

Treatment of Property Used To Acquire Parent Stock or Securities in Certain Triangular Reorganizations Involving Foreign Corporations

Notice 2014-32

SECTION 1. OVERVIEW

This notice announces that the Internal Revenue Service (IRS) and the Department of the Treasury (Treasury Department) will issue regulations under section 367 of the Internal Revenue Code (Code) relating to the treatment of property used to acquire parent stock or securities in certain triangular reorganizations involving one or more foreign corporations.

SECTION 2. BACKGROUND

.01 Issuance of Regulations

On May 27, 2008, the IRS and the Treasury Department published temporary and proposed regulations (T.D. 9400, 2008-1 C.B. 1139 [73 FR 30301]) (2008 regulations) under section 367 that applied to certain triangular reorganizations in which a subsidiary (S) acquires stock of its parent corporation (P) in exchange for property (the P acquisition), and S exchanges the P stock so acquired for stock or property of a target corporation (T), but only if P or S (or both) is a foreign corporation. On May 19, 2011, the IRS and the Treasury Department finalized the proposed 2008 regulations (T.D. 9526, 2011-24 I.R.B. 869 [76 FR 28890]), with certain modifications (final

regulations).

.02 Deemed Distribution and Contribution Rules

In the case of a triangular reorganization subject to §1.367(b)-10, the final regulations require that adjustments be made that are consistent with the adjustments that would have been made if S had in fact distributed property to P under section 301 (deemed distribution). §1.367(b)-10(b)(1). For this purpose, the amount of the deemed distribution generally is the amount of property that was transferred by S to acquire the P stock and securities in the P acquisition. In addition, the final regulations require that adjustments be made that are consistent with the adjustments that would have been made if P had in fact contributed that same property to S (deemed contribution). §1.367(b)-10(b)(2). The deemed contribution has the effect of increasing P's basis in its S stock by the amount of the deemed distribution. §1.367(b)-10(c)(2). For purposes of making the required adjustments, the deemed distribution and deemed contribution are treated as separate transactions that occur before the P acquisition or, if P does not control S at the time of the P acquisition, immediately after P acquires control of S, but before the triangular reorganization. §1.367(b)-10(b)(3). Furthermore, the final regulations provide that P's adjustment to the basis in its S stock under §1.358-6 is determined consistent with treating S as having acquired the P stock or securities in exchange for property from P or a person other than P, as the case may be. §1.367(b)-10(b)(4).

.03 Triangular Reorganizations Exempt from Final Regulations

Under §1.367(b)-10(a)(2), the final regulations do not apply to a triangular reorganization if:

(i) P and S are foreign corporations and neither P nor S is a controlled foreign corporation (within the meaning of §1.367(b)-2(a)) immediately before or immediately after the triangular reorganization;

(ii) S is a domestic corporation, P's stock in S is not a United States real property interest (within the meaning of section 897(c)), and P would not be subject to U.S. tax on a dividend from S under either section 881 (for example, by reason of an applicable treaty) or section 882 (no-U.S.-tax exception); or

(iii) In an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T and the amount of gain in the T stock or securities recognized by such U.S. persons under section 367(a)(1) is equal to or greater than the sum of the amount of the deemed distribution that would be treated by P as a dividend under section 301(c)(1) and the amount of such deemed distribution that would be treated by P as gain from the sale or exchange of property under section 301(c)(3) (together, section 367(b) income) if §1.367(b)-10 would otherwise apply to the triangular reorganization (section 367(a) priority rule).

As the corollary to the section 367(a) priority rule, the final regulations under section 367(a) also provide a priority rule in §1.367(a)-3(a)(2)(iv) (section 367(b) priority rule). The section 367(b) priority rule turns off the application of section 367(a)(1) to an

exchange under section 354 or 356 that occurs in connection with a triangular reorganization described in §1.367(b)-10 if the amount of gain that would otherwise be recognized under section 367(a)(1) (without regard to any exceptions thereto) is less than the amount of the section 367(b) income recognized under §1.367(b)-10.

.04 Anti-Abuse Rule

The final regulations provide that appropriate adjustments shall be made if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of §1.367(b)-10 (anti-abuse rule). §1.367(b)-10(d). One example is given where the earnings and profits of S will be deemed to include the earnings and profits of a corporation related to P or S for purposes of determining the consequences of the adjustments provided in the final regulations, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of that related corporation.

SECTION 3. TRANSACTIONS AT ISSUE

The IRS and the Treasury Department are aware that taxpayers are engaging in transactions designed to avoid U.S. tax by exploiting the deemed contribution provided under the final regulations. The IRS and the Treasury Department believe that the deemed contribution is inconsistent with the purpose of §1.367(b)-10, regardless of whether S acquires P stock or securities from P or from a person other than P.

The IRS and the Treasury Department also are aware that the priority rules may facilitate certain transactions designed to avoid recognizing gain under §1.367(a)-3(c).

For example, FP, a foreign corporation, intends to acquire all the stock of UST, a domestic corporation owned by U.S. persons, in exchange for FP stock in a reorganization described in section 368(a)(1)(B). FP forms USS, a domestic corporation. USS generates a small amount of earnings and profits. USS acquires FP stock from FP in exchange for a note and uses the FP stock to acquire all the stock of UST. The shareholders of UST receive 75 percent of the outstanding FP stock. The stock in USS is not a United States real property interest (within the meaning of section 897(c)), and FP would not be subject to U.S. tax under section 882 on a disposition of the stock of USS. The transaction is structured to result in a small amount of dividend income that would be subject to U.S. withholding tax on a distribution and in a significant amount of section 367(b) income in the form of section 301(c)(3) gain. The taxpayer takes the position that the transaction avoids the application of the no-U.S.-tax exception because of the small amount of dividend income. In addition, the taxpayer takes the position that the section 367(b) priority rule applies because the section 367(b) income recognized by FP by reason of the application of §1.367(b)-10 exceeds the amount of gain that would be recognized by shareholders of UST under section 367(a)(1) with respect to the UST stock. This position is taken even though the section 301(c)(3) gain that FP recognizes by reason of the application of §1.367(b)-10 (and therefore takes into account in determining section 367(b) income) is not subject to U.S. tax. Finally, the taxpayer takes the position that the anti-abuse rule does not apply with respect to the earnings and profits of UST (see further discussion of this position

below).

Based on the policy underlying the priority rules, the IRS and the Treasury Department believe that section 367(b) income should include only dividend income and gain that are subject to U.S. tax or dividend income and gain that give rise to an income inclusion under section 951(a)(1)(A) that is subject to U.S. tax.

The IRS and the Treasury Department are also concerned that some taxpayers may be taking the position that the no-U.S.-tax exception is inapplicable when S (the stock of which is not a United States real property interest) has no current or accumulated earnings and profits based on the fact that if S instead did have current or accumulated earnings and profits, the resulting dividend would be subject to U.S. tax. The IRS and the Treasury Department disagree with this interpretation of the no-U.S.-tax exception.

Finally, the IRS and the Treasury Department are concerned that some taxpayers may be interpreting the anti-abuse rule too narrowly, including with respect to what constitutes a funding for purposes of invoking the anti-abuse rule. In addition, the IRS and the Treasury Department understand that taxpayers may be taking the position that the anti-abuse rule does not apply with respect to the earnings and profits of T, including in cases where T is unrelated to P and S before the triangular reorganization or where T is acquired pursuant to a triangular asset reorganization. The IRS and the Treasury Department disagree with these interpretations.

The IRS and the Treasury Department believe that these transactions raise

significant policy concerns and will revise the final regulations in the manner described in Section 4 of this notice.

SECTION 4. REGULATIONS TO BE ISSUED

.01 Deemed Distribution and Contribution Rules

The rules in §1.367(b)-10(b)(2) and -10(c)(2) (regarding deemed contributions) will be removed. Conforming changes will be made to other parts of the final regulations. For example, the rule in §1.367(b)-10(b)(3) will be modified so that it refers only to a deemed distribution occurring as a separate transaction. In addition, the rule in §1.367(b)-10(b)(4) will be modified to provide that P's adjustment to the basis in its S stock under §1.358-6 will be determined as if P provided the P stock or securities pursuant to the plan of reorganization, notwithstanding that S in fact acquired the P stock or securities in exchange for property in the P acquisition.

.02 Triangular Reorganizations Exempt from the Final Regulations

The section 367(a) priority rule under §1.367(b)-10 will be modified by adjusting the amount of income or gain that is considered section 367(b) income for this purpose. Regulations will provide that section 367(b) income includes a section 301(c)(1) dividend or section 301(c)(3) gain that would arise if §1.367(b)-10 applied to the triangular reorganization only to the extent such dividend income or gain would be subject to U.S. tax or would give rise to an income inclusion under section 951(a)(1)(A) that would be subject to U.S. tax. A conforming change will be made to the section 367(b) priority rule under §1.367(a)-3(a)(2)(iv).

In addition, the no-U.S.-tax exception will be modified to provide that the exception will not be available if P is a controlled foreign corporation. Furthermore, where P is not a controlled foreign corporation, S is a domestic corporation, and P's stock in S is not a United States real property interest, the regulations will clarify that the no-U.S.-tax exception will apply if the deemed distribution that would result from application of §1.367(b)-10 to the triangular reorganization would not be treated as a dividend under section 301(c)(1) that would be subject to U.S. tax (for example, by reason of an applicable treaty or by reason of an absence of earnings and profits).

.03 Anti-Abuse Rule

The anti-abuse rule in §1.367(b)-10(d) will be clarified to provide that S's acquisition of P stock or securities in exchange for a note may invoke the anti-abuse rule. In addition, §1.367(b)-10(d) will be clarified to provide that the earnings and profits of a corporation (or a successor corporation) may be taken into account for purposes of determining the consequences of the adjustments provided in the final regulations, as modified by the rules announced in this notice, regardless of whether such corporation is related to P or S before the triangular reorganization. Thus, the earnings and profits of T (or a successor to T) or a subsidiary of S or T may be taken into account for purposes of determining the consequences of the adjustments provided in the final regulations, as modified by the rules announced in this notice. Section 1.367(b)-10(d) also will be clarified to provide that a funding of S may occur after the triangular reorganization and that a funding of S includes capital contributions, loans, and

distributions.

.04 Example

The following example illustrates certain clarifications and modifications to the final regulations announced in section 4 of this notice:

(i) Facts. FP is a foreign corporation that wholly owns USS, a domestic corporation with no assets and no earnings and profits. FP transfers \$100x of newly issued FP stock to USS in exchange for \$10x of USS stock and a \$90x note issued by USS. FP would be subject to U.S. tax under section 881 on a distribution from USS if, contrary to the facts here, USS had earnings and profits for purposes of applying section 301(c)(1) to the distribution. USS acquires all the stock of UST, an unrelated domestic corporation that is wholly owned by a foreign person, in exchange for the \$100x of FP stock in a triangular reorganization described in section 368(a)(1)(B). At the time of the acquisition, UST has \$100x of earnings and profits. USS's purchase of the FP stock for its note in connection with the triangular reorganization is engaged in with a view to avoid the purpose of §1.367(b)-10 because the parties seek to transfer property to FP without incurring U.S. tax.

(ii) Analysis. The triangular reorganization is described in §1.367(b)-10(a) of the final regulations. Pursuant to §1.367(b)-10(b)(1) of the final regulations, as modified by the rules announced in this notice, adjustments must be made that are consistent with the adjustments that would have been made if USS had in fact distributed the \$90x note to FP in a distribution to which section 301 would apply. Because USS's purchase of the FP stock for its note is engaged in with a view to avoid the purposes of §1.367(b)-10, the anti-abuse rule applies and therefore appropriate adjustments are made. In particular, for purposes of determining the consequences of the adjustments provided in the final regulations, as modified by the rules announced in this notice, the earnings and profits of USS are deemed to include the earnings and profits of UST. The \$90x deemed distribution is treated as separate from, and occurring immediately before, USS's acquisition of the FP stock used in the triangular reorganization. Pursuant to this notice, §1.367(b)-10(b)(2) and -10(c)(2) of the final regulations (regarding a deemed contribution) are removed. Therefore, no adjustments are made by FP to its USS stock except as provided in §1.358-6. Pursuant to this notice, FP's adjustment to the basis in its USS stock under §1.358-6 is determined as if FP provided the FP stock pursuant to the plan of reorganization.

SECTION 5. EFFECTIVE DATE

Except as otherwise provided in this section 5, the regulations described in section 4 of this notice will apply to a triangular reorganization that is completed on or after April 25, 2014. The regulations described in this notice will not apply if (i) T was not related to P or S (within the meaning of section 267(b)) immediately before the triangular reorganization; (ii) the triangular reorganization was entered into either pursuant to a written agreement that was (subject to customary conditions) binding before April 25, 2014 and all times afterward, or pursuant to a tender offer announced before April 25, 2014 that is subject to section 14(d) of the Securities and Exchange Act of 1934 (15 U.S.C. 78n(d)(1)) and Regulation 14(D) (17 CFR 240.14d-1 through 240.14d-101) or that is subject to comparable foreign laws; and (iii) to the extent the P acquisition that occurs pursuant to the plan of reorganization is not completed before April 25, 2014, the P acquisition was included as part of the plan before April 25, 2014.

No inference is intended regarding the treatment of transactions described in section 3 of this notice under current law, and the IRS may challenge such transactions under applicable Code provisions or judicial doctrines.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Shane McCarrick of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Mr. McCarrick at (202) 317-6937 (not a toll-free call).

