

LB&I International Practice Service Process Unit – Overview

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Shelf	N/A	Business Outbound	–	–
Volume	1	Income Shifting Outbound	Level 1 UIL	9411
Part	1.2	Intangible Property Transactions	Level 2 UIL	9411.02
Chapter	1.2.2	Outbound Transfer of Intangibles – IRC 367(d)	Level 3 UIL	9411.02-02
Sub-Chapter	N/A	N/A	–	–

Unit Name	Identifying Foreign Goodwill or Going Concern
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Introduction

Identifying Foreign Goodwill or Going Concern

- Certain outbound (O/B) transfers of property from U.S. persons to a foreign corporation are subject to IRC 367, which contains a special rule in IRC 367(d) for a U.S. person's transfer to a foreign corporation of IRC 936(h)(3)(B) intangibles in transactions described by IRC 351 or 361.
 - This rule requires the U.S. person to take into income deemed annual payments, contingent on productivity, use, or disposition of the transferred property over the useful life of the intangible, and these annual inclusions must be commensurate with the income attributable to the intangible. Treas. Reg. 1.367(d)-1T(c)(1).
 - The useful life of the intangible property is not to exceed 20 years. Treas. Reg. 1.367(d)-1T(c)(3).
 - No income inclusions under IRC 367(d) are required for the transfer of foreign goodwill or going concern (FGWGC) value. Treas. Reg. 1.367(d)-1T(b).
- Foreign goodwill or going concern value is defined in Treas. Reg. 1.367(a)-1T(d)(5)(iii) as:
 - “the residual value of a business operation conducted outside of the United States after all other tangible and intangible assets have been identified and valued. For purposes of section 367 and regulations thereunder the value of the right to use a corporate name in a foreign country shall be treated as foreign goodwill or going concern value.”
- The FGWGC value exception to IRC 367(d) applies only to goodwill arising from a business operation conducted outside of the U.S. before the transfer.

Process Overview

Identifying Foreign Goodwill or Going Concern

- The residual approach to determining FGWGC value has led to many valuation disputes. This unit does not directly address the valuation issue itself.
- Rather, this unit focuses on the threshold question of whether, as a factual matter, FGWGC can exist in the first place in light of all the facts of the case.
 - For example, because a business operation conducted outside the U.S. is a prerequisite for the existence of FGWGC, it is necessary to understand whether immediately before the transfer, the transferor of the property was engaged in a trade or business conducted outside of the U.S.
 - If that threshold requirement is not met, then factually there is no FGWGC and there is no need to determine FGWGC value.

Detailed Explanation of the Process


Identifying Foreign Goodwill or Going Concern

- The Supreme Court defined goodwill in a different context as “the expectancy of continued patronage.” *Newark Morning Ledger Co. v. U.S.*, 507 U.S. 546, 555 (1993). See also, *Boe v. Commissioner*, 307 F.2d 339, 343 (9th Cir. 1962), (“[t]o us, the essence of goodwill is the expectancy of continued patronage, for whatever reason”), aff’g 35 T.C. 720 (1961). Similarly, income tax regulations in a different context define goodwill as “the value of a trade or business attributable to the expectancy of continued customer patronage.” Treas. Reg. 1.1060-1(b)(2)(ii). Thus, if viewed as a customer based intangible, goodwill is located where the customers are located.
- However, as noted in TAM 200907024: “the traditional definitions are fundamentally inconsistent with the regulations’ definition of foreign goodwill or going concern value. The traditional definitions encompassed, among other things, customer-based intangibles that are specifically listed under section 936(h)(3)(B), like customer lists and trademarks. . . [S]uch identifiable intangibles are clearly excluded from the section 367(d) definition of ‘foreign goodwill or going concern value.’” Thus, “the Supreme Court’s findings in *Newark Morning Ledger* support the conclusion that the traditional definitions are too broad to be relied upon for purposes of section 367(d).”
- The Joint Committee’s General Explanation of the law enacting the IRC 367(d) provisions noted that tax will continue to be imposed on the transfer of intangibles “for use in connection with a U.S. trade or business or in connection with goods to be manufactured, sold, or consumed in the United States.”
- The legislative history noted that prior IRS ruling practice did not grant favorable PLRs to taxpayers who sold goods back to the U.S.. “Under the guidelines, a toll charge must be included in income in order to obtain a favorable ruling with respect to an exchange involving a transfer to a foreign corporation of a U.S. patent, trademark, or other intangibles for use in connection with manufacturing for sale or consumption in the United States. Thus, the transfer of U.S.-developed know-how to a tax-haven subsidiary for use in manufacturing goods for the U.S. market is subject to tax. . . . By implication, transfers of intangibles for use in connection with a foreign trade or business for consumption outside of the United States generally may not be taxable under the IRS procedures.”
- H.R. Rep. 98-432, Pt. 2, p. 1311-1312; S. Prt. No. 98-169, Vol. 1, p. 356-357. Congress thus viewed these “U-turn” transactions as resulting in tax avoidance. Accordingly, we can take the position that the regulatory exception for FGWGC does not extend to GWGC associated with sales to U.S. customers.

Detailed Explanation of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern


- The ruling guidelines treated O/B transfers of intangibles used in connection with goods to be manufactured, sold or consumed in the U.S. as taxable under the prior version of IRC 367, and not just intangibles used in connection with a U.S. trade or business. Congress wanted IRC 367(d) to tax transferred intangibles without any consideration as to whether the business using intangibles was conducted inside or outside of the U.S. for purposes of IRC 864(a).
- For this Process Unit – Overview Unit, we will examine what kind of business transfer might involve FGWGC as a factual matter. The determination of the correct amount of FGWGC value is beyond the scope of this Practice Unit and would require the assistance of an economist.

 **CAUTION:** On September 14, 2015, the Treasury Department and the IRS issued proposed regulations which propose to eliminate the FGWGC value exception. See REG-139483-13, 80 Fed. Reg. 55568 (Sept. 16, 2015). The proposed regulations also propose to eliminate the rule that limits the useful life of intangible property to 20 years. The regulations are proposed to apply to transfers occurring on or after September 14, 2015 and to transfers occurring before September 14, 2015 resulting from entity classification elections that are filed on or after September 14, 2015. As of 10/20/15, the proposed regulations have not been adopted as temporary or final regulations.

Detailed Explanation of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

- In an O/B transfer of IP to a foreign corporation, IRC 367(d) treatment applies to the intangible property transferred in an IRC 351 or an IRC 361 exchange. Any value associated with FGWGC that is not associated with IRC 936(h)(3)(B) intangibles is excluded from IRC 367(d) treatment.
- Based on Congress' intent in providing an exception for assets used in an active trade or business, the FGWGC value exception to IRC 367(d) should apply only where an active trade or business operation has been conducted outside of the U.S. As a result it is necessary to understand whether the transfer involves a trade or business conducted outside of the U.S. prior to the transfer.
- This unit will provide an overview of the steps needed to determine if a foreign business activity existed which may give rise to the existence of FGWGC:
 1. Gather the information on the IP transfer to determine whether there is a foreign active trade or business before the transaction that would support the taxpayer's claim that FGWGC exists (Step 1 – "FGWGC Identified by Taxpayer?").
 2. Perform a functional analysis to understand the business, including the economically relevant functions performed, resources employed, and risks assumed by the relevant controlled parties (Step 2 – "Functional Analysis").
 3. Based upon the information developed in Steps 1 and 2, determine if there is an active foreign trade or business with GWGC (Step 3 – "Active Foreign Trade or Business").
 4. If there is an active foreign trade or business with GWGC, determine whether the customer base relating to the transferred IP includes U.S. customers that may constitute domestic GWGC and thus would not constitute FGWGC value (Step 4 – "U.S. Customer Base?").

 **CAUTION:** There may be other factors that support a conclusion, as a threshold matter, that it is not factually possible for FGWGC value to exist that are beyond the scope of this Unit.

Detailed Explanation of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

- If you determine that a foreign business activity existed prior to the transaction, there is a potential for a portion of the transferred intangible property to be FGWGC and, thus, not be subject to IRC 367(d). Any other intangible property described in IRC 936(h)(3)(B) is subject to IRC 367(d).
- If you determine that a foreign business activity did not exist prior to the O/B transfer of IP, then no FGWGC could exist and, therefore, no exclusion for FGWGC is required. All transferred intangible property described in IRC 936(h)(3)(B) is subject to IRC 367(d) treatment, whereby, the U.S. transferor must report deemed annual license payments. Additionally, the disposition rule of IRC 367(d) applies upon a subsequent disposition, direct or indirect, of intangible property or foreign transferee stock that does not meet an exception to the rule under Treas. Reg. 1.367(d)-1T.



CONSULTATION: You should consult with legal counsel, the Transfer Pricing Practice (TPP), the Technical Specialists (TS) of the O/B Income Shifting Practice Network (PN), Engineers, and/or Economists if you are having any difficulty in the evaluation of the existence of a foreign trade or business, FGWGC, or transfer pricing functional analysis. (A consultation with an engineer or economist may be required to determine the residual value that is not associated with intangible property described in IRC 936(h)(3)(B) and which, as a result, may potentially be associated to FGWGC. This valuation issue is beyond the scope of this Practice Unit.)

Summary of Process Steps

Identifying Foreign Goodwill or Going Concern

Process Steps

The identification of FGWGC (or determination that it cannot exist) is critical in properly applying IRC 367(d) treatment to the outbound transfer of IP. Pursuant to regulations, IRC 367(d) is not applicable to any value attributable to the FGWGC relating to a foreign active trade or business existing prior to the outbound transfer. The process of making a determination of whether FGWGC exists consists of the four steps listed below.

<u>Step 1</u>	Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).
<u>Step 2</u>	Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.
<u>Step 3</u>	Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.
<u>Step 4</u>	If the taxpayer had an active foreign trade or business at the time the intangibles were transferred, identify the customer base (U.S. or foreign) related to the transferred IP.

Step 1: FGWGC Identified by Taxpayer?

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ An analysis of the information relating to the IP transferred will provide significant insight into the taxpayer's claim that FGWGC existed at the time of transfer.▪ In this analysis, the information may consist of:<ul style="list-style-type: none">– Information reported on the taxpayer's return,– Information to be secured from the taxpayer during the examination, and– Certain public information.		

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Return Information:</u></p> <ul style="list-style-type: none"> ▪ Specific information reporting requirements must be included in the U.S. tax return pursuant to IRC 6038B and the associated regulations for certain transfers of property to foreign persons. Penalties for the failure to furnish required information can be found therein. ▪ Failure to properly file Form 926 extends the statute of limitation to the date that is 3 years after the date on which the information required to be reported is provided. 	<ul style="list-style-type: none"> ▪ IRC 6038B ▪ IRC 6501(c)(8) ▪ Treas. Reg. 1.6038B-1 ▪ Treas. Reg. 1.6038B-1(f)(1)(iii) – Extension of statute due to failure to comply or failure to file Form 926. ▪ Treas. Reg. 1.6038B-1T – Disclosure ▪ Form 926 ▪ Form 926, Part IV, Questions 15a and b – Taxpayer's claim of transfer of FGWGC ▪ Form 926, Part IV, Questions 17a and b – Taxpayer's claim of transfer of IRC 936(h)(3)(B) intangibles 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Return Information (cont'd):</u></p> <ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038B-1 and 1.6038B-1T discuss the requirements of Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation" and the information that must be attached to this form. The Form 926 will segregate the properties transferred into specific categories by type of property (e.g. cash, tangible property and IP) and includes information such as, the date of transfer, description of property transferred, tax basis, and recognized gain. ▪ The transfer of intangible property is separately reflected on Form 926. In addition, Form 926, Part IV provides specific questions devoted to the transfer of IP subject to IRC 367(d) and the transfer of FGWGC. Treas. Reg. 1.6038B-1T(d) requires additional information for transfers of IP subject to IRC 367(d). 	<ul style="list-style-type: none"> ▪ IRC 6038B ▪ IRC 6501(c)(8) ▪ Treas. Reg. 1.6038B-1 ▪ Treas. Reg. 1.6038B-1(f)(1)(iii) – Extension of statute due to failure to comply or failure to file Form 926. ▪ Treas. Reg. 1.6038B-1T – Disclosure ▪ Form 926 ▪ Form 926, Part IV, Questions 15a and b – Taxpayer's claim of transfer of FGWGC ▪ Form 926, Part IV, Questions 17a and b – Taxpayer's claim of transfer of IRC 936(h)(3)(B) intangibles 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ For details of the transfer of property to a foreign corporation, it will be critical to review the following information attached to Form 1120 in the year of the transfer: <ul style="list-style-type: none"> - Form 926 - IRC 6038B disclosures - IRC 351 or IRC 368 disclosures – Description of the O/B transfer of property - Form 5471 and Schedule O – Description of type of transaction ▪ If the transfer was not reported on Form 926 or is incomplete, consider consultation with the Information Gathering PN for the possible assertion of IRC 6038B penalties. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038B-1 ▪ Treas. Reg. 1.6038B-1(f)(1)(iii) – Extension of statute due to failure to comply or failure to file Form 926. ▪ Form 926 ▪ IRC 351 or IRC 368 Disclosure ▪ Form 5471 and Schedule O 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Additional Information from the taxpayer:</u></p> <ul style="list-style-type: none">▪ In order to fully understand the transaction, consider securing additional information from the taxpayer. This information will assist you in the determination of whether FGWGC exists at the time of the transfer of property that would support the taxpayer's claim that FGWGC value must be excluded from IRC 367(d).		

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Additional Information from the taxpayer (cont'd):</u></p> <ul style="list-style-type: none"> ▪ Information to consider in determining whether or not FGWGC exists: <ul style="list-style-type: none"> - Organization Charts (tax and legal) - beginning and ending of tax years under audit - Taxpayer presentation of the transaction to the audit team - Step Plans and/or Transactional Slide Decks depicting of the transaction (organizational charts by step) - Copies of the presentation given to Board of Directors or other internal committees on the transaction - Tax opinions and/or Transactional Narratives/Memos, if any - Insurance Contracts 	<ul style="list-style-type: none"> ▪ Organization Charts ▪ Step Plans and/or Transactional Slide Decks ▪ Board of Directors Presentations/Minutes ▪ Tax Opinions ▪ Insurance Contracts 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Additional Information from the taxpayer (cont'd):</u></p> <ul style="list-style-type: none"> ▪ Information to consider in determining whether or not FGWGC exists: <ul style="list-style-type: none"> - IRC 6662 Transfer Pricing Documentation - Valuation Studies of the property transferred and any related valuation workpapers or spreadsheets - Complete description of the business activities in the foreign country of the acquiring CFC before the transfer <ul style="list-style-type: none"> ▪ If it was a foreign branch or disregarded entity (DE) – what activities were performed? employee presence? location presence? ▪ Type of activities (e.g. manufacturing, marketing, R&D, distribution, etc.) - Any cross-licensing or other agreements (e.g. intangible licenses, service agreements, etc.) - Any related cost sharing arrangements 	<ul style="list-style-type: none"> ▪ Transfer Pricing Documentation ▪ Supporting documentation ▪ Legal Agreements for IP ▪ Transfer Pricing Studies ▪ Intercompany Agreements ▪ Cost-sharing agreements 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Additional Information from the taxpayer (cont'd):</u> Due to the vast complexities usually associated with the O/B transfer of IP, and the consequences of intangible related taxable income escaping future U.S. taxation, it is prudent to corroborate information reported by the taxpayer with supporting documentation from the taxpayer or other information sources. Some of the items to consider are listed below:</p> <ul style="list-style-type: none"> ▪ Operations & Customers <ul style="list-style-type: none"> - Key agreements and contracts, including addendums and exhibits - Sales history by customer for prior 5 years, if available - Top 10 customer contracts - Functional organization charts of the foreign business activity before and after the transfer 	<ul style="list-style-type: none"> ▪ Key agreements and contracts ▪ Functional organization charts ▪ Sales history 	

Step 1: FGWGC Identified by Taxpayer? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 1

Gather information relating to the IP transfer based upon taxpayer's information reporting on the return and additional facts secured from the taxpayer to address the taxpayer's claim that a portion of the intangible property transferred is FGWGC, which is not subject to IRC 367(d).

Considerations	Resources	6103 Protected Resources
<p><u>Additional Information from the taxpayer (cont'd):</u></p> <ul style="list-style-type: none"> ▪ Some of the items to consider are listed below: ▪ Profitability <ul style="list-style-type: none"> - Financial statements of the foreign business activity before the transfer (i.e. foreign branch or DE) - Profitability of foreign business activity by product lines - Budgets, forecasts, business plans 	<ul style="list-style-type: none"> ▪ Financial statements ▪ Budgets, forecasts, business plans ▪ Board of Director minutes 	
<p><u>Other Sources:</u></p> <ul style="list-style-type: none"> ▪ Some of the items to consider are listed below: <ul style="list-style-type: none"> - Securities and Exchange Commission (SEC) Reports – Form 10K, Form 8K, Form 20, etc. - Capital IQ - Internet Sites of the Taxpayer relating to product development, foreign business activities, and/or customer base - Taxpayer Name and FC Corp name for internet searches 	<ul style="list-style-type: none"> ▪ SEC Reports ▪ Internet Research 	

Step 2: Functional Analysis

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ A complete evaluation of the supply chain, with special focus on identifying the value drivers of each business process or activity is critical for a thorough understanding of the functions and risks. This analysis will be key in the determination of whether an active foreign business existed before the transaction and the possibility of FGWGC value. The existence of FGWGC prior to the transaction is key in order to support the claim that FGWGC was transferred to the FC.▪ It is very important to analyze any changes in functions, risks and assets in the transferee foreign country immediately before and after the transfer of IP to support the proposition that either an actively conducted foreign business possessing FGWGC existed immediately prior to the transfer, or an actively conducted foreign business possessing FGWGC came into existence only after the transfer.		

Step 2: Functional Analysis (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In order to consider the factors for the determination of an active trade or business activity in the foreign country, it may be necessary to conduct functional interviews. The taxpayer may have both foreign and U.S. operations involved in the transfer. The interviews will establish the facts and circumstances regarding the activities performed and the risks assumed in each location. ▪ Determining the degree of centralization and locations where functions are performed will have a major impact on the IRC 367 treatment of any taxpayer restructuring efforts. ▪ See related Practice Unit, "Comparability Analysis for Tangible Goods Transactions - Outbound," DCN: ISO/P/01_05-01 (formerly ISO/PUO/V_1_01(2014)) for detailed steps on functional analysis. 	<ul style="list-style-type: none"> ▪ IRM Exhibit 4.61.3-4, Functional Analysis Questionnaire 	

Step 2: Functional Analysis (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<p><u>Key factors</u> to consider in your functional analysis when establishing the existence of an active foreign business activity BEFORE the transfer include:</p> <ul style="list-style-type: none"> ▪ What activities are performed in the foreign country? <ul style="list-style-type: none"> - Do such activities constitute an active conduct of a trade or business? - Who performed such activities (U.S. employees, foreign employees, independent contractors – Are there boots on the ground?) - What activities/functions are being supported/performed by employees of the U.S. corporation? 		

Step 2: Functional Analysis (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<p><u>Key factors</u> (cont'd) include:</p> <ul style="list-style-type: none"> ▪ Are there employees located in the foreign country? <ul style="list-style-type: none"> - Number of employees, positions, duties? Do the executives have other responsibilities in other jurisdictions? What are the executives credentials? ▪ Is there a physical asset presence in the foreign country? <ul style="list-style-type: none"> - Manufacturing, sales, distribution centers, R&D facilities? ▪ What type of income is generated in the foreign country? <ul style="list-style-type: none"> - Sales with foreign customers? Manufacturing? Or income generated strictly from related party transactions? 	<ul style="list-style-type: none"> ▪ Human Resource charts by entity and department, including position descriptions and headcounts ▪ Listing of assets located in the foreign country 	

Step 2: Functional Analysis (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<p><u>Key factors</u> (cont'd) include:</p> <ul style="list-style-type: none"> ▪ What is the character and significance of customer relationships or interactions in the foreign country to the business activity? Are customer relationships more closely associated with specifically listed IRC 936(h)(3)(B) marketing intangibles than FGWGC? <ul style="list-style-type: none"> - Does the foreign business activity use significant IRC 936(h)(3)(B) marketing intangibles to access its customer base? - Are there local customers in the foreign country? - Ratio of customers between related and 3rd parties? 	<ul style="list-style-type: none"> ▪ Practice Unit, "Comparability Analysis for Tangible Goods Transactions – Outbound", DCN: ISO/P/01_05-01 (formerly ISO/PUO/V_1_01(2014)) provides steps to complete a Functional Analysis. 	

Step 2: Functional Analysis (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 2

Understand the taxpayer's business by identifying the economically relevant functions performed, resources employed, and risks assumed by the relevant parties through a functional analysis.

Considerations	Resources	6103 Protected Resources
<p><u>Key factors</u> (cont'd) include:</p> <ul style="list-style-type: none"> - Does the U.S. have any pre-existing or developing customer relationships with these foreign customers? - What is the level of marketing in the foreign country? - Are any other affiliates involved with the customers in the foreign country? 	<ul style="list-style-type: none"> ▪ Practice Unit, "Comparability Analysis for Tangible Goods Transactions – Outbound", DCN: ISO/P/01_05-01 (formerly ISO/PUO/V_1_01(2014)) provides steps to complete a Functional Analysis. 	

Step 3: Active Foreign Trade or Business?

Identifying Foreign Goodwill or Going Concern

Step 3

Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Another step in the identification of FGWGC is the analysis of the supply chain activities and how the activities relate to the transferred IP. This is performed in order to determine whether an active foreign trade or business possessing FGWGC exists.▪ Business processes, operations or activities form a chain through which resources, including labor, materials and capital, are transformed into the products or services that a company provides to its customers.	<ul style="list-style-type: none">▪ Treas. Reg. 1.367(a)-2T – Active trade or business outside of the U.S.	

Step 3: Active Foreign Trade or Business? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 3

Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T(a)(2) defines a trade or business outside the U.S. for purposes of IRC 367 to include a specific unified group of activities that constitutes (or could constitute) an independent economic enterprise carried on for profit. To constitute a trade or business, a group of activities must ordinarily include every operation which forms a part of, or a step in, a process by which an enterprise may earn income or profit, including the collection of income and the payment of expenses. ▪ Treas. Reg. 1.367(a)-2T(a)(3) provides that whether a trade or business is actively conducted must be determined under all the facts and circumstances. In general, a corporation actively conducts a trade or business only if the officers or employees carry out substantial managerial and operational activities. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T – Active trade or business outside of the U.S. 	

Step 3: Active Foreign Trade or Business? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 3

Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T(b) provides the following four factual considerations on whether transferred property would be used in an active trade or business by the transferee after the transfer in order to meet the active trade or business exception of IRC 367(a)(3)(C): <ul style="list-style-type: none"> - What is the trade or business of the transferee; - Do the foreign activities constitute the active conduct of that trade or business; - Is the trade or business conducted outside of the U.S.; and - Is the transferred property used or held for use in the trade or business? 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T – Active trade or business outside of the U.S. 	

Step 3: Active Foreign Trade or Business? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 3

Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Similar factual considerations may be used to determine whether a taxpayer has an active foreign trade or business before the transfer in analyzing the elements of the supply chain activities to support the potential existence of FGWGC. <p><u>Trade or business/activity in the foreign country, if any before the transfer:</u></p> <ul style="list-style-type: none"> ▪ What is the trade or business or activity in the foreign country, if any? ▪ What kind of facilities are present in the foreign country? ▪ Check 10K for PPE and people. ▪ Is inventory created in the foreign country? ▪ Review insurance contracts to see where property is located. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T – Active trade or business outside of the U.S. 	

Step 3: Active Foreign Trade or Business? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 3

Use the information obtained under steps 1 and 2 to determine whether the taxpayer had an active foreign trade or business at the time the intangibles were transferred.

Considerations	Resources	6103 Protected Resources
<p><u>Foreign activities constitute “active conduct” of a trade or business before the transfer:</u></p> <ul style="list-style-type: none"> ▪ Are there substantial managerial and operational activities conducted in the foreign country? ▪ Are employees on site in the foreign country? ▪ What functions or activities were conducted in the foreign country prior to the transfer? ▪ Are the customers related or unrelated third parties? ▪ In addition, the customer base should be closely analyzed. Where are the customers located? – U.S. or foreign country? <p>Each primary business process or activity adds value to the product or service provided. A systems approach to business evaluation analyzes the value that each subsystem provides to the overall supply chain.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T – Active trade or business outside of the U.S. 	

Step 4: Customer Base – U.S. or Foreign?

Identifying Foreign Goodwill or Going Concern

Step 4

If the taxpayer had an active foreign trade or business at the time the intangibles were transferred, identify the customer base (U.S. or foreign) related to the transferred IP.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ One of the first steps in identifying FGWGC is to identify the customer base related to the transferred IP and whether a foreign customer base exists. 	<ul style="list-style-type: none"> ▪ IRC 367(d) ▪ Treas. Reg. 1.367(d)-1T(b) – IP Subject to IRC 367(d) ▪ Treas. Reg. 1.367(a)-1T(d)(5)(iii) – Definition of FGWGC ▪ Treas. Reg. 1.367(a)-2T(b)(4) – Trade or Business Outside of the U.S. 	

Step 4: Customer Base – U.S. or Foreign?

Identifying Foreign Goodwill or Going Concern

Step 4

If the taxpayer had an active foreign trade or business at the time the intangibles were transferred, identify the customer base (U.S. or foreign) related to the transferred IP.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The continued patronage of the U.S. customer base, as shown by the U.S. customers' purchase of some, if not the bulk of, the output of the business, may represent value associated with intangible property described in IRC 936(h)(3)(B) or otherwise not associated with a foreign business operation conducted outside the United States. In common situations where a majority of the sales are made to related parties, the related party may resell the products into the U.S. market. An analysis of the flow of products through related parties may be required to determine whether there is a U.S. customer base. This may lead to a conclusion that a portion of the total GWGC is attributable to IRC 936(h)(3)(B) marketing intangibles (or a business operation conducted in the United States). 	<ul style="list-style-type: none"> ▪ IRC 367(d) ▪ Treas. Reg. 1.367(d)-1T(b) – IP Subject to IRC 367(d) ▪ Treas. Reg. 1.367(a)-1T(d)(5)(iii) – Definition of FGWGC ▪ Treas. Reg. 1.367(a)-2T(b)(4) – Trade or Business Outside of the U.S. 	

Step 4: Customer Base – U.S. or Foreign? (cont'd)

Identifying Foreign Goodwill or Going Concern
Step 4
If the taxpayer had an active foreign trade or business at the time the intangibles were transferred, identify the customer base (U.S. or foreign) related to the transferred IP.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Treas. Reg. 1.367(a)-2T(b)(4) defines “outside of the United States” with respect to the conduct of a business operation. (This definition relates to the IRC 367(a)(3) rule for the transfer of property for use in the active conduct of a trade or business outside the U.S..) It provides that, generally, a foreign corporation conducts a business outside the U.S. when its primary managerial and operational activities are conducted outside of the U.S., and substantially all of its assets are located outside of the U.S. 		

Step 4: Customer Base – U.S. or Foreign? (cont'd)

Identifying Foreign Goodwill or Going Concern

Step 4

If the taxpayer had an active foreign trade or business at the time the intangibles were transferred, identify the customer base (U.S. or foreign) related to the transferred IP.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ FGWGC only exists with respect to a business operation “conducted outside of the United States.” Sales back to the U.S. may create an asset located in the U.S. (i.e., goodwill and going concern value). Treas. Reg. 1.367(a)-1T(d)(5)(iii). In order to be considered “outside of the United States,” for purposes of the active trade or business exception under IRC 367(a), the regulations provide that “substantially all of the transferred assets” must be located outside the United States. Treas. Reg. 1.367(a)-2T(b)(4). 	<ul style="list-style-type: none"> ▪ IRC 367(d) ▪ Treas. Reg. 1.367(d)-1T(b) – IP Subject to IRC 367(d) ▪ Treas. Reg. 1.367(a)-1T(d)(5)(iii) – Definition of FGWGC ▪ Treas. Reg. 1.367(a)-2T(b)(4) – Trade or Business Outside of the U.S. 	

Definitions

Identifying Foreign Goodwill or Going Concern

Description

- IRC 936(h)(3)(B) Intangibles – A patent, invention, formula, process, design, pattern, know-how, copyright, literary, musical, or artistic composition, trademark, trade name, brand name, franchise, license, contract, method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, technical data or any similar item which has substantial value independent of the services of an individual.
- Foreign Goodwill or Going Concern - The residual value of a business operation conducted outside of the U.S. after all other tangible and intangible assets have been identified and valued. For purposes of IRC 367 and its regulations, the value of the right to use a corporate name in a foreign country shall be treated as foreign goodwill or going concern value.

Examples of the Process

Identifying Foreign Goodwill or Going Concern

Description

Examples of transactions that may indicate the O/B transfer of existing FGWGC include, but are not limited to:

- A newly formed CFC that was previously a foreign branch (or a DE of a U.S. corporation) with foreign employees and a presence in the foreign country conducting business with unrelated foreign customers. See [Scenario 1](#)
- A newly formed CFC that was previously a foreign branch (or a DE of a U.S. corporation) with foreign and domestic employees and unrelated foreign and U.S. customers.
- An O/B “F” reorganization of a U.S. corporation that has significant U.S. operations, holds numerous IP, including U.S. and Country X customer lists/relationships, conducts no direct foreign business activities, but operates a trade or business indirectly in Country X via its DE. See [Scenario 2](#)
- An O/B asset reorganization of a U.S. corporation that has significant U.S. and Country X operations.

Examples of transactions that may indicate the O/B transfer of IP, but not FGWGC include, but are not limited to:

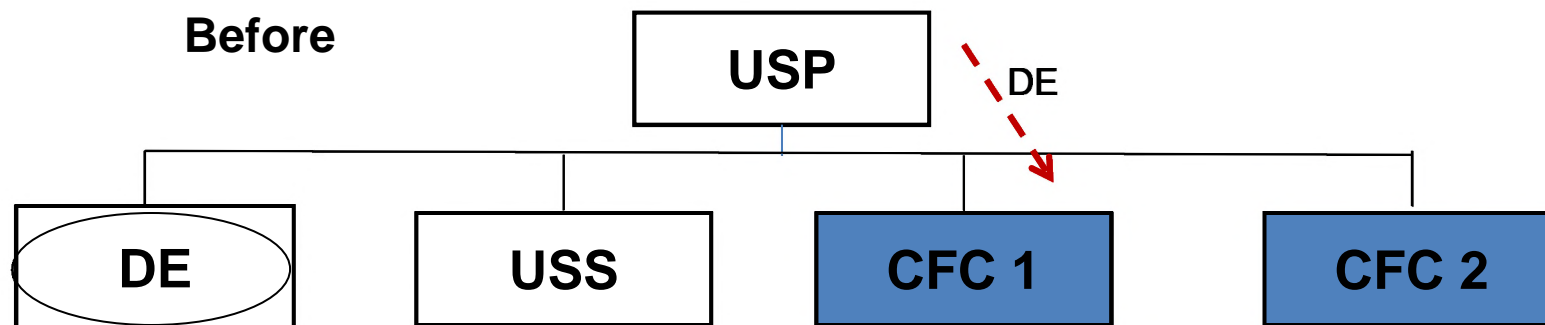
- A newly formed CFC of the taxpayer that did not previously have any activities in the foreign country in which the new CFC was formed.
- An O/B asset reorganization of a U.S. corporation with U.S. manufacturing activities, which possesses valuable IP, including U.S. and Country Y customer lists and relationships, but has conducted no business activities in Country Y. See [Scenario 3](#).

Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 1 - A transaction that may give rise to FGWGC - An O/B Transfer of DE to CFC1 under IRC 351



Steps:

1. USP executes an IRC 351 transfer of DE to CFC 1 by a legal transfer of the shares of DE. For U.S. tax purposes, this would be treated as an IRC 351 transfer of DE's assets to CFC1.
2. DE had operations, employees and unrelated customers in Country X prior to the transfer.

Assumptions:

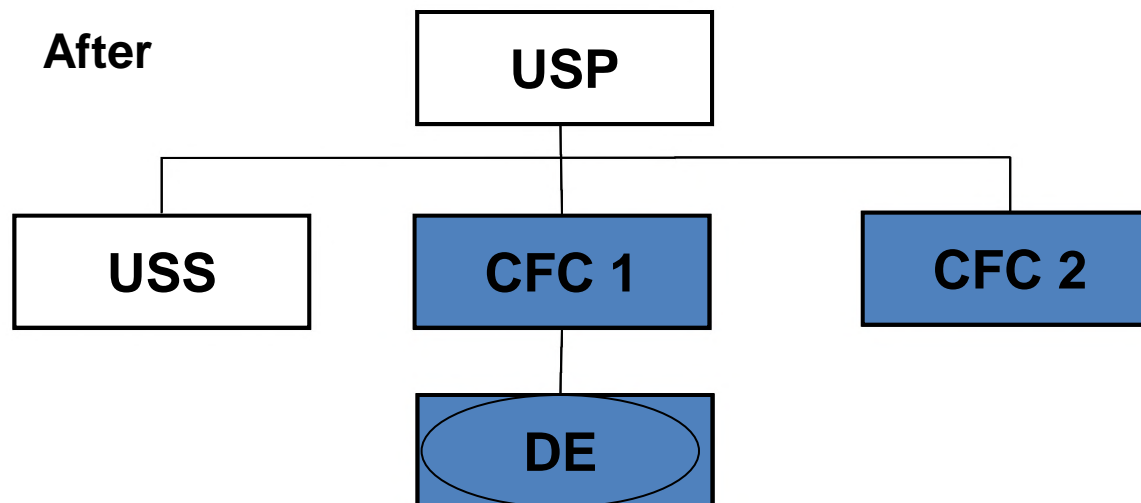
1. DE conducts manufacturing operations in Country X, possesses valuable IP, including manufacturing know-how, marketing IP, and customer lists and relationships (U.S. and Country X).
2. USS, incorporated in U.S., performs all R&D activities for USP in the U.S. and holds all U.S. global patents related to the products.

Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 1 - A transaction that may give rise to FGWGC - An O/B Transfer of DE to CFC1 under IRC 351 (cont'd)



Potential Results:

1. DE may own transferred FGWGC based upon the fact that it conducted an active trade or business in Country X with unrelated foreign customers prior to the transfer.
2. The transfer of DE to CFC had no impact on the operations/activities performed in the U.S. by USS.

Alternative Facts:

The same potential results would have occurred if DE elected (under Treas. Reg. 301.7701-3) to be treated as a Foreign Corporation (FC). USP would be deemed to have transferred DE's property to a new FC in exchange for FC stock pursuant to IRC 351.

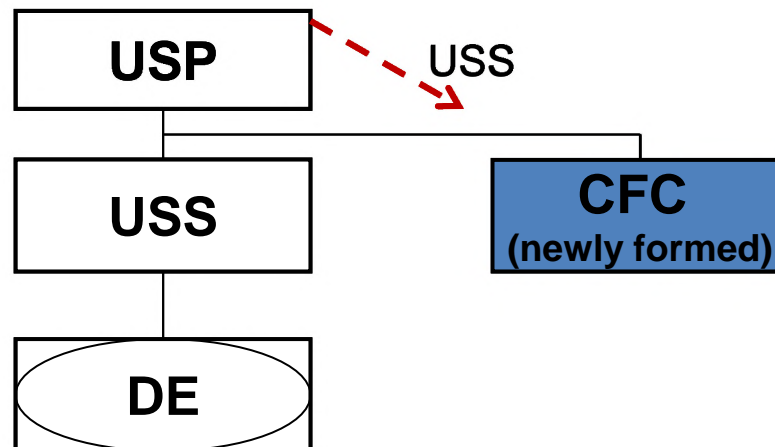
Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 2 - A transaction that may give rise to the transfer of FGWGC under IRC 367(d) – An O/B “F” Reorganization of USS to CFC1

Before



Facts:

1. USS completes an O/B “F” reorg into a newly formed CFC, owned 100% by USP, via:
 - USP transfers USS stock to CFC
 - USS converts to disregarded LLC of CFC

Assumptions:

1. USS, incorporated in U.S., conducts manufacturing and R&D activities in the U.S. on behalf of USP, holds patents, customer lists and relationships (U.S. and Country X), but conducts no direct business activities in Country X.
2. USS operates in Country X via its DE, conducts manufacturing operations in Country X and possesses valuable IP, including Country X customer lists and relationships.

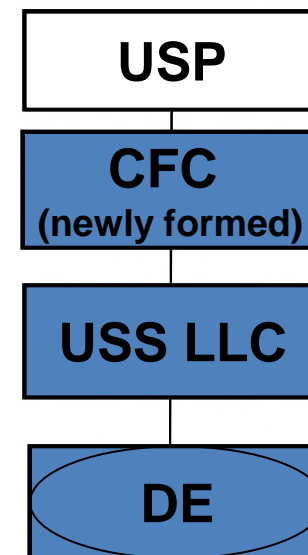
Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 2 - A transaction that may give rise to the transfer of FGWGC under IRC 367(d) – An O/B “F” Reorganization of USS to CFC1 (cont'd)

After



Potential Results:

1. After the transaction, USS, originally incorporated in U.S. and converted to a single member U.S. LLC, is owned by CFC.
2. DE continues to operate in Country X.
3. Because there was a transfer of an active trade or business in Country X conducted by DE, there was a potential transfer of FGWGC.

Post “F” Potential Steps – to strip IP out from under USS LLC to CFC

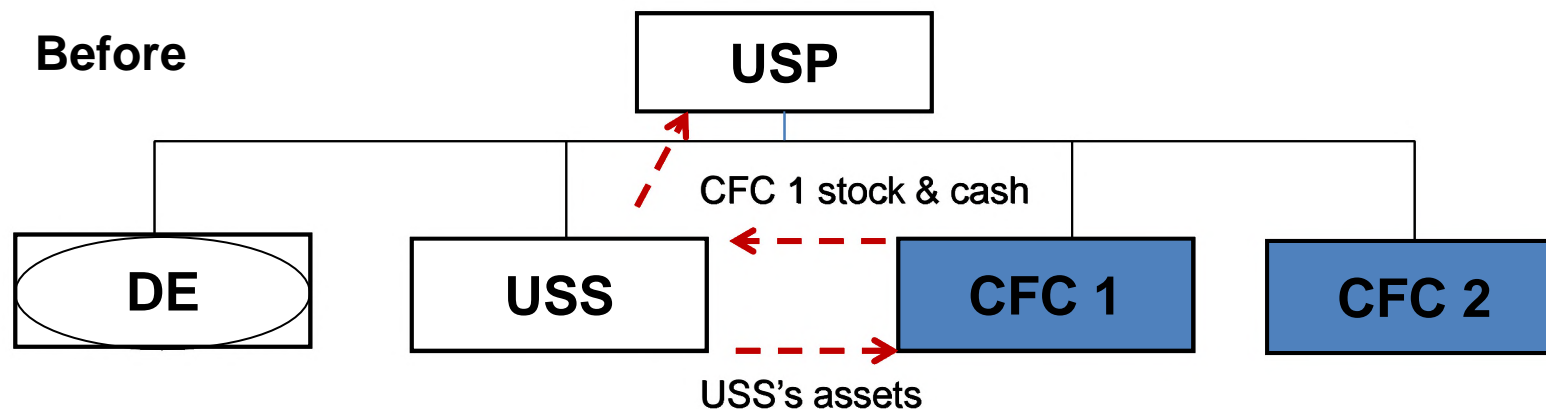
1. USS LLC may transfer (from a legal perspective) its IP and DE interest to CFC in a disregarded transaction for U.S. tax purposes.
2. CFC may sell remaining tangible assets of USS LLC back to the USP and/or a U.S. subsidiary to avoid a potential IRC 956 income inclusion. There would generally be no IRC 956 inclusion resulting from holding self-created IP. In order to have “U.S. Property” for IRC 956 purposes, the property must have a tax basis. Most self-created IP has no tax basis because the costs in creating the IP was currently expensed and not capitalized.

Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 3 – A transaction that may be subject to IRC 367(d) but not involve a transfer of FGWGC - An O/B Cash “D” Reorganization of USS to CFC1.



Steps:

1. USS transfers its assets to CFC1 in exchange for CFC1 stock and cash.
2. USS distributes CFC1 stock and cash to USP in liquidation as part of the cash “D” reorganization and USS ceases to exist.

Assumptions:

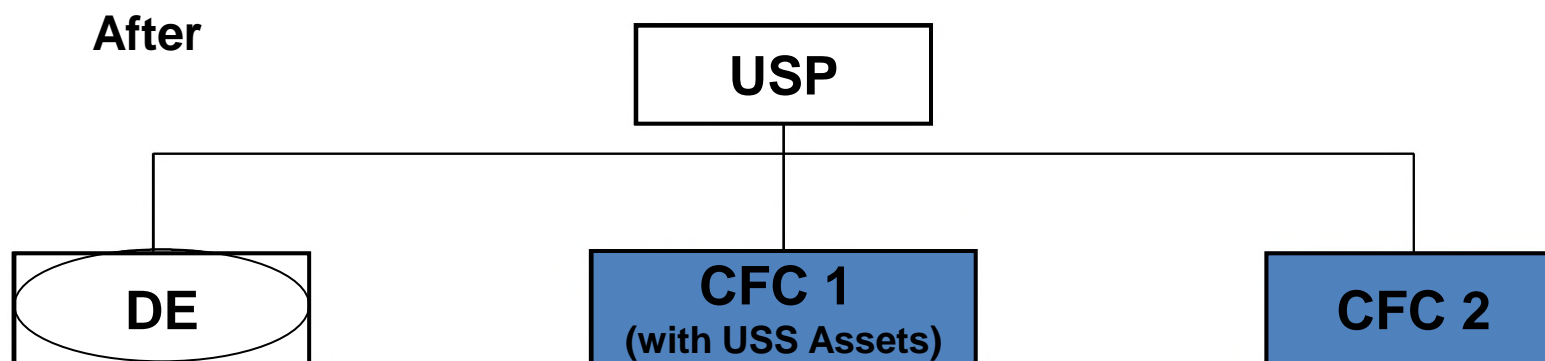
1. Prior to the reorganization, USS conducts manufacturing and R&D activities in the U.S., possesses valuable IP including global patents, customer lists and relationships (U.S. and Country Y), but has conducted no business activities in Country Y.
2. Prior to the reorganization CFC1, incorporated in Country Y, performs some manufacturing and R&D activities for USP in Country Y.
3. DE conducts manufacturing operations in Country X, possesses valuable IP, including manufacturing know-how, marketing IP and U.S. and Country X customer lists and relationships.

Examples of the Process (cont'd)

Identifying Foreign Goodwill or Going Concern

Description

Scenario 3 – A transaction that may be subject to IRC 367(d) but not involve a transfer of FGWGC – An O/B Cash “D” Reorganization of USS to CFC1 (cont'd)



Potential Results:

1. USS ceases to exist.
2. CFC1 now owns all of USS's assets (including IP). As a result, IRC 367(d) may apply to the O/B transfer of IP.
3. USS did not transfer FGWGC based upon the fact that it conducted no business operations in Country Y immediately before the transfer.
4. FGWGC may have existed at CFC1's level due to its prior business operations in Country Y before the transaction, but would not have been transferred in the IRC 367(d) transaction.
5. CFC will likely sell remaining tangible assets and U.S. operations of USS LLC back to the USP and/or a U.S. subsidiary to avoid having a U.S. trade or business.

Training and Additional Resources

Identifying Foreign Goodwill or Going Concern		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	▪ 2012 CPE CENTRA – IRC 367(d)	
Issue Toolkits	▪ Audit Tool - Transfer Pricing Roadmap	
Podcasts / Videos	▪ 2011 CPE CENTRA – Intangible Migration (Day 3)	

Glossary of Terms and Acronyms

Term/Acronym	Definition
CU	Concept Unit
CFC	Controlled Foreign Corporation
DCN	Document Control Number
DE	Disregarded Entity
FGWGC	Foreign Goodwill or Going Concern
GWGC	Goodwill or Going Concern
IDR	Information Document Request
IP	Intangible Property
IRC	Internal Revenue Code
ISO	Income Shifting Outbound
LLC	Limited Liability Corporation
O/B	Outbound
PN	Practice Network
R&D	Research and Development
SEC	Securities and Exchange Commission
TPP	Transfer Pricing Practice

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
Treas. Reg.	Treasury Regulation
TS	Technical Specialist
USS	U.S. Subsidiary
USP	U.S. Parent

Index of Related Issues

Issue	Associated UIL(s)	References
Comparability Analysis for Tangible Goods Transactions – Outbound	<ul style="list-style-type: none"> ▪ 9411 	<ul style="list-style-type: none"> ▪ Practice Unit, “Comparability Analysis for Tangible Goods Transactions - Outbound,” DCN: ISO/P/01_05-01 (formerly ISO/PUO/V_1_01(2014))
Comparison of the Arm’s Length Standard with Other Valuation Approaches	<ul style="list-style-type: none"> ▪ 9411 and 9422 	<ul style="list-style-type: none"> ▪ Practice Unit, “Comparison of Arm’s Length Standard with Other Valuation Approaches Outbound,” DCN: ISO/C/01-03 (formerly ISO/CU/V_1_03(2014)) ▪ Practice Unit, “Comparison of Arm’s Length Standard with Other Valuations Approaches Inbound,” DCN: ISI/C/06-04 (formerly ISI/CU/V_6_01(2014))
IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)	<ul style="list-style-type: none"> ▪ 9411.01-01 	<ul style="list-style-type: none"> ▪ Practice Unit, “Section 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA),” DCN: ISO/T/01_01_01-04
License of Intangible Property from U.S. Parent to a Foreign Subsidiary	<ul style="list-style-type: none"> ▪ 9411.02 	<ul style="list-style-type: none"> ▪ Practice Unit, “License of Intangible Property from U.S. parent to a Foreign Subsidiary,” DCN: ISO/T/01_02_01-01 (formerly ISO/9411.02_03(2013))
Distinguishing Between Sale, License and Other Transfers of Intangibles to CFCs by US Transferors	<ul style="list-style-type: none"> ▪ 9411.02-01 and 9411.02-02 	<ul style="list-style-type: none"> ▪ Practice Unit, “Distinguishing Between Sale, License and Other Transfers of Intangibles to CFCs by US Transferors,” DCN: ISO/T/01_02-04 (formerly ISO/9411.02_02(2013))

Index of Related Issues (cont'd)

Issue	Associated UIL(s)	References
Deemed Annual Royalty Income Under IRC 367(d)	<ul style="list-style-type: none"> ▪ 9411.02-02 	<ul style="list-style-type: none"> ▪ Practice Unit, “Deemed Annual Royalty Income Under IRC 367(d),” DCN: ISO/T/01_02_02-01 (formerly ISO/9411.02_01(2013))
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 Corporation - IRC 367 Overview,” DCN: ISO/T/01_08_01-01 (formerly ISO/9411.08_01(2013))
Arm’s Length Standard	<ul style="list-style-type: none"> ▪ 9422.09 	<ul style="list-style-type: none"> ▪ Practice Unit, “ Arm’s Length Standard,” DCN: ISI/T/06-05 (formerly ISI/9422.09_06(2013))