IRC 1248 E&P amount

Issue 3, Step 3: Additional Factual Development

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ A determination of the fair market value (FMV) of the CFC's assets transferred to FC is needed to determine the FMV of the FC stock received by USP as part of this transaction. <ul style="list-style-type: none"> – Do you have a list of the property transferred by CFC to FC? – Do you have a list of the FMV of each item of property transferred by CFC to FC? – Was a valuation completed on the FMV of CFC? – Did CFC receive any other property in addition to FC stock? <ul style="list-style-type: none"> ▪ If so, need details of boot received. ▪ Did USP receive such boot as part of its exchange of CFC stock (canceled) for FC stock? 	<ul style="list-style-type: none"> ▪ Form 5471 Schedule O - Description of the transfer. ▪ IRC 368 Disclosure ▪ Valuation study of CFC's assets (FMV of CFC's stock) ▪ Consultation with economist and/or engineer may be required 	

Issue 3, Step 3: Additional Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What was USP's tax basis in its stock ownership of CFC at the time of the exchange? Request stock basis of CFC and verify accuracy. ▪ Verification of stock basis is needed to determine the possible gain realized on the exchange. 	<ul style="list-style-type: none"> ▪ Stock basis of CFC ▪ IRC 368 Disclosure ▪ CFC balance sheet, financial statements 	

Issue 3, Step 3: Additional Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Verification of CFC's IRC 1248 E&P is required in order to determine the income inclusion under Treas. Reg. 1.367(b)-4. <ul style="list-style-type: none"> – Issue an Information Document Request (IDR) for CFC's E&P calculations: E&P pools, FTC pools, PTI balances – How is USP's share of such earnings calculated? – If CFC owned lower-tier CFCs, you must take into consideration, in the computation of IRC 1248 E&P, any IRC 1248 E&P from such subsidiaries. – If related FTC exist, consider verification of FTC pools and the calculation of deemed paid credits. 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule J ▪ Financial statements ▪ Form 1118 for prior years ▪ E&P and FTC tax pool calculations for CFC ▪ Lower-tier CFC's E&P and FTC tax pools, if any 	

Issue 3, Step 3: Additional Factual Development (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">Request and review USP's calculation of deemed dividend income inclusion.	<ul style="list-style-type: none">USP's calculation of deemed income inclusionForm 1120Form 1118	

Issue 3, Step 4: Develop Arguments

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Based upon your analysis for Issue #1 and #2, you have concluded that there is a potential of income recognition under Treas. Reg. 1.367(b)- 4 due to the loss of IRC 1248 S/H status. ▪ The next step is to determine the amount of the deemed dividend income inclusion required to be reported, if any, pursuant to Treas. Reg. 1.367(b)-4(b). 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(b)-4(b) – Loss of IRC 1248 S/H status and deemed dividend inclusion of Section 1248 amount. ▪ Treas. Reg. 1.367(b)-1(c) – IRC 367(b) Disclosure ▪ Treas. Reg. 1.367(b)-2(b) - Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P 	

Issue 3, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ This is accomplished by first determining if there is a “realized” gain at the exchanging S/H’s level on the stock exchange. <ul style="list-style-type: none"> – Realized gain = FMV of the FC stock received less USP’s tax basis of CFC stock. – If there is no “realized gain”, there is no income inclusion required under IRC 367(b), regardless of the amount of IRC 1248 E&P of CFC. – If there is a substantial amount of IRC 1248 E&P of CFC and there is no “realized gain”, ensure that the valuation of FC stock received and the tax basis of CFC stock are true and accurate. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(b)-4(b) – Loss of IRC 1248 S/H status and deemed dividend inclusion of Section 1248 amount ▪ Treas. Reg. 1.367(b)-2 – Limitation of IRC 1248 deemed dividend to gain realized 	

Issue 3, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Request and verify: <ul style="list-style-type: none"> ▪ USP's basis in CFC stock ▪ Valuation study on FMV of CFC's assets transferred in exchange of FC stock ▪ E&P and tax pools for the computation of IRC 1248 E&P ▪ TP's calculation of deemed dividend reported on return ▪ Assuming that the facts presented in Our Fact Pattern was confirmed through examination, USP has a realized gain of \$5M (\$10M FMV - \$5M basis). 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(b)-4(b) – Loss of IRC 1248 S/H status and deemed dividend inclusion of Section 1248 amount ▪ Treas. Reg. 1.367(b)-2 – Limitation of IRC 1248 deemed dividend to gain realized ▪ Basis computation of CFC stock ▪ Valuation Study ▪ E&P and tax pool computations 	

Issue 3, Step 4: Develop Arguments (cont'd)

Foreign-To-Foreign Transactions – IRC 367(b) Overview

Issue 3

Whether the exchanging shareholder shall include in income as a deemed dividend the IRC 1248 amount attributable to the stock that it exchanges.

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Secondly, if there is a realized gain (\$5M), a comparison must be made of this gain to CFC's IRC 1248 E&P amount (\$8M). See Fact Pattern. <ul style="list-style-type: none"> – The deemed dividend required to be included in income at the exchanging S/H level is limited to the amount of gain. In our Fact Pattern, the reportable gain equals \$5M and is treated as ordinary income. – Any excess IRC 1248 E&P amount over the \$5M gain totaling \$3M (\$8M E&P - \$ 5M Gain) is not taxed. ▪ Finally, compare the proper amount of the deemed dividend income inclusion to the amount reported by USP. Any difference should be adjusted through the examination. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(b)-4(b) – Loss of IRC 1248 S/H status and deemed dividend inclusion of Section 1248 amount ▪ Treas. Reg. 1.367(b)-2 – Limitation of IRC 1248 deemed dividend to gain realized 	

Training and Additional Resources

Chapter 1.8.4 IRC 367(b) - Foreign-To-Foreign Transactions

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ (TPO) & (IBC) FY 2013 CPE CENTRA – Hot Topics of IRC 367 	
Reference Materials - Treaties	<ul style="list-style-type: none"> ▪ BNA Tax Management Int'l Portfolio 919-3rd Sec. IV – See Section E – Interaction with 367(b) ▪ BNA Tax Management Int'l Portfolio 920-3rd Sec. II – IRC 367(b) Transactions <ul style="list-style-type: none"> – See Section B – <i>Domestication Transactions Under 367(b)</i> – See Section C – <i>Outbound and Foreign-to-Foreign Exchanges under 367(b)</i> ▪ Dolan – U.S. Tax Int'l Mergers, Acquis. & Jt. Ventures Chapter 12 – <i>Foreign-to-Foreign Reorganizations and Section 351 Exchanges of Controlled Foreign Corporation Stock: Section 367(b) Regulations</i> 	

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
CTB	Check-The-Box
DE	Disregarded Entity
E&P	Earnings and Profits
ETR	Effective Tax Rate
F-to-F	Foreign-to-Foreign
FC	Foreign Corporation
FMV	Fair Market Value
FP	Foreign Parent
FTC	Foreign Tax Credit
I/B	Inbound
IRC	Internal Revenue Code
GRA	Gain Recognition Agreement

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
O/B	Outbound
PRI	Permanently Reinvested Income
PTI	Previously Taxed Income
SEC	Securities Exchange Commission
S/H	Shareholder
USP	U.S. Parent Corporation

Index of Related Issues

Issue	Associated UIL(s)	References
Outbound Transfer of Property to Foreign Corporation – IRC 367 Overview	<ul style="list-style-type: none"> ▪ 9411.08 	<ul style="list-style-type: none"> ▪ Practice Unit, “Outbound Transfer of Property to Foreign Corporations – IRC 367 Overview,” DCN: ISO/9411.08_01(2013)
Outbound Transfer of CFC Stock Followed by CTB Election (Deemed F-to-F Asset Reorganization)	<ul style="list-style-type: none"> ▪ 9411.08 	<ul style="list-style-type: none"> ▪ Practice Unit, “Outbound Transfer of CFC Stock Followed by CTB Election,” DCN: ISO/9411.08_05(2014)
Inbound Liquidations – IRC 367(b) Overview	<ul style="list-style-type: none"> ▪ 9411.08 	<ul style="list-style-type: none"> ▪ Practice Unit, “Inbound Liquidation of Foreign Corporation into a U.S. Corporate Shareholder – Under IRC 367(b),” DCN: ISO/9411.08_02(2013)
Outbound Transfer of CFC Stock – Interplay IRC 367(b) with IRC 367(a)”	<ul style="list-style-type: none"> ▪ 9411.08 	<ul style="list-style-type: none"> ▪ Practice Unit, “Outbound Transfer of CFC Stock – Interplay IRC 367(b) with IRC 367(a),” to be developed as of 06/2015