

## Part III - Administrative, Procedural, and Miscellaneous

### Treatment of Certain Triangular Reorganizations Involving Foreign Corporations; Amount of Income Inclusion in Certain Inbound Nonrecognition Transactions

Notice 2016-73

#### SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue regulations under section 367 of the Internal Revenue Code (Code) to modify the rules relating to the treatment of property used to acquire parent stock or securities in certain triangular reorganizations involving one or more foreign corporations, and the consequences to persons that receive parent stock or securities pursuant to such triangular reorganizations. This notice also announces that the Treasury Department and the IRS intend to issue regulations under section 367 to modify the amount of an income inclusion required in certain inbound nonrecognition transactions.

#### SECTION 2. BACKGROUND

##### *.01 Section 367(a)*

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person (U.S. person) transfers property to a foreign corporation, the foreign corporation shall not, for purposes of

determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. Sections 367(a)(2), (3), and (6) provide exceptions to the general rule of section 367(a)(1) and grant regulatory authority to the Secretary to provide additional exceptions and to limit the statutory exceptions.

*.02 Section 367(b)*

Section 367(b)(1) provides that, in the case of an exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary that are necessary or appropriate to prevent the avoidance of U.S. federal income taxes. Section 367(b)(2) provides that the regulations prescribed pursuant to section 367(b)(1) shall include (but shall not be limited to) regulations dealing with the sale or exchange of stock or securities in a foreign corporation by a U.S. person, including regulations providing the circumstances under which gain is recognized or deferred, amounts are included in gross income as a dividend, adjustments are made to earnings and profits, or adjustments are made to the basis of stock or securities.

*.03 Section 1.367(b)-10*

(a) In General

Section 1.367(b)-10 (final regulations) applies to certain triangular reorganizations in which a subsidiary (S) acquires stock or securities of its parent corporation (P) in exchange for property (the P acquisition), and S exchanges the P

stock or securities so acquired for stock, securities, or property of a target corporation (T). The final regulations do not apply unless P or S (or both) is a foreign corporation. The application of the final regulations is also subject to certain exceptions, including the section 367(a) priority rule discussed below.

When applicable to a triangular reorganization, the final regulations require that adjustments be made that have the effect of a distribution of property from S 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. *Id.* For purposes of making the required adjustments, the final regulations treat the deemed distribution as a separate transaction that occurs 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).

The term property for purposes of the final regulations has the meaning set forth in section 317(a) (that is, money, securities, and any other property, other than stock in the corporation making the distribution), as modified to take into account certain assumed liabilities and S stock or rights used by S to acquire P stock or securities from a person other than P. §1.367(b)-10(a)(3)(ii).

(b) Priority Rules

Section 1.367(b)-10(a)(2)(iii) provides that the final regulations do not apply to a triangular reorganization if, 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 the final regulations otherwise would apply to the triangular reorganization (section 367(a) priority rule).

Section 1.367(a)-3(a)(2)(iv) provides a similar priority rule that 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 the final regulations if the amount of gain that otherwise would 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 the final regulations (section 367(b) priority rule).

(c) 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 the final regulations (anti-abuse rule). §1.367(b)-10(d). The anti-abuse rule sets forth one example, which provides that 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 the final

regulations with respect to the earnings and profits of that related corporation. Id.

(d) Notice 2014-32

On April 25, 2014, the Treasury Department and the IRS issued Notice 2014-32 (2014-20 IRB 1006) (2014 notice), which announced the intention to issue regulations modifying and clarifying the final regulations. The 2014 notice addressed, in part, certain inversion transactions that were structured to be subject to the final regulations in order to avoid shareholder-level gain recognition under section 367(a)(1) by reason of the section 367(b) priority rule, notwithstanding that only a minimal amount of income was subject to U.S. tax by reason of a deemed distribution under the final regulations. The 2014 notice announced that the final regulations would be modified to provide that section 367(b) income includes a section 301(c)(1) dividend or section 301(c)(3) gain that would arise if the final regulations 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.

The 2014 notice also announced that the anti-abuse rule would be clarified to provide that S's acquisition of P stock or securities in exchange for a note may invoke the anti-abuse rule, and 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 the notice, regardless of whether such corporation is related to P or S before the triangular reorganization.

Finally, the 2014 notice announced that the anti-abuse rule would be clarified to provide that a funding of S may occur after the triangular reorganization and that a funding of S could include capital contributions, loans, and distributions.

*.04 Sections 1.367(b)-4 and 1.367(b)-4T*

Sections 1.367(b)-4 and 1.367(b)-4T apply to certain acquisitions by a foreign corporation of the stock or assets of a foreign corporation (referred to in those regulations and this notice as the “foreign acquired corporation”) in an exchange described in section 351 or in a reorganization described in section 368(a)(1). Sections 1.367(b)-4T(b) and 1.367(b)-4(b)(1) provide that, if the potential application of section 1248 cannot be preserved following the acquisition of the stock or assets of a foreign corporation by another foreign corporation in an exchange subject to section 367(b), then certain exchanging shareholders of the foreign acquired corporation must include in income as a dividend the section 1248 amount attributable to the stock of the foreign acquired corporation exchanged. However, the scope and purpose of the grant of authority in section 367(b) are not limited to the preservation of section 1248 amounts, and the regulations thereunder are not limited to requiring an inclusion of the section 1248 amount with respect to the stock of a foreign acquired corporation exchanged. Section 367(b) provides the Treasury Department and the IRS broad authority to issue regulations applicable to nonrecognition transactions that are “necessary or appropriate to prevent the avoidance of Federal income taxes,” including regulations that prescribe “the circumstances under which gain shall be recognized currently, or amounts included

in gross income currently as a dividend, or both.”

*.05 Inbound Transactions and the All Earnings and Profits Amount*

Section 1.367(b)-3 applies when a foreign corporation transfers assets to a domestic corporation pursuant to either a liquidation described in section 332 or an asset reorganization described in section 368 (in each case, an “inbound transaction”). Section 1.367(b)-3(a) and this notice refer to such foreign corporation as the “foreign acquired corporation” and such domestic corporation as the “domestic acquiring corporation.” When there is an inbound transaction, in general, §1.367(b)-3 requires certain shareholders (including certain foreign corporate shareholders) of the foreign acquired corporation to include in income as a deemed dividend the all earnings and profits amount with respect to their stock. Under §1.367(b)-2(d), the all earnings and profits amount of a foreign acquired corporation is determined under the principles of section 1248 for computing the amount of earnings and profits attributable to stock, with certain modifications. For example, the all earnings and profits amount does not take into account earnings and profits of foreign subsidiaries of the foreign acquired corporation, notwithstanding section 1248(c)(2). §1.367(b)-2(d)(3)(ii).

Section 1.367(b)-3 is intended to ensure that a domestic acquiring corporation does not succeed to the basis in the assets of the foreign acquired corporation except to the extent that a U.S. person that is a shareholder (including indirect ownership through certain foreign corporate shareholders) of the foreign acquired corporation has been subject to U.S. tax on its share of the earnings and profits that gave rise, in whole

or in part, to the basis. See, for example, the discussion concerning inbound transactions in the preambles to TD 8862 (65 FR 3589-01, 2000-1 CB 466) and proposed regulations issued in 1991 (56 FR 41993, 1991-2 CB 1070). The definition of the all earnings and profits amount, in particular its limitation with respect to the earnings and profits of subsidiaries, is premised on an assumption that the basis in the assets of the foreign acquired corporation reflects solely the earnings and profits of the foreign acquired corporation, the liabilities of the foreign acquired corporation, and capital acquired from a shareholder.

#### *.06 Nonqualified Preferred Stock*

Section 351(g)(1) provides, in relevant part, that section 351(a) does not apply to a transfer of property in exchange for nonqualified preferred stock, as defined in section 351(g)(2).

### SECTION 3. TRANSACTIONS AT ISSUE

The Treasury Department and the IRS are aware that taxpayers are engaging in transactions designed to repatriate earnings and basis of foreign corporations without incurring U.S. tax by exploiting the section 367(a) priority rule, as modified by the 2014 notice. In one such transaction, USP, a domestic corporation, wholly owns FP, a foreign corporation, which, in turn, wholly owns FS, another foreign corporation. FP has no earnings and profits, but FS has substantial earnings and profits. A dividend from FS to FP would qualify for the exception to foreign personal holding company income under section 954(c)(6). USP also wholly owns USS, a domestic corporation, which, in

turn, wholly owns FT, a foreign corporation. Pursuant to a transaction undertaken for the purported business purpose of integrating FT into the FP-FS ownership chain, FS acquires FP stock from FP in exchange for cash, a note, or other property (the FP acquisition) and uses the FP stock to acquire all of the stock of FT from USS in a transaction intended to qualify as a reorganization described in section 368(a)(1)(B) (FT reorganization). On a later date, and purportedly unrelated to the FT reorganization, FP engages in an inbound transaction described in §1.367(b)-3, for example, a transfer of all of FP's assets, including the cash, note, or other property received from FS, to USP or a domestic subsidiary of USP.

In this transaction, the transfer by USS of the FT stock to FS in exchange for stock of FP pursuant to the FT reorganization is an indirect stock transfer described in §1.367(a)-3(d)(1)(iii)(A). Pursuant to §1.367(a)-3(b), the taxpayer files a gain recognition agreement under §1.367(a)-8 with respect to USS's transfer of FT stock on all but a de minimis amount of FT stock, and, with respect to that de minimis amount of FT stock, recognizes a small amount of gain under section 367(a)(1). Furthermore, the taxpayer applies the priority rules by comparing the section 367(b) income to the de minimis amount of gain under section 367(a)(1) to determine whether the final regulations apply to the FP acquisition. In computing the amount of section 367(b) income for purposes of the section 367(a) priority rule, the taxpayer takes the position that a deemed distribution from FS to FP would not result in section 367(b) income, as described in the 2014 notice, because any dividend income to FP would not be subject

to U.S. tax and would not give rise to an income inclusion under section 951(a)(1)(A) by reason of section 954(c)(6). Accordingly, the taxpayer takes the position that the section 367(b) income (which, under this position, is zero) does not exceed the section 367(a) gain and, therefore, the final regulations do not apply to the FP acquisition by reason of the section 367(a) priority rule. Furthermore, the taxpayer takes the position that the subsequent inbound transaction with respect to FP results in no income inclusion to USP under §1.367(b)-3 because FP's earnings and profits are not increased under the final regulations and thus FP's all earnings and profits amount is zero. Finally, the taxpayer takes the position that the anti-abuse rule does not apply in this case for various reasons that may include: (1) the FP acquisition is not engaged in with a view to avoid the purpose of the final regulations because it is engaged in for the purpose of integrating FT into the FP-FS chain; (2) the FP acquisition is not a transaction that occurs in connection with the FT reorganization because the acquisition is specifically contemplated by the final regulations; (3) the inbound transaction with respect to FP does not occur in connection with the FT reorganization because it does not occur pursuant to the same plan as the FT reorganization; or (4) the anti-abuse rule only applies to adjust the earnings and profits of FS to take into account the earnings and profits of another corporation and, in this regard, FS is not created, organized, or funded to avoid the purpose of the final regulations with respect to the earnings and profits of another corporation.

The Treasury Department and the IRS also are aware of a similar transaction in which taxpayers take advantage of the rule in section 951(a)(1)(A) that requires a U.S. shareholder to include in its gross income its pro rata share of the subpart F income of a foreign corporation only if the foreign corporation has been a controlled foreign corporation for an uninterrupted period of 30 days or more during the taxable year (the 30-day rule). In this form of the transaction, FP is formed, and the FP acquisition occurs, during the final 29 days of FP's taxable year. In computing the amount of section 367(b) income for purposes of the section 367(a) priority rule in this transaction, the taxpayer takes the position that a deemed distribution from FS to FP would not result in any section 367(b) income, as described in the 2014 notice, because any income recognized by FP (including capital gain under section 301(c)(3)) would not be subject to U.S. tax and would not give rise to an income inclusion under section 951(a)(1)(A) by reason of the 30-day rule.

The Treasury Department and the IRS also are aware of another variation of the transaction intended to repatriate earnings of a foreign corporation without U.S. tax through the use of nonqualified preferred stock. In one such transaction, USP, a domestic corporation, wholly owns both FP, a foreign corporation, and USS, a domestic corporation. USS wholly owns FT, a foreign corporation, which has substantial earnings and profits. FP has no earnings and profits. FP acquires newly-issued stock of USP from USP in exchange for nonqualified preferred stock of FP, and then FP uses the USP stock as consideration to acquire all of the stock of FT from USS in a

transaction intended to qualify as a reorganization described in section 368(a)(1)(B).

On a subsequent date, when FP still has no earnings and profits, FP redeems the FP nonqualified preferred stock held by USP in exchange for cash or a note.

The taxpayer takes the position that FP's acquisition of USP stock is not subject to the final regulations because the FP nonqualified preferred stock is not "property" within the meaning of §1.367(b)-10(a)(3)(ii). Furthermore, the taxpayer takes the position that USP's transfer of its own stock to FP in exchange for nonqualified preferred stock does not qualify as an exchange described in section 351 pursuant to section 351(g)(2) and, therefore, USP takes a basis in the FP nonqualified preferred stock equal to its fair market value under §1.1032-1(d). In addition, the taxpayer takes the position that the redemption of the FP nonqualified preferred stock does not result in dividend income or capital gain to USP under section 301(c) because FP does not have earnings and profits and the redemption is applied against and reduces USP's basis in the FP stock under section 301(c)(2). Finally, the taxpayer takes the position that the anti-abuse rule does not apply in such a case for reasons similar to those discussed above in the context of the transaction involving section 954(c)(6).

The Treasury Department and the IRS have determined that these transactions raise significant policy concerns and that the revisions to the regulations described in Section 4 of this notice are necessary or appropriate to prevent the avoidance of U.S. federal income taxes. The Treasury Department and the IRS intend to revise the regulations under section 367 accordingly.

## SECTION 4. REGULATIONS TO BE ISSUED

### *.01 Priority Rules*

The Treasury Department and the IRS intend to modify the section 367(a) priority rule to apply only when T is a domestic corporation. Accordingly, when T is a foreign corporation, the final regulations, as modified by the rules described in this notice, will apply to a triangular reorganization described in §1.367(b)-10(a)(1), unless an exception in §1.367(b)-10(a)(2)(i) or (ii) applies.

The Treasury Department and the IRS intend to modify the section 367(b) priority rule to provide that, in an exchange under section 354 or 356 that occurs in connection with a transaction described in the final regulations, to the extent one or more U.S. persons exchange stock or securities of a foreign corporation for P stock or securities acquired by S in exchange for property (as defined in §1.367(b)-10(a)(3)(ii), as modified by the regulations described in this notice) in the P acquisition, section 367(a)(1) will not apply to such U.S. persons with respect to the exchange of the stock or securities of the foreign corporation. Instead, the exchange will be subject to §§1.367(b)-4 and 1.367(b)-4T, as modified by the regulations described in this notice. The section 367(b) priority rule, as modified by the regulations described in the 2014 notice, will continue to apply when T is a domestic corporation. In addition, section 367(a) will apply to the exchange of stock or securities of a foreign corporation to the extent such T stock or securities are exchanged for P stock or securities that are not acquired by S in exchange for property (as defined in §1.367(b)-10(a)(3)(ii), as modified

by this notice) in connection with a transaction described in §1.367(b)-10.

*.02 Sections 1.367(b)-4 and 1.367(b)-4T*

The Treasury Department and the IRS intend to modify §§1.367(b)-4 and 1.367(b)-4T to provide that, in an exchange under section 354 or 356 that occurs in connection with a transaction described in the final regulations, to the extent an exchanging shareholder exchanges stock or securities of a foreign acquired corporation for P stock or securities acquired by S in exchange for property (defined in §1.367(b)-10(a)(3)(ii), as modified by the regulations described in this notice) in the P acquisition, then such shareholder must:

(i) Include in income as a deemed dividend the section 1248 amount attributable to the stock of the foreign acquired corporation that it exchanges; and

(ii) After taking into account the increase in basis provided in §1.367(b)-2(e)(3)(ii) resulting from the deemed dividend (if any), recognize all realized gain with respect to the stock or securities of the foreign acquired corporation exchanged that would not otherwise be recognized.

For purposes of the preceding paragraph, an exchanging shareholder is a U.S. person or foreign person that exchanges stock of a foreign acquired corporation in a prescribed exchange, regardless of whether such U.S. person is a section 1248 shareholder or such foreign person is a foreign corporation in which a U.S. person is a section 1248 shareholder.

*.03 All Earnings and Profits Amount*

(a) General Rule

The Treasury Department and the IRS intend to modify §1.367(b)-2(d)(3)(ii) to provide that, if there is excess asset basis with respect to a foreign acquired corporation, then, in the case of an exchanging shareholder to which §1.367(b)-3(b)(3) applies, the all earnings and profits amount with respect to the stock in the foreign acquired corporation that it exchanges will be increased by the specified earnings with respect to such stock (if any).

(b) Excess Asset Basis

The term excess asset basis means, with respect to a foreign acquired corporation, the amount by which the inside asset basis of the foreign acquired corporation exceeds the sum of the following amounts:

(i) The earnings and profits of the foreign acquired corporation attributable to the outstanding stock of the foreign acquired corporation. For this purpose, the earnings and profits attributable to stock of the foreign acquired corporation is determined under the principles of §1.367(b)-2(d) but without regard to whether the exchanging shareholder is described in §1.367(b)-3(b)(1) or is a U.S. person or a foreign person. Furthermore, the earnings and profits of the foreign acquired corporation will include amounts described in section 1248(d)(3) or 1248(d)(4).

(ii) The aggregate basis in the outstanding stock of the foreign acquired corporation determined immediately before the inbound transaction and without regard to any basis increase described in §1.367(b)-2(e)(3)(ii) resulting from such inbound

transaction.

(iii) The aggregate amount of liabilities of the foreign acquired corporation that are assumed by the domestic acquiring corporation in the inbound transaction determined under the principles of section 357(d).

(c) Inside Asset Basis

The term inside asset basis means, with respect to a foreign acquired corporation, the adjusted basis of the assets of the foreign acquired corporation in the hands of the domestic acquiring corporation determined immediately after the inbound transaction.

(d) Specified Earnings

The term specified earnings means, with respect to the stock of a foreign acquired corporation that is exchanged by an exchanging shareholder, the lesser of the following amounts (but not below zero):

(i) The sum of the earnings and profits (including a deficit) with respect to each foreign subsidiary of the foreign acquired corporation that are attributable under section 1248(c)(2) to the stock of the foreign acquired corporation exchanged. For purposes of the preceding sentence, the modifications described in §1.367(b)-2(d)(2) and (d)(3)(i) apply. Thus, for example, the amount of the earnings and profits of a foreign subsidiary that are attributable to stock of the foreign acquired corporation is determined without regard to whether the foreign subsidiary was a controlled foreign corporation at any time during the five years preceding the inbound transaction. The amount described in

this Section 4.03(d)(i) is referred to in this notice as the “lower-tier earnings.”

(ii) The product of the excess asset basis of the foreign acquired corporation, multiplied by the exchanging shareholder’s specified percentage.

(iii) The amount of gain that would be realized by the exchanging shareholder if, immediately before the inbound transaction, the exchanging shareholder had sold the stock of the foreign acquired corporation for fair market value, reduced by the exchanging shareholder’s all earnings and profits amount (for this purpose, determined without regard to the modifications described in this notice). The amount described in this Section 4.03(d)(iii) is referred to in this notice as the “specified stock gain.”

(e) Specified Percentage

The term specified percentage means, with respect to an exchanging shareholder, a fraction (expressed as a percentage), the numerator of which is the amount of the exchanging shareholder’s specified stock gain, and the denominator of which is the sum of the aggregate of the specified stock gain with respect to all exchanging shareholders to which §1.367(b)-3(b)(3) applies and the aggregate of the gain realized (regardless of whether such gain is recognized) with respect to the stock exchanged by all other exchanging shareholders.

(f) Source of Specified Earnings

If the specified earnings attributable to the stock of a foreign acquired corporation exchanged by an exchanging shareholder is less than the lower-tier earnings attributable to the stock exchanged, the specified earnings of the exchanging

shareholder will be sourced from lower-tier earnings of foreign subsidiaries of the foreign acquired corporation under the principles of §1.1248-1(d)(3).

(g) Adjustments to Excess Asset Basis

If there is excess asset basis with respect to a foreign acquired corporation, as determined under Section 4.03(b) of this notice, a taxpayer may reduce the excess asset basis to the extent that the excess asset basis is not attributable, directly or indirectly, to property provided by a foreign subsidiary of the foreign acquired corporation. For example, if there was a transfer of property to the foreign acquired corporation described in section 362(e)(2), and the election described in section 362(e)(2)(C) was made to limit the basis in the stock received in the foreign acquired corporation to its fair market value, then, for purposes of determining excess asset basis, the basis in the stock of the foreign acquiring corporation may be determined without regard to the application of section 362(e)(2).

For purposes of this Section 4.03(g), property used by a foreign subsidiary to purchase the stock of the foreign acquired corporation in connection with a triangular reorganization is treated as property provided by the foreign subsidiary. In addition, the term property has the meaning provided in §1.367(b)-10(a)(3)(ii), as modified by this notice. Finally, a reference to a foreign acquired corporation or foreign subsidiary includes a predecessor of the foreign acquired corporation or foreign subsidiary.

(h) Anti-Abuse Rule

The regulations to be issued under §1.367(b)-3 will include an anti-abuse rule to

address transactions engaged in with a view to avoid the purposes of the rules described in this Section 4.03. Under the anti-abuse rule, adjustments must be made, including by disregarding the effects of transactions, to carry out the purposes of this section. Thus, as one example, if a transaction is engaged in with a view to reduce excess asset basis, including by increasing the basis in the stock of the foreign acquired corporation without a corresponding increase in the basis in the assets of the foreign acquired corporation, that increase in the basis in the stock of the foreign acquired corporation will be disregarded for purposes of computing excess asset basis.

#### *.04 Nonqualified Preferred Stock*

The definition of property provided in §1.367(b)-10(a)(3)(ii) will be modified to include S stock that is nonqualified preferred stock (as defined in section 351(g)(2)).

#### *.05 Examples*

The following examples illustrate certain modifications to the final regulations described in this Section 4:

Example 1. (i) Facts. USP, a domestic corporation, wholly owns FP and USS. FP is a foreign corporation that wholly owns FS, a foreign corporation. USS is a domestic corporation that wholly owns FT, a foreign corporation. USS owns 100 shares of FT stock, which constitutes a single block of stock with a fair market value of \$100x, an adjusted basis of \$20x, and a section 1248 amount of \$50x. FS has earnings and profits of \$60x. A dividend from FS to FP would qualify for the exception to foreign personal holding company income under section 954(c)(6). FP issues 100 shares of voting stock with a fair market value of \$100x to FS in exchange for \$40x of common stock of FS and \$60x cash. FS acquires all of the stock of FT held by USS solely in exchange for the \$100x of FP voting stock in a triangular reorganization described in section 368(a)(1)(B).

(ii) Analysis. The triangular reorganization is described in §1.367(b)-10(a). Pursuant to §1.367(b)-10(b)(1), as modified by the rules announced in the 2014 notice,

adjustments must be made that have the effect of a distribution of property in the amount of \$60x from FS to FP under section 301. The \$60x deemed distribution is treated as separate from, and occurring immediately before, FS's acquisition of the \$60x of FP stock used in the triangular reorganization. The \$60x deemed distribution from FS to FP results in \$60x dividend income to FP under section 301(c)(1) that is not subpart F income under section 954(c)(6). Pursuant to Section 4.01 of this notice, §1.367(b)-4 (as modified by Section 4.02 of this notice), rather than section 367(a)(1), applies to the \$60x of FT stock exchanged for the \$60x of FP stock acquired by FS from FP in exchange for \$60x cash. Thus, USS must include in income a \$30x deemed dividend (\$50x section 1248 amount x 60%) with respect to the FT stock exchanged for FP stock that was acquired by FS from FP for \$60x cash. In addition, USS must recognize the remaining \$18x gain (\$48x gain ((\$80x gain x 60%) - \$30x deemed dividend) realized with respect to such FT stock. If USS properly files a gain recognition agreement pursuant to §§1.367(a)-3(b)(2) and 1.367(a)-8, USS does not recognize gain under section 367(a)(1) with respect to the \$40x of FT stock exchanged for FP stock that was acquired by FS from FP in exchange for the \$40x of FS common stock.

Example 2. (i) Facts. USP, a domestic corporation, owns 90% of the stock of FP, a foreign corporation. The remaining 10% of the stock of FP is owned by FI, a nonresident alien individual unrelated to USP. FP is a foreign corporation that wholly owns FS1, a foreign corporation, which, in turn, wholly owns FS2, a foreign corporation. The FP stock owned by USP has a fair market value of \$90x and an adjusted basis of \$17x. The FP stock owned by FI has a fair market value of \$10x and an adjusted basis of \$6x. The all earnings and profits amount with respect to USP's FP stock, determined without regard to this notice, is \$27x. The assets of FP have an adjusted basis of \$78x, FP has no liabilities, and the earnings and profits of FP attributable to the outstanding FP stock is \$30x (in this case, as determined under the principles of §1.367(b)-2(d) but without regard to whether USP and FI are exchanging shareholders described in §1.367(b)-3(b)(1) or U.S. or foreign persons). The earnings and profits of FS1 and FS2 attributable to the FP stock owned by USP under section 1248(c)(2) (as determined under the principles of §1.367(b)-2(d)(2) and (d)(3)(i)) are \$80x and (\$20x) respectively. In a reorganization described in section 368(a)(1)(F), US Newco, a newly-formed domestic corporation that is wholly owned by USP, acquires all of the assets of FP solely in exchange for stock of US Newco. No adjustment under Section 4.03(g) of this notice is appropriate.

(ii) Analysis--(A) All earnings and profits amount. Under §1.367(b)-3(b)(3), USP must include in income as a deemed dividend the all earnings and profits amount with respect to its FP stock. Pursuant to Section 4.03 of this notice, the all earnings and profits amount of \$27x, determined without regard to this notice, is increased by the specified earnings of FP, because there is excess asset basis with respect to FP

determined as follows.

(B) Excess asset basis. The amount of the excess asset basis is \$25x, the amount that the inside asset basis of FP (\$78x) exceeds the sum of (i) the earnings and profits of FP (\$30x), (ii) the aggregate basis in all of the FP stock (\$23x), and (iii) the liabilities of FP assumed by US Newco (\$0x).

(C) Specified earnings. The specified earnings with respect to the stock of FP exchanged by USP equals \$23x, the lesser of the following amounts (but not below zero) (i) \$60x, the sum of the earnings and profits (including deficits) with respect to FS1 and FS2 attributable under section 1248(c)(2) to the stock of FP exchanged by USP; (ii) \$23x, the product of the excess asset basis with respect to FP (\$25x), multiplied by USP's specified percentage (92%), determined based on a fraction, the numerator of which is USP's specified stock gain (\$46x), and the denominator of which is the sum of the aggregate of the specified stock gain and gain realized with respect to FP stock (\$50x), and (iii) \$46x, USP's specified stock gain, which is the amount of gain that would be realized by USP if immediately before the inbound transaction USP had sold the stock of FP for fair market value (\$73x), reduced by USP's all earnings and profits amount (determined without regard to the modifications described in this notice) (\$27x).

(D) All earnings and profits amount, as modified by this notice. The all earnings and profits amount that USP must include in income as a deemed dividend is \$50x (\$27x + \$23). Under §1.367(b)-2(e)(2), \$23x of the deemed dividend is determined by reference to the earnings and profits of FS1 and is considered as having been paid by FS1 to USP through FP. Under §1.367(b)-2(e)(3)(ii), immediately before the exchange, USP's basis in the stock of FP is increased by the amount of the \$50x deemed dividend for purposes of determining USP's basis in its stock of US Newco. However, the basis increase under §1.367(b)-2(e)(3)(ii) is not taken into account for purposes of calculating USP's all earnings and profits amount, as modified by Section 4.03 of this notice.

## SECTION 5. EFFECTIVE DATE

The regulations described in Section 4 of this notice will apply to transactions completed on or after December 2, 2016, and to any inbound transactions treated as completed before December 2, 2016 as a result of an entity classification election made under §301.7701-3 of this chapter that is filed on or after December 2, 2016. No inference is intended regarding the treatment of transactions described in Section 3 of

this notice under current law. For example, these transactions are currently subject to challenge under the anti-abuse rule.

## SECTION 6. COMMENTS

The Treasury Department and the IRS request comments on the rules described in this notice. In particular, §1.367(b)-10(b)(3) currently provides that the deemed distribution described in §1.367(b)-10(b)(1) is treated as occurring immediately before the P acquisition. Comments are requested on whether, in light of the modifications announced by this notice, it may be more appropriate (in particular, when T is a foreign corporation) to treat the deemed distribution as occurring immediately after, rather than before, the triangular reorganization. In addition, comments are requested as to whether any specific adjustments to excess asset basis should be allowed, or not allowed, consistent with the principles underlying Section 4.03 of this notice. Finally, comments are requested as to whether there are transactions other than those described in Section 3 of this notice that may give rise to excess asset basis.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Lynlee Baker, Internal Revenue Service, IR-4554, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to [Notice.comments@irsounsel.treas.gov](mailto:Notice.comments@irsounsel.treas.gov). Comments will be available for public inspection and copying. Written or electronic comments must be received by March 2, 2017.

## SECTION 7. DRAFTING INFORMATION

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