INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-117370-08

District Director
LMSB:CTM

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Accounting Firm X =
Accounting Firm Y =
Corporation AA =
Corporation X =
Corporation Y =
Corporation Z =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Employee A =
Employee B =
Employee C =
Foreign Region =
Law Firm =

LLC =
M shares =
N shares =
Representative D =
Representative E =
Representative F =
Representative G =
Taxpayer =
Year 1 =
Year 2 =
H =
J =
K =
L =

ISSUES

1. Whether a domestic corporation's transfer, in connection with an exchange described in section 354, of the stock of a foreign corporation to another foreign corporation in exchange for stock of a domestic corporation that controls the foreign acquiring corporation in a reorganization described in section 368(a)(1)(B) is subject to section 367(a)(1), as provided under Treas. Reg. §1.367(a)-3(a)?[1]

2. If the answer to Issue 1 is yes, whether Taxpayer qualifies for the reasonable cause exception under Treas. Reg. §1.367(a)-8(c)(2) such that it is eligible to file a gain recognition agreement pursuant to Treas. Reg. §1.367(a)-3(b)(1)(ii)?

3. If the answer to Issue 1 is yes, and the answer to Issue 2 is no, whether the application of section 367(a)(1) to the stock transfer causes the transfer to be characterized as an acquisition to which section 304 applies?

CONCLUSIONS

1. A domestic corporation's transfer, in connection with an exchange described in section 354, of the stock of a foreign corporation to another foreign corporation in exchange for stock of a domestic corporation that controls the foreign acquiring corporation in a reorganization described in section 368(a)(1)(B) is subject to section 367(a)(1), as provided under Treas. Reg. §1.367(a)-3(a).

2. Taxpayer's failure to file a gain recognition agreement was not due to reasonable cause and Taxpayer did not file a gain recognition agreement when it became aware of the failure to file and, as a result, it cannot file a gain recognition agreement pursuant to Treas. Reg. §1.367(a)-3(b)(1)(ii).

[1] Unless otherwise noted, all citations to regulations are to those effective as of Date 6.

3. The application of section 367(a)(1) to the stock transfer does not cause the transfer to be characterized as an acquisition to which section 304 applies.

FACTS

I. Background

Taxpayer, a publicly traded domestic corporation, engaged in various business lines in both the United States and abroad. Taxpayer conducted manufacturing operations in H countries and sold its products in over J countries.

II. Structure and Transaction

Before the transaction described below, Taxpayer, the common parent of a consolidated group, owned 100 percent of the stock of Corporation X. Corporation X is a domestic corporation and is a member of the Taxpayer consolidated group. Taxpayer also owned 100 percent of the stock of Corporation Y, a foreign corporation.

Corporation X owned 100 percent of the interests in LLC, a limited liability company. LLC was disregarded as an entity separate from its owner for federal tax purposes. LLC owned M shares of the stock of Corporation Z, a foreign corporation. Taxpayer owned the remaining N shares of Corporation Z stock.

Because LLC is disregarded as an entity separate from its owner, for purposes of this memorandum the M shares of Corporation Z stock held by LLC are treated as if they are held by the owner of LLC (Corporation X or Corporation Y, as applicable). Consequently, for purposes of this memorandum a transfer of the interests in LLC by Corporation X is treated as a transfer by Corporation X of the M shares of Corporation Z stock that are held by LLC.

Corporation X's ownership of the M shares of Corporation Z stock constituted control, within the meaning of section 368(c), of Corporation Z.

Prior to Date 6, Corporation Y purchased Taxpayer stock from Taxpayer shareholders on the open market. On Date 6, Corporation Y acquired, in exchange for the Taxpayer stock that it had purchased on the open market, the M shares of Corporation Z stock from Corporation X.

For purposes of this memorandum, Corporation Y's purchase of Taxpayer stock on the open market, and the exchange of such stock for the M shares of Corporation Z stock held by Corporation X, together will be referred to as the "Transaction," and Corporation X's transfer of the M shares of Corporation Z stock to Corporation Y will be referred to as the "Outbound Stock Transfer."

Taxpayer took the position that the acquisition by Corporation Y of the M shares of Corporation Z stock held by Corporation X, in exchange for Taxpayer's stock, qualified as a reorganization described in section 368(a)(1)(B). Corporation X included an amount in its gross income as a deemed dividend under Treas. Reg. §1.367(b)-4(b)(1) as a result of the Outbound Stock Transfer. Even though Taxpayer did not file a gain recognition agreement under Treas. Reg. §1.367(a)-8 with respect to the Outbound Stock Transfer, Taxpayer took the position that the Outbound Stock Transfer was not subject to section 367(a)(1).

The form of the Transaction was highly-structured and tax-motivated. Taxpayer's treatment of the Transaction had the effect of repatriating current or future deferred earnings of Corporation Y without a corresponding dividend that would be subject to U.S. tax.[2]

III. Structuring, Implementing, and Reporting the Transaction

A. Overview

Taxpayer engaged Accounting Firm X and Law Firm to advise Taxpayer on tax matters related to the Transaction. Over a period of several months, Employee A and Employee B, both employees of Taxpayer, worked with Representative D and Representative E from Accounting Firm X, and Representative F and Representative G from Law Firm (together, the "Working Group"). The members of the Working Group communicated frequently regarding various tax issues arising in connection with the structuring, implementing, and reporting of the Transaction.

B. Individuals Involved

Employee A was the Tax Manager, Foreign Region. Employee A, a certified public accountant, was employed by Accounting Firm X as a Senior Tax Manager before becoming a Taxpayer employee. Employee A earned a Masters in Accounting degree and had K years of federal tax experience. Employee A was the primary international tax planner and tax technical research source within the tax department. In addition to responsibilities involving Foreign Region, Employee A was responsible for tax planning, compliance, and reporting for a number of Taxpayer's U.S. and international operations. For example, Employee A had the responsibility for determining and reviewing the required international tax filings and disclosures for Taxpayer. Employee A was the

[2] The Internal Revenue Service and Treasury Department believe that Taxpayer's characterization of these types of transactions raises significant policy concerns and, in response to such transactions, issued Notice 2006-85, 2006-2 C.B. 677, Notice 2007-48, 2007-1 C.B. 1428, and Treas. Reg. §1.367(b)-14T. Subject to certain exceptions, §1.367(b)-14T applies to transactions described in Notice 2007-48 (such as the Transaction) that occur on or after May 31, 2007. Treas. Reg. §1.367(b)-14T(e). Accordingly, Treas. Reg. §1.367(b)-14T does not apply to the Transaction.

person within Taxpayer's tax department most involved with the Transaction from both a factual and tax technical and research perspective. Employee A reported to and made recommendations to Employee B.

Employee B was Vice President – Tax, and supervised Employee A. Employee B, a certified public accountant, was an international tax partner at Accounting Firm Y before becoming a Taxpayer employee. Employee B had over L years of federal tax experience and had significant international tax experience, particularly in the area of cross-border mergers and acquisitions. Employee B had extensive involvement in various international tax matters of Taxpayer, including the Transaction. Employee B reviewed all elections, agreements and required information statements prepared by Employee A. In addition, Employee B met annually with Employee A to review this element of the tax return preparation process.

Employee A and Employee B were the primary members of the Taxpayer tax department responsible for the Transaction.

Employee C was the Director of Tax Analysis and Compliance. Employee C was generally responsible for the preparation of Taxpayer's tax return, but was not in charge of disclosures or agreements that must be included with the tax return, such as gain recognition agreements required under Treas. Reg. §1.367(a)-8.

Representative D was a tax principal in Accounting Firm X. Representative E was a tax partner in Accounting Firm X.

Representative F and Representative G were tax partners in Law Firm.

C. Communications and Documentation

Over a period of at least six months prior to Date 6, the date of the Transaction, Employee A and Employee B communicated with each other, and other members of the Working Group, regarding the Transaction. These communications included the discussion and consideration of certain issues related to the Transaction, the opinions that Accounting Firm X was willing to provide on the Transaction, and the representations required by Accounting Firm X to render such opinions. In addition, various documents and e-mail correspondence were circulated among members of the Working Group. Several of these documents were prepared by Accounting Firm X. Some of these documents, described in further detail below, discussed and analyzed the application of section 367(a) to the Transaction, and contained representations relating thereto.

On Date 1, approximately six months prior to Date 6, the first document prepared by Accounting Firm X that addressed the application of section 367(a) was a memorandum that Representative E sent to Employee A. This memorandum analyzed, among other

issues, the application of section 367(a) to a proposed transaction involving Taxpayer that was substantially similar to the Transaction.[3] The memorandum described the tax consequences that arise when a U.S. person transfers stock of a foreign corporation to a foreign acquiring corporation in exchange for stock of a domestic corporation that controls the foreign acquiring corporation in a reorganization described in section 368(a)(1)(B):

> The IRC § 354 exchange by [Corporation X] (a US person) in which [Corporation X] transfers property ([Corporation Z stock]) to [Corporation AA] (a foreign corporation) is also an exchange described in IRC § 367(a). Treas. Reg. § 1.367(a)-3(b) addresses exchanges where the property transferred is stock of a foreign corporation to provide for concurrent application of IRC §§ 367(a) and (b). [Footnote citing Treas. Reg. § 1.367(a)-3(a) and (b)(2).] The regulation permits nonrecognition (except for the dividend required to be reported under IRC § 367(b)) if [Taxpayer] executes and files with its income tax return for the year of transfer a 5-year gain recognition agreement described in Treas. Reg. § 1.367(a)-8 and makes the annual certifications also required under Treas. Reg. § 1.367(a)-8.

On Date 2, Representative E circulated to the other members of the Working Group a draft of representations and related opinions with respect to the Transaction. The opinions provided by Accounting Firm X would be contingent on the representations provided to Accounting Firm X by Taxpayer. One of the representations stated:

> [Taxpayer] will execute and file with its income tax return for the year of the transfer a 5-year gain recognition agreement described in Treas. Reg. § 1.367(a)-8 and makes the annual certifications also required under Treas. Reg. § 1.367(a)-8.

Following the representations that Accounting Firm X required to render its opinions regarding the Transaction, this document also stated:

> [Taxpayer] acknowledges that an opinion of [Accounting Firm X] will be based on the facts, assumptions and representations set forth in this letter. It generally represents that it has provided [Accounting Firm X] with all facts and circumstances that it knows or has reason to know are pertinent to the Transaction. If any of the facts, assumptions, or representations set forth above is not entirely complete or accurate,

[3] The proposed transaction differed from the Transaction in that the foreign corporation that acquires the stock of the domestic corporation would purchase the stock of a member of the Taxpayer consolidated group directly from the member, rather than purchasing Taxpayer stock from Taxpayer's shareholders as was the case in the Transaction. Like the Transaction, the transaction discussed in the memorandum was later addressed by the published guidance discussed in footnote 2 of this memorandum.

> [Taxpayer] understands that it will be imperative that [Accounting Firm X] be informed immediately in writing, because the incompleteness or inaccuracy could cause a change in the [Accounting Firm X] opinions.

Several e-mails were circulated among members of the Working Group, including Employee A and Employee B, that analyzed the draft representations required by Accounting Firm X to render its opinions on the Transaction. Each draft of the representations circulated included a representation substantially similar to that quoted above that a gain recognition agreement would be filed in connection with the Outbound Stock Transfer. In addition, each draft of the representations included language substantially similar to that quoted above regarding the facts, assumptions and representations set forth in the letter.

On Date 3, Employee A circulated a redlined version of the representations that reflected comments from Employee A, Employee B, and another Taxpayer employee. The comments and changes in this redlined draft involved several of the representations, including modifications to the representation that immediately followed the representation quoted above that a gain recognition agreement would be filed in connection with the Outbound Stock Transfer. On Date 5, Employee B re-circulated the redlined representations to the Working Group, asking individuals to focus on modifications to certain representations.

Employee A and Employee B were also involved in analysis and correspondence intended to ensure that certain aspects of the Transaction were structured to be consistent with the representations. For example, on Date 4, Employee A sent an e-mail to Representative G indicating that Taxpayer must represent to Accounting Firm X that a certain amount of shares must be received as of a particular date. The e-mail also noted that Employee B had suggested including a clause in the reorganization agreement as a means of ensuring that the Transaction would be consistent with this representation.

On Date 7, a 26 page draft opinion letter from Accounting Firm X (“Opinion Letter”), dated Date 5, was circulated to the Working Group. Accounting Firm X did not circulate a subsequent draft of the Opinion Letter, nor was the Opinion Letter, including representations contained therein, ever finalized. Taxpayer stated that while it intended to have the Opinion Letter finalized, Taxpayer was comfortable with the advice received, as well as the structure of the Transaction, as of the date of the Transaction.

The Opinion Letter included the representation that Taxpayer would file a gain recognition agreement with respect to the Outbound Stock Transfer. Specifically, the Opinion Letter required Taxpayer to represent to Accounting Firm X that:

> [Taxpayer] will execute and file with its income tax return for the year of transfer a 5-year gain recognition agreement described in Treas. Reg. §

> 1.367(a)-8 with respect to [Corporation X's] transfer of [Corporation Z] shares to [Corporation Y] and will make the annual certifications also required under Treas. Reg. § 1.367(a)-8. The parties will comply with all other filing, notice, record keeping, and similar requirements under section 367 and its regulations.

For purposes of this memorandum, this representation, along with similar representations referred to above, will collectively be referred to as the "GRA Representation."

At the beginning of the Opinion Letter, Accounting Firm X informed Taxpayer: "If any of these facts, assumptions, or representations is not entirely complete or accurate, it is imperative that we be informed immediately in writing, because the incompleteness or inaccuracy could cause us to change our opinions."

In the discussion section of the Opinion Letter, Accounting Firm X analyzed the application of section 367(a) to the Outbound Stock Transfer:

> An exchange which ordinarily would be afforded nonrecognition treatment under section 354 may be treated as a taxable exchange under sections 367(a) and (b). Treas. Reg. § 1.367(a)-3(b)(2)(i). Among the several exchanges subject to this possible treatment is a triangular B reorganization. . . .
>
> Generally, section 367(a) denies the status as a corporation to certain foreign corporations, which effectively precludes the operation of the nonrecognition rules of section 354 and 361 (among other sections). Thus, for example, an exchanging shareholder in a triangular B reorganization may recognize gain, if any, and after the application of section 367(b), under section 367(a). But section 367(a) does not apply if a US shareholder who transfers shares of stock of a foreign target corporation to a foreign acquiring corporation enters into a five-year gain recognition agreement with respect to the target shares. Treas. Reg. § 1.367(a)-3(b)(1)(ii). Treas. Reg. § 1.367(a)-8 contains the rules and requirements governing the gain recognition agreement, including the requirement for annual certifications.

Finally, in applying section 367(a) to the Outbound Stock Transfer, the opinion concluded:

> The status as corporations of [Corporation Z] and [Corporation Y], both foreign corporations will be relevant to determining the US federal tax consequences of a triangular B reorganization. . . . The circumstances that make section 367(a) [applicable] should also exist. Your

> representation KK indicates that a proper gain recognition agreement and annual certifications will be made. For this reason, section 367(a) should not apply to require [Corporation X] to recognize further gain or loss from the Transaction.

The Opinion Letter discussed, at length, certain issues related to the Transaction the outcome of which Accounting Firm X believed to be uncertain. It analyzed arguments and authorities supporting both sides of these issues and concluded what Accounting Firm X believed should be the result. The Opinion Letter did not, however, note any uncertainty with respect to the application of section 367(a) to the Outbound Stock Transfer, or the requirement to file a gain recognition agreement in connection with the Outbound Stock Transfer to avoid the application of section 367(a)(1).

In an affidavit dated Date 9, after the request for this memorandum had been submitted, Representative E asserts that Accounting Firm X did not focus on section 367(a) as a "critical aspect" of the Transaction because Accounting Firm X believed a gain recognition agreement was required for nonrecognition treatment for the Outbound Stock Transfer. The affidavit further states that:

> There were a substantial number of issues which were fully researched and discussed amongst [the Working Group]. However, the [gain recognition agreement] issue, including Representation KK and the [discussion in the Opinion regarding the effects of section 367], was not among them.

The affidavit also states that the Opinion Letter's discussion of section 367(a) was based on Accounting Firm X's view that the transfer of stock in a reorganization described in section 368(a)(1)(B) to a foreign acquiring corporation was concurrently subject to section 367(a) and (b) based on the parenthetical language in Treas. Reg. §1.367(a)-3(a) and the example in Treas. Reg. §1.367(a)-3(b)(2)(ii). The affidavit further provided that "We did not examine whether a different conclusion was warranted in the circumstances of [Taxpayer's] transaction where [Corporation Y] received [Taxpayer] stock rather than stock of the acquiring foreign corporation."

In this same affidavit Representative E asserts that the principal purpose of the Opinion Letter was to address the requirements to qualify the transaction as a reorganization under section 368. Moreover, the affidavit states "[t]he discussion of the [gain recognition agreement] in the draft document was intended to insure that the exchanging shareholder would not recognize gain beyond the section 1248 amount with respect to its section 354 exchange."

Neither the Opinion Letter nor any other correspondence from Accounting Firm X that was circulated among the Working Group indicated that the analysis and discussion

regarding the application of section 367(a) was more or less valid than the analysis and discussion of any other issues addressed in the Opinion Letter.

Neither the Opinion Letter, nor any other contemporaneous communications among members of the Working Group, raise or discuss any of the arguments now being made by Taxpayer with respect to Issue 1 of this memorandum that the Outbound Stock Transfer is not subject to section 367(a)(1).

No one in the Working Group, including Employee A and Employee B, questioned or otherwise informed Accounting Firm X that they disagreed with Accounting Firm X's conclusion that filing a gain recognition agreement was necessary to avoid the application of section 367(a)(1) to the Outbound Stock Transfer. In addition, no one in the Working Group, including Employee A and Employee B, questioned the need for the GRA Representation to ensure that the Outbound Stock Transfer was not subject to section 367(a)(1).

D. Tax Compliance Process

As noted above, Employee A had the primary responsibility for the preparation and filing of all elections, agreements and information statements related to matters within her responsibility. Employee B reviewed every such election, agreement and statement, and met with Employee A annually to review with her this element of the tax return process.

As part of the tax return review process, Employee C met with the tax managers responsible for planning and tax research matters, including Employee A, to review all transactions that occurred during the year. These meetings were intended to ensure that all of the required forms, statements, elections, and return disclosures were made in accordance with the law.

With respect to the Transaction, Taxpayer included with its timely filed tax return for Year 1 the notices required under Treas. Reg. §§1.367(b)-1(c) and 1.368-3(a). As noted above, Taxpayer did not, however, include in its timely filed tax return for Year 1 a gain recognition agreement under Treas. Reg. §1.367(a)-8 with respect to the Outbound Stock Transfer.

Employee B asked Employee A to research all reporting issues with respect to the Transaction, as well as with respect to other unrelated restructuring transactions that took place during Year 1. Employee A asserts that, as part of her overall duties, she researched the application of section 367(a) to the Outbound Stock Transfer, including examining the regulations, legislative history and other existing precedents. According to Employee A, she concluded in early Fall, Year 2, that the section 367(a) regulations then in effect did not require the filing of a gain recognition agreement to avoid the application of section 367(a)(1) to the Outbound Stock Transfer. Taxpayer asserts that

Employee A conducted “robust” research and analysis to arrive at her conclusion. However, Employee A did not create any contemporaneous documents or other materials in connection with this research and analysis, such as memoranda, outlines, e-mails or notes. In addition, Employee A did not discuss her research or analysis with anyone, including any other member of the Working Group or Employee C.

When Employee A conducted her research on this issue, she did not recall that Accounting Firm X had reached the opposite conclusion in its Opinion Letter. Nor did she recall that, contrary to her conclusion, Accounting Firm X required the GRA Representation as a condition for rendering its opinion.

Employee A did not recall having read the sections of the Opinion Letter, including the GRA Representation, that addressed the filing of a gain recognition agreement with respect to the Outbound Stock Transfer. Although she was e-mailed several documents prepared by Accounting Firm X that addressed the application of section 367(a) to the Transaction, including the Opinion Letter, she asserts that she only reviewed the portions of the documents that related to the specific issues she was asked to consider, such as certain treasury issues.

Employee A asserts that if she had been aware that the Opinion Letter concluded that a gain recognition agreement was required, she would have consulted with Accounting Firm X before determining whether to include a gain recognition agreement in Taxpayer’s tax return.

Employee B met with Employee A to discuss and review the Year 1 tax return filing process. Employee A recalls that the conclusion not to file a gain recognition agreement was mentioned as part of this general review, but that she did not identify the decision of whether to file a gain recognition agreement as “an ambiguous situation requiring further investigation.” Employee A further recalls that Employee B accepted her conclusion that no gain recognition agreement was required.

Employee B does not recall specifically discussing this issue with Employee A, but stated that Employee A had the authority to make decisions on certain tax matters without his express approval. Employee B further stated that his philosophy and normal practice in an ambiguous situation would be to file a “protective GRA,” but neither Employee A nor Employee B has any recollection of having discussed this possibility with each other.

Employee A and Employee B did not discuss the Opinion Letter or GRA Representation during this meeting. In addition, they did not review any of the Accounting Firm X documents addressing the application of section 367(a), including the Opinion Letter and the GRA Representation. They assert that the reason they did not review these documents at such time is because the Opinion Letter and representations were never

finalized, and because they were unaware that the Opinion Letter addressed section 367 or contained the GRA Representation.

Employee C also met with Employee A as part of the Year 1 tax return review process. Employee C and Employee A assert that they discussed the Year 1 filings related to the Transaction, including whether a gain recognition agreement was required in connection with the Outbound Stock Transfer. Employee C asserts that he raised the issue of whether a gain recognition agreement was required for the Outbound Stock Transfer. Employee A asserts that she determined that a gain recognition agreement was not necessary. Employee A and Employee C had no further discussions regarding the application of section 367(a) to the Outbound Stock Transfer.

E. Notification of Requirement to File a Gain Recognition Agreement

On Date 8, the Internal Revenue Service, as part of its examination of Taxpayer's Year 1 Federal income tax return, furnished to Taxpayer an Information Document Request informing Taxpayer that the Outbound Stock Transfer was subject to the General Rule, and therefore taxable, unless Taxpayer filed a gain recognition agreement. Taxpayer did not file a gain recognition agreement at that time.

ISSUE 1: Whether the Outbound Stock Transfer is Subject to the General Rule of Treas. Reg. §1.367(a)-3(a)?

I. LAW

A. Reorganizations Described in Section 368(a)(1)(B)

A reorganization described in section 368(a)(1)(B) (B reorganization) means the acquisition by one corporation, in exchange solely for all or part of its voting stock (or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

In the case of a B reorganization, both the acquiring corporation and the acquired corporation qualify as parties to a reorganization. Section 368(b)(2). In the case of a B reorganization where voting stock of a corporation in control of the acquiring corporation is exchanged (triangular B reorganization), the corporation controlling the acquiring corporation (issuing corporation) also qualifies as a party to a reorganization. Section 368(b) (first sentence of flush language).

Section 354(a)(1) provides that no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of

reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

B. General Rule of Section 367(a)(1)

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 transfers property to a foreign corporation, such 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. Thus, the general rule of section 367(a)(1) is that a U.S. person recognizes gain on its transfer of property to a foreign corporation when one of the enumerated provisions, such as section 354, applies to the transfer.

Section 367(a)(2) states that, except to the extent provided in regulations, section 367(a)(1) shall not apply to the transfer of stock or securities of a foreign corporation which is a party to the exchange or a party to the reorganization.

Congress enacted section 367(a) to prevent the avoidance of tax on transfers of appreciated property outside the United States in nonrecognition transfers involving foreign corporations. S.R. Rep. No. 169, Vol. 1, 98th Cong. 2d Sess., at 360 (Apr. 2, 1984). Congress has been concerned with the potential avoidance of tax by means of such transfers since 1932, when Congress enacted the predecessor to section 367(a). H.R. Rep. No. 708, 72d Cong., 1st Sess. 20 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 26-27 (1932) (enacting section 112(k), the predecessor to section 367(a)(1)).

Treasury Reg. §1.367(a)-1T(c)(1) provides that a transfer described in section 367(a)(1) is any transfer of property by a U.S. person to a foreign corporation pursuant to an exchange described in section 332, 351, 354, 355, 356, or 361. It further provides that section 367(a)(1) applies to such a transfer whether it is made directly, indirectly, or constructively. Finally, it notes that indirect or constructive transfers that are described in section 367(a)(1) include the transfers described in Treas. Reg. §1.367(a)-1T(c)(2) through (7) (such as transfers involving partnerships, trusts, and estates).

The second sentence of Treas. Reg. §1.367(a)-3(a) (the "General Rule") specifically identifies which transfers of stock or securities are subject to section 367(a)(1). It states:

> In general, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B) and including an indirect stock transfer described in paragraph (d) of this section), 356 or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b) of this section (regarding transfers of

foreign stock or securities) or paragraph (c) of this section (regarding transfers of domestic stock or securities) applies.

Thus, the General Rule provides that, notwithstanding the statutory exception under section 367(a)(2), transfers of stock or securities in connection with the enumerated exchanges are subject to section 367(a)(1), unless one of the exceptions provided under Treas. Reg. §1.367(a)-3(b) or (c) applies.

C. Indirect Stock Transfers

Treasury Reg. §1.367(a)-3(d) provides special rules under section 367(a) for "indirect stock transfers." In general, for purposes of Treas. Reg. §1.367(a)-3, a U.S. person who exchanges, under section 354 (or section 356) stock or securities in a domestic or foreign corporation for stock or securities in a foreign corporation in connection with certain enumerated transactions shall be treated as having made an indirect transfer of such stock or securities to a foreign corporation that is subject to the rules of Treas. Reg. §1.367(a)-3, including, for example, the requirement, where applicable, that the U.S. transferor enter into a gain recognition agreement to preserve nonrecognition treatment under section 367(a). Treas. Reg. §1.367(a)-3(d)(1).

One of the enumerated indirect stock transfers is a triangular B reorganization where the issuing corporation is foreign ("foreign issuing triangular B reorganization"). Treas. Reg. §1.367(a)-3(d)(1)(iii). At the time of the Transaction, a triangular B reorganization where the issuing corporation is domestic ("domestic issuing triangular B reorganization") was not enumerated as an indirect stock transfer. On January 5, 2005, however, proposed regulations were issued that would amend the indirect stock transfer rules to include a domestic issuing triangular B reorganization. Prop. Treas. Reg. §1.367(a)-3(d)(1)(iii)(B). The proposed regulations would make conforming changes to related regulations, including a modification to the definition of the term "transferee foreign corporation" (discussed below). Prop. Treas. Reg. §1.367(a)-3(d)(2)(i). On January 23, 2006, the proposed regulations were, subject to certain modifications, adopted as final regulations. TD 9243, 2006-1 C.B. 475. The treatment of domestic issuing triangular reorganizations as indirect stock transfers applies prospectively. Treas. Reg. §1.367(a)-3(g)(1)(B)(5).

D. Exceptions to General Rule of Section 367(a)(1)

Two exceptions from section 367(a)(1) may apply to a U.S. person's transfer of foreign stock that is otherwise subject to the General Rule. Treas. Reg. §1.367(a)-3(b)(1)(i) and (ii). The first exception applies if the U.S. person owns less than five percent (applying the attribution rules of section 318, as modified by section 958(b)) of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer. Treas. Reg. §1.367(a)-3(b)(1)(i).

At the time of the Transaction, the term “transferee foreign corporation” was defined in two provisions of the regulations. First, it was defined in Treas. Reg. §1.367(a)-3(c), which addressed transfers of stock or securities of domestic corporations. Specifically, Treas. Reg. §1.367(a)-3(c)(5)(vi) defined the transferee foreign corporation as the foreign corporation whose stock is received in the exchange by U.S. persons. The term was also defined in Treas. Reg. §1.367(a)-3(d), which addressed indirect stock transfers. Specifically, Treas. Reg. §1.367(a)-3(d)(2)(i) defined the transferee foreign corporation as the foreign corporation that issues stock or securities to the U.S. person in the exchange. Neither of these definitions, however, explicitly identified the transferee foreign corporation in a domestic issuing triangular B reorganization because in these reorganizations the issuing corporation is domestic. Accordingly, Treas. Reg. §1.367(a)-3 was modified to, among other things, clarify the definition of transferee foreign corporation in such a case. TD 9243, 2006-1 C.B. 475. As modified, Treas. Reg. §1.367(a)-3(d)(2)(i)(B) provides that in the case of a domestic issuing triangular B reorganization, the transferee foreign corporation is the foreign acquiring corporation.

The second exception applies if the U.S. person enters into a five-year gain recognition agreement with respect to the transferred stock as provided in Treas. Reg. §1.367(a)-8. Treas. Reg. §1.367(a)-3(b)(1)(ii). The definition of transferee foreign corporation is also relevant for purposes of applying the gain recognition agreement rules (discussed below). See, for example, Treas. Reg. §1.367(a)-8(g)(1).

E. Gain Recognition Agreements

As indicated above, the exception to the General Rule provided under Treas. Reg. §1.367(a)-3(b)(1)(ii) requires the U.S. person that transfers the stock or securities to file a gain recognition agreement with respect to the transfer. Pursuant to the gain recognition agreement, the person generally agrees, among other things, to include in income the gain realized, but not recognized, on the initial transfer of the stock or securities, and pay any applicable interest, upon certain events (such as a disposition of the transferred stock or securities by the transferee foreign corporation), that occur before the close of the fifth full taxable year following the year of the initial transfer. Treas. Reg. §1.367(a)-8(b)(1)(iii) and (3)(i).

II. ANALYSIS

A. Application of the General Rule

Taxpayer does not argue that an exception under Treas. Reg. §1.367(a)-3(b)(1) applies to the Outbound Stock Transfer. Rather, Taxpayer makes three primary arguments that the Outbound Stock Transfer is not subject to the General Rule. First, Taxpayer argues that the General Rule is inapplicable to the Outbound Stock Transfer because of the inability to identify the transferee foreign corporation for purposes of applying the exception under Treas. Reg. §§1.367(a)-3(b)(1) and 1.367(a)-8. Second, Taxpayer

argues that the General Rule is inapplicable because of subsequent revisions to the indirect stock transfer rules. Third, Taxpayer claims that direct transfers and indirect transfers are mutually exclusive and that the Transaction can only be an indirect transfer.

1. Taxpayer's first argument: The General Rule is inapplicable because of inability to identify the transferee foreign corporation

Taxpayer argues that the Outbound Stock Transfer is not subject to the General Rule because there is no entity in the Transaction that, as a technical matter, satisfies the definition of a transferee foreign corporation. As indicated above, at the time of the Transaction, the transferee foreign corporation was defined as the foreign corporation whose stock is received in the exchange by U.S. persons, or as the foreign corporation that issues stock or securities to the U.S. person in the exchange. Treas. Reg. §1.367(a)-3(c)(5)(vi) and (d)(2)(i). Although Taxpayer states that these definitions do not technically apply to the Outbound Stock Transfer,[4] Taxpayer argues that it is reasonable to apply these definitions for purposes of direct stock transfers. In the Outbound Stock Transfer, the stock received is stock in a domestic, rather than a foreign, corporation. Accordingly, Taxpayer argues that it cannot identify the transferee foreign corporation, a term that is used in the exceptions to the General Rule provided under Treas. Reg. §1.367(a)-3(b)(1) and the gain recognition agreement rules of Treas. Reg. §1.367(a)-8. Taxpayer argues that the inability to identify the transferee foreign corporation renders it unable to file a gain recognition agreement with respect to the Outbound Stock Transfer such that all such transfers would be taxable under the General Rule. Taxpayer concludes that this cannot be an appropriate result and, consequently, the Outbound Stock Transfer should not be subject to the General Rule.

Taxpayer's argument is incorrect. The Outbound Stock Transfer is subject to the General Rule, and the definition of the transferee foreign corporation does not change this result. Applying the General Rule to Taxpayer's facts, the Outbound Stock Transfer is subject to section 367(a)(1). Corporation X (a U.S. person) transferred stock (the stock of Corporation Z) to a foreign corporation (Corporation Y) in a transfer described in section 354. Moreover, the parenthetical contained in the General Rule cites, as an example of a transaction that is taxable under section 367(a)(1) pursuant to the General Rule, Taxpayer's very transaction – that is, a B reorganization. Thus, the Outbound Stock Transfer is taxable under section 367(a)(1) as a result of the application of the General Rule, unless an exception under §1.367(a)-3(b)(1) applies.

[4] As indicated above, the term transferee foreign corporation is defined in Treas. Reg. §1.367(a)-3(c)(5)(vi), which applies to transfers of stock or securities of domestic corporations. The term is also defined in Treas. Reg. §1.367(a)-3(d)(2)(i), which applies to indirect stock transfers. The Outbound Stock Transfer does not involve the transfer of domestic stock or securities and is not in connection with an indirect stock transfer. As a result, Taxpayer asserts that neither definition of transferee foreign corporation explicitly applies to the Outbound Stock Transfer.

The term transferee foreign corporation is relevant for purposes of applying the exceptions to the General Rule, but is irrelevant for purposes of interpreting the General Rule. Indeed, the term transferee foreign corporation does not even appear in the General Rule and in no way affects the application of the General Rule. Although the interpretation of a term that is found in an exception (but not the general rule) affects the application of the exception itself, it does not affect the application of the general rule to which the exception applies.

In addition to the General Rule, by its terms, expressly applying to the Outbound Stock Transfer, such application comports with the policies underlying section 367(a). As noted above, Congress enacted section 367(a) to prevent the avoidance of U.S. tax on transfers of appreciated property outside the United States in nonrecognition transfers involving foreign corporations. S.R. Rep. No. 169, Vol. 1, 98th Cong. 2d Sess., at 360 (Apr. 2, 1984). Specifically, Congress enacted section 367(a) to provide that a U.S. person's transfer of appreciated property (including stock) to a foreign corporation in connection with certain nonrecognition exchanges is treated as a taxable transaction, unless an exception applies. If the Outbound Stock Transfer were not subject to the General Rule, the result would be contrary to the longstanding policy of section 367(a) because it would allow a U.S. person (Corporation X) to transfer appreciated property (the stock of Corporation Z) to a foreign corporation (Corporation Y) in a nonrecognition transfer (section 354 exchange) without being subject to section 367(a)(1). In such a case, the foreign acquiring corporation could then sell the appreciated property without being subject to U.S. tax. It is precisely this concern with potential tax avoidance that spurred Congress to enact section 367(a). See H.R. Rep. No. 708, 72d Cong., 1st Sess. 20 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 26-27 (1932) (enacting section 112(k), the predecessor to section 367(a)(1)). Taxpayer's position that the Outbound Stock Transfer is not subject to the General Rule is directly contrary to the policies underlying section 367(a).

Taxpayer also incorrectly asserts that the exceptions to the General Rule contained in §1.367(a)-3(b)(1) are unavailable for transfers such as the Outbound Stock Transfer. While it is true that the definitions of the term transferee foreign corporation in the regulations do not explicitly describe an entity in the Transaction, this does not prevent the application of the exceptions. Because the term is not explicitly defined with respect to the Outbound Stock Transfer, the term transferee foreign corporation must be construed in a reasonable manner, taking into account the plain meaning of the words and the purpose of the provision.[5] In the Outbound Stock Transfer, Corporation Y is the foreign corporation to which property is transferred.[6] Accordingly, it would be reasonable to construe the regulations such that Corporation Y is the transferee foreign

[5] Under cannons of construction, statutes and regulations are interpreted in a manner consistent with the drafters' intent. See K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 291 (1988); Offshore Logistics, Inc. v Tallentire, 477 U.S. 207, 221 (1986); United States v. Murphy, 35 F.3d 143, 145 (4th Cir. 1994).

[6] Black's Law Dictionary defines "transferee" as "[o]ne to whom a property interest is conveyed." Black's Law Dictionary 1536 (8th ed. 2004).

corporation for purposes of applying the exceptions to the General Rule. Thus, Taxpayer could have avoided the application of the General Rule by entering into a gain recognition agreement.[7]

In summary, although the term transferee foreign corporation is relevant for purposes of applying the exceptions to the General Rule, the term does not appear in the General Rule and is irrelevant for purposes of applying the General Rule. The term is, however, relevant for purposes of applying the exceptions to the General Rule, and such exceptions are available provided Taxpayer applies them in a reasonable manner. Moreover, even if it is unclear which entity in the Transaction is the transferee foreign corporation, the Outbound Stock Transfer is clearly described in, and therefore subject to, the General Rule. This is true both as a technical matter and as a policy matter. Ambiguity regarding the application of an exception to a general rule does not render the general rule inapplicable.

2. Taxpayer's second argument: The General Rule is inapplicable because of subsequent revisions to the indirect stock transfer rules

Taxpayer asserts that the Outbound Stock Transfer is not subject to the General Rule because of subsequent revisions to the indirect stock transfer rules of Treas. Reg. §1.367(a)-3(d). Taxpayer notes that at the time of the Transaction, only foreign issuing triangular B reorganizations were subject to the indirect stock transfer rules. After the Transaction, the indirect stock transfer rules were revised to apply, prospectively, to domestic issuing triangular B reorganizations, such as the one that occurred in connection with the Transaction. TD 9243; 2006-1 C.B. 475. Taxpayer argues that this subsequent change to the indirect stock transfer rules implies that the Outbound Stock Transfer was not subject to the General Rule. In further support of its position, Taxpayer cites language in the preamble to the regulations that states that indirect stock transfers would be "extended" to include domestic issuing triangular B reorganizations.[8]

Taxpayer's argument is incorrect. Adding a transaction to the indirect stock transfer rules does not prove that the General Rule did not apply to the transaction prior to such addition. Transfers such as the Outbound Stock Transfer were subject to the General Rule in Year 1 and remain subject to the General Rule today. The plain language of the General Rule cannot be ignored. That is, transfers such as the Outbound Stock Transfer involve a transfer of property by a U.S. person to a foreign corporation in a

[7] Taxpayer asserts that certain issues would arise in applying the exceptions even if Corporation Y were treated as the transferee foreign corporation. Consistent with the discussion above, these issues would not arise if the exceptions were applied in a reasonable manner.

[8] "The current regulations do not, however, treat as an indirect stock transfer a triangular section 368(a)(1)(B) reorganization where the acquiring corporation is foreign and the controlling corporation is domestic. The 2005 proposed regulations would extend the indirect stock transfer rules to include triangular section 368(a)(1)(B) reorganizations in which a U.S. person exchanges stock of the acquired corporation for voting stock of a domestic corporation that controls the foreign acquiring corporation." T.D. 9243, 2006-1 C.B. 475.

nonrecognition exchange described in section 354. Corporation X (a U.S. person) transferred stock (the stock of Corporation Z) to a foreign corporation (Corporation Y) in a transfer described in section 354. Thus, the Outbound Stock Transfer is subject to section 367(a)(1) under the General Rule, without regard to the application of the indirect stock transfer rules.

The indirect stock transfer rules serve two purposes. First, they subject to the General Rule certain transactions that are not otherwise described in the General Rule, but that have an effect substantially similar to transfers that are described in the General Rule. For example, an indirect stock transfer includes a reorganization described in section 368(a)(1)(C) where a U.S. person exchanges stock or securities of a domestic corporation for voting stock or securities of a foreign corporation that controls a domestic acquiring corporation. Treas. Reg. §1.367(a)-3(d)(1)(iv). But for its treatment as an indirect stock transfer, this transaction would not be described in the General Rule even though has the effect of a transaction that would be described in the General Rule. That is, the transaction has the effect of the U.S. person transferring the stock of the domestic corporation to the foreign corporation that controls the domestic acquiring corporation pursuant to a nonrecognition provision.

Second, the indirect stock transfer rules set forth provisions necessary to apply the exceptions to the General Rule provided under Treas. Reg. §1.367(a)-3(b)(1), including the application of the gain recognition agreement provisions of Treas. Reg. §1.367(a)-8, to triangular B reorganizations (which are direct transfers subject to the General Rule without regard to the indirect stock transfer rules). Most direct stock transfers that are subject to the General Rule involve three entities or persons: (1) the U.S. person that transfers the stock or securities, (2) the foreign corporation to which stock or securities is transferred, and (3) the entity the stock or securities of which are transferred. The gain recognition agreement rules generally apply based on a framework comprised of these three entities (or persons). For example, a taxable disposition of the stock of the transferred corporation by the foreign corporation to which the stock is transferred is generally an event that triggers the gain recognition agreement. See Treas. Reg. §1.367(a)-8(e)(1)(i). Further, a taxable disposition by the U.S. transferor of the stock of the foreign corporation to which the stock is transferred may terminate the gain recognition agreement. See Treas. Reg. §1.367(a)-8(h)(1)(i). However, direct stock transfers that are triangular B reorganizations involve a fourth entity – that is, the issuing corporation. In such a case, special provisions are needed to explain how the entities are treated for purposes of the exceptions to the General Rule, including the gain recognition agreement rules. The later revision to the indirect stock transfer rules provided these provisions for domestic-issuing triangular reorganizations. See Treas. Reg. §1.367(a)-3(d)(2).

As Taxpayer's first argument indicates, at the time of the Transaction there was some uncertainty as to the application of the exceptions to the General Rule with respect to domestic issuing triangular B reorganizations because, as a technical matter, the

transferee foreign corporation was not clearly defined. This is the very reason the indirect stock transfer rules were subsequently revised. See Treas. Reg. §1.367(a)-3(d)(2)(iii)(B) and -3(d)(2)(iv) (second to last sentence), as contained in 26 CFR Part 1 revised as of April 1, 2008. This revision did not, as taxpayer asserts, subject domestic issuing triangular B reorganizations to the General Rule for the first time. Clarifying how an exception to a General Rule applies to a transfer does not prove that the General Rule did not apply to the transfer before such clarification.

Moreover, the indirect stock transfer rules can only expand the types of transfers that are subject to the General Rule; they cannot, as Taxpayer asserts, operate to exclude a transfer from being subject to the General Rule. Only the exceptions to the General Rule provided under Treas. Reg. §1.367(a)-3(b) and (c) can exclude a transaction from the application of the General Rule. Treas. Reg. §1.367(a)-3(a).

Finally, and contrary to what Taxpayer asserts, nothing in the preamble to the proposed regulations or the preamble to the final regulations suggests that domestic issuing triangular reorganizations were not subject to the General Rule before being included as indirect stock transfers. Merely noting the undisputed fact that the current regulations "do not treat as an indirect stock transfer" domestic issuing triangular B reorganizations, or correctly stating that the effect of the change to the indirect stock transfer rules was to "extend" the rules to include domestic issuing triangular B reorganizations, does not support Taxpayer's position. These statements are entirely consistent with the second purpose of the indirect stock transfer rules.

3. Taxpayer's third argument: Direct and indirect stock transfers are mutually exclusive and domestic issuing triangular reorganizations can only be indirect stock transfers

Taxpayer argues that prior to applying the General Rule, it must first be determined whether a transfer is "described in section 367(a)(1)" within the meaning of Treas. Reg. §1.367(a)-1T(c). Next, taxpayer claims that pursuant to Treas. Reg. §1.367(a)-1T(c) and the general framework of the section 367(a) regulations, direct and indirect transfers are mutually exclusive. Taxpayer then asserts that domestic issuing triangular B reorganizations should be categorized solely as indirect transfers. It follows, according to the Taxpayer, that because the indirect stock transfer rules did not include a domestic issuing triangular B reorganization at the time of the Transaction, the Outbound stock transfer is excepted from section 367(a)(1) by virtue of section 367(a)(2). This argument is incorrect.

(a) Application of Treas. Reg. §1.367(a)-1T(c) prior to the applying the General Rule

Taxpayer argues that prior to applying the General Rule to a transfer, it must first be determined whether a transfer is "described in section 367(a)(1)" within the meaning of Treas. Reg. §1.367(a)-1T(c).

This argument is incorrect. First, on its face, Treas. Reg. §1.367(a)-1T(c) does not purport to serve the "gatekeeper" function that Taxpayer ascribes to it. The first sentence of Treas. Reg. §1.367(a)-1T(c)(1) simply paraphrases section 367(a)(1): "a transfer described in section 367(a)(1) is any transfer of property by a U.S. person to a foreign corporation pursuant to an exchange described in section 332, 351, 354, 355, 356, or 361." Under this rule, and consistent with the General Rule, the Outbound Stock Transfer is taxable under section 367(a)(1). The second sentence only explains that a transfer described in the first sentence, which would include the Outbound Stock Transfer, can be direct, indirect or constructive. Finally, the third sentence explains that the types of transfers that are indirect or constructive include the transfers described in paragraphs (c)(2) through (7) of that provision (for example, certain transfers made by partnerships, trusts, estates, and transfers incident to section 1504(d) election terminations). Thus, nothing in the regulation suggests that it must be applied prior to applying the General Rule.

Second, Taxpayer's argument is inconsistent with the structure of Treas. Reg. §1.367(a)-3. The opening sentences of Treas. Reg. §1.367(a)-3(a), including the General Rule, contain no mention of Treas. Reg. §1.367(a)-1T(c). Instead, these opening sentences set forth self-contained and self-referencing rules of what is "an exchange described in section 367(a)(1)." That is, Treas. Reg. §1.367(a)-3(a) operates independently and "occupies the field" on stock transfers. Indeed, several sentences after the General Rule, Treas. Reg. §1.367(a)-3(a) provides "For rules regarding <u>other</u> indirect or constructive transfers of stock or securities subject to section 367(a), see §1.367(a)-1T(c)" (emphasis added). Thus, Treas. Reg. §1.367(a)-3(a) does not suggest any overarching function for Treas. Reg. §1.367(a)-1T(c), or its various categories. To the contrary, Treas. Reg. §1.367(a)-3(a) suggests that Treas. Reg. §1.367(a)-1T(c) is relevant only insomuch as it includes transfers not explicitly described in the General Rule (such as the partnership and trust rules); it does not, as taxpayer asserts, somehow narrow or otherwise affect the scope of the General Rule.

Finally, taxpayer's interpretation is inconsistent with the structure of Treas. Reg. §1.367(a)-1T itself. The third sentence of Treas. Reg. §1.367(a)-1T(a) provides "Rules concerning the application of section 367(a)(1) to transfers of stock or securities are provided in §1.367(a)-3."

(b) <u>Direct and indirect transfers are mutually exclusive and the Transaction could only be categorized as an indirect stock transfer</u>

Taxpayer asserts that the use of the word "or" in Treas. Reg. §1.367(a)-1T(c)(1) and in a preamble to a section 367 regulation,[9] coupled with the general

[9] "Outbound transfers of stock that are subject to section 367(a) may be either direct (such as an outbound transfer of stock described under section 351), indirect (as described below with respect to certain transfers) or constructive (such as an outbound stock transfer that may occur pursuant to a

framework of the section 367 regulations, divide transfers into the mutually exclusive categories of direct transfers and indirect transfers. Taxpayer argues that the use of the term "or" indicates that the regulation intended to treat direct, indirect, and constructive transfers as mutually exclusive because the word "or" is commonly understood to have disjunctive meaning. Taxpayer asserts that the disjunctive "or" would not have been used if it was intended that these categories of transfers were not mutually exclusive. Taxpayer next asserts that a triangular B reorganization can only be an indirect transfer because it "fits the paradigm" of an indirect stock transfer. Taxpayer supports its position by noting that triangular B reorganizations were included as indirect stock transfers in the regulations.[10] Taxpayer concludes that because domestic issuing triangular reorganizations were not included as indirect stock transfers at the time of the Transaction, the Outbound Stock Transfer is not subject to section 367(a)(1).

This argument is incorrect. First, the General Rule makes no distinction between a direct transfer, an indirect transfer, and a constructive transfer. The General Rule straightforwardly applies to a particular category of transfers that includes the Outbound Stock Transfer. The use of the word "or" when generally describing transfers in Treas. Reg. §1.367(a)-1T(c)(1) (and the preamble cited by Taxpayer) is not relevant and does not change this result. The use of the word "or" in Treas. Reg. §1.367(a)-1T(c)(1) (and the preamble) cannot exempt a transaction described in the General Rule from being subject to the General rule; this can only be done by the exceptions to the General Rule provided in Treas. Reg. §1.367(a)-3(b)(1).

Second, even if Treas. Reg. §1.367(a)-1T(c)(1) were relevant, Taxpayer's interpretation of that rule is incorrect. The first sentence of Treas. Reg. §1.367(a)-1T(c)(1) describes the Transaction and states that it is described in section 367(a)(1) (and therefore is taxable, absent an exception). Taxpayer asserts that the second sentence somehow narrows the scope of the first sentence – or narrows the scope of the General Rule in Treas. Reg. §1.367(a)-3(a). Taxpayer asserts that the use of "or" in the second sentence divides the transactions described in the first sentence into mutually exclusive categories such that a transaction that is clearly described in the first sentence ceases to be so described. This assertion is incorrect. The second sentence does not narrow the first sentence or the General Rule, but rather simply explains that section 367(a)(1) applies to all transfers described in the first sentence. This is evident by the use of the words "such transfer," which refer to transfers described in the first sentence, including the Transaction, without regard to whether it is made directly, indirectly, or constructively.

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change in an entity's classification). See §1.367(a)-3(a) (as amended) for the general rules regarding the scope of stock transfers that are subject to section 367(a)." T.D. 8770, 1998-2 C.B. 3.

[10] As noted above, foreign issuing triangular B reorganizations were included as indirect stock transfers at the time of the Transaction, and domestic issuing triangular B reorganizations were subsequently added to the list of indirect stock transfers.

Third, and again assuming Treas. Reg. §1.367(a)-1T(c)(1) is relevant, it is well established that "or" can have conjunctive, rather than disjunctive, meaning where the context dictates the former meaning. Treasury Reg. §1.368-2(h) provides:

> As used in section 368, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received.

Consistent with this regulation, courts have recognized that while "or" may be naturally disjunctive, in statutory construction it is well settled that "or" has conjunctive meaning when the context so dictates. See Union Insurance Co. v. United States, 73 U.S. 759, 764 (1867); De Sylva v. Ballantine, 351 U.S. 570, 573 (1956); Willis v. United States, 719 F.2d 608, 612-13 (2d Cir. 1983).

Here, the context requires that the use of "or" denotes both the conjunctive and the disjunctive. That is, the General Rule applies to a transfer that is made both "directly and indirectly," as well as a transfer that is made "directly or indirectly." The plain language of the General Rule mandates this result because it does not draw a distinction between transfers made directly, indirectly or constructively. Rather, it simply applies to transfers from a U.S. person to a foreign corporation pursuant to enumerated exchanges. Moreover, and as noted above, this interpretation is consistent with the policy underlying section 367(a). Taxpayer's position that the use of the word "or" should have only the disjunctive meaning is directly contrary to both the plain language of the General Rule and would yield a result that undermines the policy of section 367(a).

Finally, the use of the word "or," as opposed to "and," more coherently illustrates the application of the rules. For example, if a rule governing tax professionals stated that it applied to "lawyers or accountants," the rule could not reasonably be read such that it did not apply to a person that is both a lawyer and an accountant. In this example, "or" is preferable to "and" because it avoids the question of whether both conditions have to be met in order for the rule to apply (that is, so that it is not read to only apply to a person who is both a lawyer and an accountant). In addition, to read substantive meaning into the choice of the word "or" instead of "and" in this context is inappropriate because the use of the alternative word "and" would render the sentence incoherent ("Section 367(a)(1) applies to a transfer whether it is made directly, indirectly, and constructively").

B. Exceptions to the General Rule

Because the Outbound Stock Transfer is subject to the General Rule, it is taxable under section 367(a)(1) unless one of the exceptions in Treas. Reg. §1.367(a)-3(b)(1) applies. The first exception applies if the U.S. person owns less than five percent (applying the attribution rules of section 318, as modified by section 958(b)) of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer. Treas. Reg. §1.367(a)-3(b)(1)(i). This exception is inapplicable to the Outbound Stock Transfer because, as Taxpayer notes, there is no corporation that technically meets the definition of "transferee foreign corporation." Furthermore, the exception would not apply if Taxpayer treated one of the foreign corporations involved in the Transaction, such as Corporation Y or Corporation Z, as the transferee foreign corporation. Applying the attribution rules of section 318, as modified by section 958(b), Corporation X owns 100 percent of the stock of Corporation Y and Corporation Z immediately after the transfer.

The second exception applies if the U.S. person enters into a five-year gain recognition agreement with respect to the transferred stock as provided in Treas. Reg. §1.367(a)-8. Treas. Reg. §1.367(a)-3(b)(1)(ii). Because no gain recognition agreement was entered into in connection with the Outbound Stock Transfer, this exception is inapplicable, unless Taxpayer demonstrates that its failure to enter into a gain recognition agreement was due to reasonable cause, and it filed the agreement as soon as it became aware of the failure. See Treas. Reg. §1.367(a)-8(c)(2) and Issue 2 of this memorandum.

III. CONCLUSION

The application of the stock transfer rules is straightforward. If a transfer is described in the General Rule it is taxable under section 367(a)(1), unless an exception described in Treas. Reg. §1.367(a)-3(b)(1) applies. Here, the Outbound Stock Transfer is described in the General Rule. Thus, unless the taxpayer is entitled to relief under Treas. Reg. §1.367(a)-8(c)(2), no exception applies and the Outbound Stock Transfer is taxable under section 367(a)(1). Moreover, this application of the General Rule is consistent with the policy underlying section 367(a)(1).

Despite this straightforward application of the stock transfer rules, Taxpayer makes several lengthy and complicated arguments to support its assertion that the Outbound Stock Transfer should not be subject to the General Rule. As discussed above, none of these arguments is correct. These arguments are based on various provisions having little or no bearing on the application of the General Rule, or the exceptions thereto. In addition, this result would be directly contrary to the policy underlying section 367(a)(1).

ISSUE 2: Whether Taxpayer Qualifies for the Reasonable Cause Exception under Treas. Reg. §1.367(a)-8(c)(2)?

I. LAW

If a person that is required to file a gain recognition agreement fails to file the agreement in a timely manner, then the initial transfer of property is described in section 367(a)(1) and will be treated as a taxable exchange. Treas. Reg. §1.367(a)-8(c)(1). However, the transfer will not be described in section 367(a)(1) if the person is able to show that the failure to enter into the gain recognition agreement was due to reasonable cause and not willful neglect, and the person files the agreement as soon as he becomes aware of the failure. Treas. Reg. §1.367(a)-8(c)(2). Whether a failure to file a gain recognition agreement was due to reasonable cause is determined under all the facts and circumstances. Id.

No authority directly addresses the question of what constitutes reasonable cause under Treas. Reg. §1.367(a)-8(c)(2). Thus, to make this determination, it is necessary to look to other areas of law that invoke the reasonable cause standard. For example, a taxpayer may not be subject to the failure to file penalty if it can show "that such failure is due to reasonable cause and not due to willful neglect." Section 6651(a)(1). In addition, taxpayers may avoid the underpayment penalties provided under sections 6662 and 6663 "with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." Section 6664(c)(1).

A. Reasonable Cause – In General

The Supreme Court has defined reasonable cause as "ordinary business care and prudence." United States v. Boyle, 469 U.S. 241, 246 (1985).

Consistent with Treas. Reg. §1.367(a)-8(c)(2), other regulations and case law generally require the determination of reasonable cause to be made on a case-by-case basis, taking into account all pertinent facts and circumstances. Treas. Reg. §1.6664-4(b)(1); Reynolds v. Comm'r, 296 F.3d 607, 618 (7th Cir. 2002); Williams v. Comm'r, 123 T.C. 144, 153 (2004). The most important factor is the extent of the taxpayer's effort to assess its proper tax liability. Thompson v. Comm'r, 499 F.3d 129, 134 (2d Cir. 2007); Reynolds, 296 F.3d at 618; Treas. Reg. §1.6664-4(b)(1).

Reasonable cause is determined at the time the tax return was filed, or, if not filed, when it was due. Morrissey v. Comm'r, T.C. Memo. 1998-443. Reasonable cause determinations do not factor in subsequent legal developments, such as newly decided cases or the issuance of new regulations. Id.

Taxpayers bear the burden of establishing reasonable cause. See Boyle, 469 U.S. at 245.

Regarding filing standards, the Supreme Court stated "[t]he Government has millions of taxpayers to monitor, and our system of self-assessment in the initial calculation of a tax simply cannot work on any basis other than one of strict filing standards." Boyle, 469

U.S. at 249. “Any less rigid standard would risk encouraging a lax attitude toward filing dates.” Id.

B. Circumstances that May Indicate Reasonable Cause

Although the facts and circumstances are unique to any particular case, courts have considered various circumstances that, if present, should be taken into account in determining reasonable cause. Circumstances that are relevant to the case at hand include: (1) taxpayer’s sophistication, experience, knowledge and education; (2) contemporaneous documentation, research, analysis, and supporting legal authority; (3) complexity, uncertainty, and ambiguity of the law; (4) mistaken belief and lack of knowledge; and (5) advice from qualified tax professionals.

1. Taxpayer’s sophistication, experience, knowledge and education

When determining whether a taxpayer has reasonable cause for failing to comply with his obligations under the tax laws, the taxpayer’s experience, knowledge, and education must be taken into account. See Van Scoten v. Comm’r, 439 F.3d 1243, 1259 (10th Cir. 2006); Estate of True v. Comm’r, 390 F.3d 1210, 1245 (10th Cir. 2004); Geary v. Comm’r, 235 F.3d 1207, 1211 (9th Cir. 2000)). For example, a taxpayer’s sophistication may factor into a determination of whether a misunderstanding of law was reasonable. Compare Reynolds, 296 F.3d at 618 (upholding penalties for overstated deductions because taxpayer’s misunderstanding of law was not reasonable in light of the fact that taxpayer was a licensed attorney, certified public accountant, and former Internal Revenue Service audit supervisor) with Geary, 235 F.3d at 1210-11 (reversing penalties because taxpayer’s attempt to deduct expenses was an honest misunderstanding of law that was reasonable in light of taxpayer’s relative lack of experience and the absence of case law on point).

2. Contemporaneous documentation, research, analysis, and supporting legal authority

The extent to which a taxpayer documents the position taken, conducts related analysis, and has supporting legal authority, must be considered because such efforts reflect a taxpayer’s attempt to properly assess its tax liability. A taxpayer demonstrates a lack of reasonable cause when it fails to make a required filing based on an interpretation of a tax provision without conducting, documenting, or memorializing any analysis. Ballmer v. Comm’r, T.C. Memo. 2007-295; Wadsworth v. Comm’r, T.C. Memo. 2008-171.

3. Complexity, uncertainty, and ambiguity of the law

The complexity, uncertainty, and ambiguity of the underlying tax provision are circumstances to consider in determining reasonable cause. Economy Savings & Loan Co. v. Comm’r, 158 F.2d 472, 475 (6th Cir. 1947); United States v. Brennan, 488 F.2d 858, 861 (5th Cir. 1974). In Economy Savings & Loan Co. and Brennan, courts

determined that reasonable cause existed where the underlying tax provision was complex or ambiguous. However, the complexity, uncertainty or ambiguity of a tax provision alone is not sufficient to deem noncompliance reasonable. Ellwest Stereo Theatres of Memphis, T.C. Memo. 1995-610; Williams, 123 T.C. 144 (providing that reasonable cause determinations are made on a case-by-case basis, taking into account all the facts and circumstances); Edgar v. Comm'r, 56 T.C. 717, 762-63 (1971) (noting that complexity is not "sufficient to show reasonable cause"). Moreover, while uncertainty may be one of the many facts and circumstances that goes into a reasonable cause determination, complexity without any proof that the complexity actually affected the taxpayer's decision not to comply with the tax law does not support a finding that a taxpayer had reasonable cause for his compliance failure. Ellwest Stereo Theatres of Memphis, T.C. Memo. 1995-610.

4. Mistaken belief and lack of knowledge

The mistaken belief that a tax filing is unnecessary does not, by itself, constitute reasonable cause. See Beck Chem. Equip. Corp. v. Comm'r, 27 T.C. 840 (1957), acq. 1957-2 C.B. 3. In Beck, the taxpayer believed that it did not have sufficient profits to necessitate filing a required excess profits tax return. In finding that the taxpayer did not have reasonable cause for failing to file the excess profits tax return, the Tax Court stated:

> Even if it was unaware of the fact that sales and income for 1944 and 1945 were substantial, its failure to file a return cannot be excused on the ground of reasonable cause unless it had reliable and affirmative information that its share of the earnings for the years in question were in fact less than the amount of the exemption. . . . .The personal good faith belief that the taxpayer is not required to file an excess profits tax return is insufficient alone to discharge the addition to tax under section 291(a) [Citations omitted].

Beck Chem. Equip. Corp., 27 T.C. at 859-60.

Taxpayers who decide not to make tax filings must take reasonable steps to ensure that their decision is correct and must demonstrate that care was taken in making the decision. Id. at 860 ("Taxpayers deliberately omitting to file returns must use reasonable care to ascertain that no returns were necessary…. [M]istaken belief on the part of petitioner that no return was required under the statute does not constitute reasonable cause for noncompliance." (citations omitted)).

In Saigh v. Comm'r, 36 T.C. 395 (1961), *acq.* 1962-2 C.B. 3, taxpayer did not have reasonable cause for failing to file a personal holding company return when it incorrectly argued a transaction was a loan, and thus it did not necessitate a personal holding company return filing. The Tax Court stated:

> [A]lthough reasonable men might differ on the effect of the transfer, petitioners failed to show that they consulted a lawyer or other tax counsel concerning the transactions of 1946 or that they relied upon any competent advice received on the matter. Indeed, there is no showing that petitioners themselves considered the question, even though they were aware of all the facts.

Saigh, 36 T.C. at 430.

Lack of knowledge of relevant, material facts is insufficient to establish reasonable cause for the failure to comply with a tax provision. Roberts v. Comm'r, 860 F.2d 1235 (5th Cir. 1988), *aff'g* T.C. Memo. 1987-391; Estate of Rector v. Comm'r, T.C. Memo. 2007-367; Morrissey, T.C. Memo. 1998-443. The relevant inquiry is whether the taxpayer knew or should have known the relevant facts. Roberts, 860 F.2d at 1238; Estate of Rector, T.C. Memo. 2007-367. For example, in Roberts, the court held that the wife of a husband who earned kickback income related to real estate transactions did not have reasonable cause for failing to file an income tax return reporting that income because she knew or should have known about the income as a result of having access to her family's books and records. Roberts, 860 F.2d at 1241-42. See also Treas. Reg. §1.6664-4(b)(1), -4(b)(2), Example 1, and -4(c)(1). Thus, when making a reasonable cause determination, it is necessary to look beyond a taxpayer's actual knowledge and consider what the taxpayer should have known.

5. Advice from qualified tax professionals

A taxpayer's reliance on advice received from qualified tax professionals may indicate reasonable cause if such reliance is reasonable. Advice can come in many forms, whether formal, informal, written, or oral. Treasury Reg. §1.6664-4(c)(2) states that advice "is any communication," and "does not need to be in any particular form."

Many cases address fact patterns where taxpayers follow erroneous advice of counsel and the court must determine the extent to which such reliance is reasonable. E.g., Hatfried, Inc. v. Comm'r, 162 F.2d 628 (3d. Cir. 1947); Girard Inv. Co. v. Comm'r, 122 F.2d 843 (3d Cir. 1941); Ellwest Stereo Theatres of Memphis, Inc. v. Comm'r, T.C. Memo. 1995-610. However, few reported cases address facts where taxpayer was correctly advised by its tax professional but chose not to follow such advice. In such cases, reasonable cause is only found if the taxpayer's decision not to follow the advice was reasonable. See Wadsworth v. Comm'r, T.C. Memo. 2008-171; Condor International, Inc. v. Comm'r, 98 T.C. 203, *rev'd in part on other grounds,* 78 F.3d 1355 (9th Cir. 1996).

In Wadsworth, the taxpayer filed amended tax returns claiming an erroneous contingent liability deduction under section 461(f). The taxpayer's certified public accountant

advised Wadsworth that he was not entitled to a section 461(f) deduction, but Wadsworth filed the amended returns contrary to this advice. T.C. Memo. 2008-171. The taxpayer presented no evidence that he relied upon any authority that rebutted his advisor's opinion, or that he had a reason, other than to obtain a tax refund, for disregarding his certified public accountant's advice. Id. The Tax Court held that the certified public accountant's advice should have "raised a red flag" in the taxpayer's mind that the claimed deduction was not allowable, and thus the taxpayer, a successful businessman who operated a multi-million dollar business, did not have reasonable cause for claiming the section 461(f) deduction in error. Id.

Similarly, in Condor International, the Tax Court held that when a taxpayer erroneously relied upon the advice of one advisor that tax returns were not required, instead of contrary advice from another advisor that tax returns were required, it did not have reasonable cause. Condor International, 98 T.C. at 223. Because the taxpayer was unable to explain why it chose one advisor's advice over the other's advice, the taxpayer did not have reasonable cause for its failure to file the required tax returns. Id.

Although, as noted above, a taxpayer may be able to establish reasonable cause by reasonable reliance on a qualified tax professional, a corporate taxpayer cannot rely on its own tax department employees to establish reasonable cause. Valen Mfg. Co. v. United States, 90 F.3d 1190, 1193 (6th Cir. 1996); *cf.* Treas. Reg. §301.9100-3(b)(1)(v) (allowing taxpayers to rely upon their employees to obtain relief for missing deadlines for regulatory elections under Treas. Reg. §301.9100-1). Because corporations only act through their employees, a corporation cannot argue it reasonably relied on an outside qualified tax professional when it relies on one of its own employees. Valen Mfg. Co., 90 F.3d at 1193. A corporate taxpayer cannot show reasonable cause for the failure to perform a tax compliance obligation by showing that it delegated tax compliance duties to employees. Obstetrical & Gynecological Group, P.A. v. United States, 79-2 USTC 9511 (D. Colo. 1979).

II. ANALYSIS

A. Reasonable Cause

Taxpayer makes several arguments why its failure to file a gain recognition agreement in connection with the Outbound Stock Transfer was due to reasonable cause. Taxpayer first argues that where the tax law is complex, ambiguous or uncertain, noncompliance should be excused for that reason alone. Second, Taxpayer argues that relief for failure to file a gain recognition agreement should be governed by standards similar to those provided in granting relief under Treas. Reg. §§301.9100-1 through -3 (9100 relief) and, based on those standards, it is entitled to relief. Third, taxpayer argues that it satisfied the ordinary business care and prudence standard.

1. Taxpayer's first argument: Because the law was ambiguous, the failure to file the gain recognition agreement was, per se, due to reasonable cause

Taxpayer cites two cases for the proposition that a failure to comply with a complex, uncertain, or ambiguous provision is deemed automatically to be due to reasonable cause, without regard to other facts and circumstances: Brennan, 488 F.2d 858 and Economy Savings & Loan Co., 158 F.2d 472. Further, Taxpayer argues that no reported case has found reasonable cause not to exist where the underlying tax provision was complex or ambiguous.

This argument is incorrect. First, Taxpayer's argument is inconsistent with the express language of Treas. Reg. §1.367(a)-8(c)(2), which provides that whether a failure to file was due to reasonable cause shall be determined "under all the facts and circumstances" (emphasis added). Taxpayer's argument requires construing the word "all" in the governing regulation to have no meaning, which violates basic canons of construction. See Babbitt v. Sweet Home Chapter of Cmtys. for a Great Or., 515 U.S. 687, 698 (1995).

Second, Taxpayer's per se argument is contrary to the case law. The complexity of a statute alone is not sufficient for a reasonable cause finding; rather, the complexity of a statute is one circumstance to consider in determining whether the taxpayer had reasonable cause. Brennan, 488 F.2d at 861. In Brennan, the court considered both the ambiguity in the statute and the knowledge of the taxpayer. For example, the court considered what the taxpayer actually knew about the issue before holding that taxpayer had reasonable cause for failing to pay interest equalization tax when taxpayer had no notice that a tax might be due. Id. Such a multi-factored analysis comports with other case law that states that whether a taxpayer has reasonable cause is a case-by-case, facts and circumstances determination. See e.g., Reynolds, 296 F.3d 607; Williams, 123 T.C. 144.

In Economy Savings & Loan Co., the Sixth Circuit found the taxpayer had a reasonable belief that an excess profits tax return was not required and that the taxpayer made "an honest effort upon reasonable grounds" to determine whether it had to file the return. 158 F.2d at 474-75. Central to the court's finding that the taxpayer had reasonable cause was its determination that taxpayer acted reasonably in trying to interpret the ambiguous rules regarding whether an excess profits tax return was necessary. This case does not support the proposition that complexity or ambiguity alone necessitates a finding of reasonable cause because the court also considered whether the taxpayer acted reasonably in interpreting the provision at issue.

In addition, Taxpayer's argument is contrary to authority that provides that complexity alone is insufficient to establish reasonable cause. In Ellwest Stereo Theatres of Memphis, the Tax Court wrote "[e]ven if we grant that the reporting and withholding obligations involved in these cases are relatively complicated, petitioners have not

demonstrated that this complexity was responsible for their failure to comply." Ellwest Stereo, T.C. Memo. 1995-610. The Tax Court also wrote "[t]hat tax obligations are complex does not necessarily make noncompliance reasonable." Id. This further illustrates that complexity does not constitute reasonable cause as a per se rule of law. See also Edgar, 56 T.C. 717, 762-63. Instead, all the facts and circumstances must be considered.

2. Taxpayer's second argument: 9100 relief standards should be used to determine whether Taxpayer's failure to file the gain recognition agreement was due to reasonable cause

Taxpayer argues that 9100 relief standards should apply to determine whether its failure to file was due to reasonable cause because the filing of a gain recognition agreement constitutes a tax election. Consistent with the 9100 relief standards, Taxpayer argues that reasonable cause relief should be granted in this case because it would not prejudice the interests of the Government. Taxpayer asserts that the Government's interests would not be prejudiced because there has not been a triggering event that would have required Taxpayer to recognize the gain had the gain recognition agreement been timely filed.

Taxpayer's argument is incorrect. The standards for determining reasonable cause and the 9100 relief standards are distinct and must be separately applied, as appropriate. No reported federal tax case has looked to the 9100 relief standards to determine whether a taxpayer had reasonable cause. Moreover, Treas. Reg. §301.9100-1(d)(2) expressly states that for elections "where alternative relief is provided by . . . a regulation published in the Federal Register" the Commissioner may not grant relief. Here, Treas. Reg. §1.367(a)-8(c)(2) provides relief is granted if a taxpayer has reasonable cause for failing to file a gain recognition agreement and files the agreement as soon as he becomes aware of the failure. This provision renders 9100 relief inapplicable, by its terms, to the Outbound Stock Transfer. Further, nowhere in the 9100 relief regulations is reasonable cause even mentioned. Thus, it is inappropriate to look to 9100 relief standards to determine whether reasonable cause exists. Reasonable cause and 9100 relief are distinct concepts, and reasonable cause is governed by standards entirely separate from the 9100 relief standards.[11]

[11] Assuming only for the sake of argument that 9100 relief standards govern the determination of whether Taxpayer had reasonable cause for its failure to file, Taxpayer would be ineligible for relief. Under Treas. Reg. §301.9100-3(b)(3)(ii), taxpayers that were "informed in all material respects of the required election and related tax consequences, but chose not to file the election" are ineligible for 9100 relief. Accounting Firm X informed Taxpayer, through the Opinion Letter and other documents, of the need for a gain recognition agreement for the Outbound Stock Transfer and of the related tax consequences. Despite being informed of the need to file a gain recognition agreement, Taxpayer chose not to file one. Thus, Taxpayer would not be eligible for 9100 relief, even if that were the standard governing relief in this case.

Taxpayer is also incorrect in its assertion that granting reasonable cause relief is appropriate if doing so would not prejudice the interests of the Government.[12] No reported case has considered prejudice to the Government when determining reasonable cause. Moreover, as discussed in Boyle, the Government has millions of taxpayers to monitor. Filing requirements, such as gain recognition agreements, are the responsibility of taxpayers and must be governed by strict filing standards. Whether gain recognition agreements might later be triggered is of no consequence to determining whether they must be filed, or whether the failure to file one is due to reasonable cause. This kind of "wait-and-see" approach is antithetical to sound tax administration.

3. Taxpayer's Third Argument: It satisfied the ordinary business care and prudence standard

Taxpayer claims it acted with ordinary business care and prudence and therefore has reasonable cause for its failure to file a gain recognition agreement. Taxpayer argues that it acted with ordinary business care and prudence in determining its tax obligations by taking the degree of care that a reasonably prudent person would exercise. It claims this degree of care led it to interpret Treas. Reg. §1.367(a)-3 to not require the filing of a gain recognition agreement for the Outbound Stock Transfer. Taxpayer asserts that its normal tax return review process, including the analysis by Employee A of whether a gain recognition agreement should be filed, along with Employee A's meetings with Employee B and Employee C, constitutes ordinary business care and prudence. To further support its position, Taxpayer notes that it included in its return for Year 1 the notices required under Treas. Reg. §§1.368-3(a) and 1.367(b)-1(c), which demonstrates Taxpayer's willingness to comply with the law.

Taxpayer also asserts that it is entitled to relief notwithstanding the Opinion Letter advising it that a gain recognition agreement must be filed. In support of this contention, it argues that the Opinion Letter did not constitute advice and therefore need not be considered. In further support of this position, Taxpayer states that, at the time the Year 1 tax return was filed, Employee A and Employee B were unaware of the Opinion Letter's conclusions regarding section 367.

For the reasons discussed below, this argument is incorrect. The discussion analyzes five circumstances that should be considered in determining whether Taxpayer had reasonable cause for its failure to file. Although certain aspects of these circumstances overlap with one another, each will be analyzed separately.

a. Taxpayer's sophistication, experience, knowledge and education

[12] No inference is intended as to whether there would be prejudice to the government under these facts.

Taxpayer is sophisticated. Taxpayer is a large multinational corporation with substantial foreign operations. It has a sophisticated tax department that is staffed with experienced tax professionals, including certified public accountants. For example, Employee A and Employee B, the primary Taxpayer employees involved in the Transaction, had significant international tax experience both at Taxpayer and with firms prior to being employed by Taxpayer. Employee A was a former senior manager at Accounting Firm X and had K years of tax experience. Employee B was a former international tax partner at Accounting Firm Y and had L years of federal tax experience, including extensive experience in the area of cross-border mergers and acquisitions. Further, Taxpayer has the means to, and does, hire respected accounting and law firms such as Accounting Firm X and Law Firm, to assist it in its tax matters, including the Transaction. Finally, the Transaction itself was highly-structured and tax-motivated, many aspects of which involved detailed review and consideration from members of the Working Group.

A taxpayer with Taxpayer's resources, experience, knowledge, and sophistication does not reasonably disregard the unqualified advice of Accounting Firm X on such a significant tax issue without, at a minimum, conducting thorough research and analysis to reasonably question its advisor's conclusions, and subsequently discussing the issue with its advisor. Indeed, ordinary business care and prudence would require Taxpayer to follow the advice of its advisor or, at a minimum, to conduct further research and analysis to verify or disprove that advice before choosing to disregard it. Taxpayer did neither here, which indicates that Taxpayer did not exercise ordinary business care and prudence.

b. Contemporaneous documentation, research, analysis, and supporting legal authority

Contemporaneous documentation, research, analysis, and supporting legal authority compiled by a taxpayer with respect to the issue at hand indicate that the taxpayer exercised ordinary business care and prudence. Ballmer, T.C. Memo. 2007-295; Wadsworth, T.C. Memo. 2008-171. In Ballmer, the Tax Court ruled that a taxpayer's interpretation of a tax provision, made without any proof that the taxpayer conducted any contemporaneous analysis to properly interpret that provision, demonstrated a lack of reasonable cause for failure to follow that provision. Ballmer, T.C. Memo. 2007-295.

The facts at hand are similar to those in Ballmer. Taxpayer asserts that Employee A reviewed the applicable law and conducted a robust analysis of the application of Treas. Reg. §1.367(a)-3 to the Outbound Stock Transfer. However, Taxpayer has produced no evidence, other than Employee A's assertion, that would establish the extent of the research supporting that interpretation, or that such research was even conducted before, or contemporaneous with, the decision not the file a gain recognition agreement. It was unable to produce any memoranda, notes, e-mails, lists of authority, or other legal analysis discussing why it believed a gain recognition agreement was not required. Indeed, Employee A did not even discuss her analysis with anyone, including any other

member of the Working Group, or Employee C. The only contemporary evidence of any legal analysis produced by Taxpayer reached the opposite conclusion. The Opinion Letter and GRA Representation explicitly provided that Taxpayer was required to file a gain recognition agreement to avoid the application of section 367(a)(1) to the Outbound Stock Transfer.

Taxpayer's lack of contemporaneous documentation and support for its position is also similar to the lack of authority Wadsworth had. Wadsworth, T.C. Memo. 2008-171. Both Wadsworth and Taxpayer received advice from a qualified tax advisor that their position was incorrect, and both still took the position without contemporaneous legal support. Id.

Taking the position that a gain recognition agreement was not required, with no contemporaneous documented legal authority to support that position, notwithstanding Accounting Firm X's unqualified advice that a gain recognition agreement was in fact required, demonstrates that Taxpayer did not have reasonable cause for failing to file the gain recognition agreement.

c. Complexity, uncertainty, and ambiguity of the law

The complexity, uncertainty, and ambiguity of a tax provision is a relevant factor to determine if reasonable cause exists for the failure to comply with the tax provision. Economy Savings & Loan Co., 158 F.2d at 475; Brennan, 488 F.2d at 861. The law governing cross border mergers and acquisitions, such as section 367 and the underlying regulations, is complex. Such complexity is a factor that may indicate reasonable cause. However, as discussed above, the complexity of the provision at issue is only one factor in the reasonable cause determination and does not, as a per se rule, mean that Taxpayer had reasonable cause for failing to file the gain recognition agreement. In determining whether Taxpayer had reasonable cause for its failure to file a gain recognition agreement, all the pertinent facts and circumstances must be considered.

d. Mistaken belief and lack of knowledge

Taxpayer's mistaken belief that it did not have to file a gain recognition agreement does not indicate reasonable cause. Such a belief must be reasonable in light of all the facts and circumstances. Beck Chem. Corp., 27 T.C. at 860. Taxpayer failed to thoroughly research and document its conclusion on the issue and failed to consider the Accounting Firm X advice, including the Opinion Letter, which specifically stated a gain recognition agreement was due. In addition, Taxpayer's compliance efforts with respect to the Outbound Stock Transfer were lacking.

Employee A and Employee B's forgetting that the draft Opinion Letter stated that a gain recognition agreement was due is not relevant. Employee A and Employee B, the two

Taxpayer employees most involved with the Transaction, received, reviewed, and commented on the Opinion Letter and other advice, including several drafts of representations, from Accounting Firm X. This should have alerted them to the need to file a gain recognition agreement. Employee A asserts that she did not read the portions of the Opinion Letter involving section 367(a), including the GRA Representation, at any time. Employee A was the primary international tax planner and tax technical research source within Taxpayer's tax department, and the application of section 367 to the Outbound Stock Transfer was the sole international tax issue addressed in the Opinion Letter. For purposes of reasonable cause determinations, what the taxpayer knew or should have known is the relevant inquiry. Roberts, 860 F.2d at 1238; Estate of Rector, T.C. Memo. 2007-367. Taxpayer should have known that Accounting Firm X specifically and unequivocally advised it to file a gain recognition agreement and required the GRA Representation. In determining whether Taxpayer had reasonable cause, Taxpayer is charged with that knowledge.

The application of section 367(a)(1) to the Outbound Stock Transfer would cause Taxpayer to recognize an amount of gain that would substantially eliminate the desired tax benefits of the Transaction. Nevertheless, when Employee A and Employee B met to discuss the reporting of the Transaction, Employee A did not identify the application of section 367 to the Outbound Stock Transfer as "an ambiguous situation requiring further investigation." Employee B does not recall discussing the application of section 367. Moreover, apparently neither Employee A nor Employee B consulted or reviewed the Opinion Letter or other correspondence from Accounting Firm X when considering whether all the appropriate filings were included in the tax return. Employee C states that he accepted Employee A's assertion that a gain recognition agreement was not due. Employee C did not, however, discuss Employee A's conclusion with her, question her assertions, or request any supporting documentation.

For the reasons discussed above, Taxpayer's mistaken belief or lack of knowledge regarding the requirement to file a gain recognition agreement is not reasonable.

e. Advice from qualified tax professionals

Taxpayer argues that it reasonably relied upon the judgment of a qualified tax professional, Employee A, in deciding not to file a gain recognition agreement. It notes that Employee A had extensive experience in tax matters and asserts that Employee A reviewed the facts and relevant law and determined that Taxpayer did not have to file a gain recognition agreement. Taxpayer argues that its reliance upon Employee A satisfied the ordinary business care and prudence standard.

Taxpayer further asserts that the Opinion Letter does not affect this result. First, Taxpayer argues that the discussion of the need for a gain recognition agreement in the Opinion Letter did not constitute advice that would have alerted Taxpayer to the need to file a gain recognition agreement. This is the case, according to Taxpayer, because the

Opinion was never finalized and because Accounting Firm X did not focus on the section 367(a) issue as a critical aspect of the Transaction. Taxpayer argues that the discussion of section 367(a) did not constitute robust advice that was meant to advise Taxpayer to file a gain recognition agreement. Rather, taxpayer asserts that the GRA Representation allowed Accounting Firm X to "assume away" the issue instead of providing in-depth legal analysis of the issue. Second, Taxpayer argues that reasonable cause is determined at the time the tax return is filed. At such time, over a year after the Outbound Stock Transfer occurred, neither Employee A nor Employee B recalled that the Opinion Letter addressed the issue. As a result, Taxpayer asserts that the Opinion Letter need not be taken into account.

This argument is incorrect for the reasons discussed below.

i. Relevance of advice from Employee A

Taxpayer cannot rely on advice from Employee A. As the court in Valen Mfg. Co. stated, corporations only act through their employees. Taxpayer cannot rely upon its own employee to establish reasonable cause for failure to file a gain recognition agreement. Further, as illustrated by Obstetrical & Gynecological Group, a corporate taxpayer cannot claim it has reasonable cause because a delegated-to employee failed to appropriately comply with the tax law. Instead, Employee A's actions and role in this matter must be considered along with all the other facts and circumstances.

ii. Relevance of Opinion Letter

The Opinion Letter constitutes advice and therefore must be taken into account in determining whether Taxpayer had reasonable cause. Under Treas. Reg. §1.6664-4(c)(2), advice "is any communication," and "[a]dvice does not need to be in any particular form." The Opinion Letter, written by experienced tax practitioners Representative D and Representative E, analyzed the relevant provisions, unequivocally stated that a gain recognition agreement was necessary, and required the GRA Representation. This would put a reasonable taxpayer on notice that it should file a gain recognition agreement, conduct a thorough, documented analysis to determine that Accounting Firm X was incorrect in its position, or, at a minimum, discuss the issue with Accounting Firm X. A reasonable taxpayer does not simply disregard advice from a firm such as Accounting Firm X that Taxpayer will recognize a substantial gain if it does not file a gain recognition agreement.

In addition, no language in the Opinion Letter, or in any other contemporaneous documents, states that the section 367(a) analysis was less valid than any other analysis contained in the Opinion Letter.[13] Unlike with respect to certain other issues addressed in the Opinion Letter, Accounting Firm X did not express any doubt as to its

[13] Representative E's assertions to the contrary were not supported by any contemporaneous documents.

conclusion regarding the filing of a gain recognition agreement, nor did it state that it was merely assuming that Taxpayer would file a gain recognition agreement. The unqualified Opinion Letter analyzed the issue, plainly concluded that a gain recognition agreement was due, and, as a result, required the GRA Representation from Taxpayer. Moreover, the Opinion Letter stated "If any of these facts, assumptions, or representations is not entirely complete or accurate, it is imperative that we be informed immediately in writing, because the incompleteness or inaccuracy could cause us to change our opinions." This language demonstrates the importance of the representations underlying the opinions expressed in the Opinion Letter.[14]

Employee A and Employee B's failing to recall the fact that the Opinion Letter addressed section 367(a) does not affect the significance of the Opinion Letter. Taxpayers are assumed to have the knowledge they reasonably should have. Roberts, 860 F.2d 1235. In this case, considering Taxpayer's sophistication and the amount of gain at issue, both Employee A and Employee B, international tax professionals with years of experience and education, should have known that the Opinion Letter addressed section 367(a). Employee A and Employee B should have consulted the file and the Opinion Letter to ensure they properly treated the Outbound Stock Transfer on Taxpayer's tax return. Taxpayer's employees received, reviewed, and commented on several documents, including the Opinion Letter, that provided that a gain recognition agreement must be filed. Accordingly, Taxpayer should have known at the time it filed its tax return that it was advised by Accounting Firm X that a gain recognition agreement was required.

Thus, the Opinion Letter must be taken into account. As a result, it must be determined the extent to which the Opinion Letter affects the reasonable cause determination.

iii. Effect of Opinion Letter on reasonable cause determination

Disregarding advice from taxpayer's tax advisor, especially without any contemporaneous justification for doing so, does not support a finding of reasonable cause. Wadsworth, T.C. Memo. 2008-171; Condor International, 98 T.C. at 223.

Taxpayer's facts are similar to the facts presented in Wadsworth. In both situations sophisticated taxpayers had the advice of qualified tax professionals interpreting a tax provision. In both cases the taxpayers failed to follow that advice. Moreover, the taxpayers failed to provide any sort of documentation that would justify their failure to follow the advice. In Wadsworth, the Tax Court stated that the certified public accountant's refusal to amend tax returns based on claiming a section 461(f) deduction should have "raised a red flag" in the taxpayer's mind. Similarly, the unqualified Opinion Letter stating that a gain recognition agreement was required should, at a minimum, have alerted Taxpayer that it ought to file a gain recognition agreement, question

[14] Taxpayer did not at any time inform Accounting Firm X that it disagreed with or questioned the accuracy of the GRA Representation.

Accounting Firm X's opposite conclusion, or at least discuss the issue with the Working Group. Just as Mr. Wadsworth did not have reasonable cause for disregarding his advisor's opinion that he could not claim a section 461(f) deduction, Taxpayer's disregarding Accounting Firm X's advice indicates a lack of reasonable cause.

B. Filing a Gain Recognition Agreement when Becoming Aware of Failure to File

Taxpayer argues that it was not required to file a gain recognition agreement with respect to the Outbound Stock Transfer as soon as it was notified that one was due because of its belief that a gain recognition agreement was not required. That is, Taxpayer asserts that this requirement of Treas. Reg. §1.367(a)-8(c)(2) does not apply if the taxpayer disputes the need for a gain recognition agreement to be filed with respect to the transaction.

This argument is incorrect. Nothing in the regulation suggests that the filing obligation does not apply if taxpayer believed that a gain recognition agreement was not due. Taxpayer's failure to file a gain recognition agreement as soon as being notified one was due renders it ineligible for relief under Treas. Reg. §1.367(a)-8(c)(2).

III. CONCLUSION

For the reasons discussed above, Taxpayer has not met its burden of establishing that its failure to file a gain recognition agreement was due to reasonable cause and not willful neglect as provided under Treas. Reg. §1.367(a)-8(c)(2). In addition, Taxpayer's failure to file a gain recognition agreement after being notified one was due renders it ineligible for relief under Treas. Reg. §1.367(a)-8(c)(2). Thus, the Outbound Stock Transfer is described in section 367(a)(1) and is a taxable exchange.

ISSUE 3: Whether the Application of Section 367(a)(1) to the Outbound Stock Transfer Causes the Transfer to be Characterized as a Transaction to which Section 304 Applies?

I. LAW

As noted above in the discussion of Issue 1, 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 transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain is recognized on such transfer, be considered to be a corporation. Thus, the general rule of section 367(a)(1) is that a U.S. person must recognize gain on its transfer of property to a foreign corporation when one of the enumerated provisions, such as section 354, applies to the transfer.

Character and source of gain recognized under section 367(a)(1) are determined as if the transferred property had been disposed of in a taxable exchange with the transferee foreign corporation. Treas. Reg. §1.367(a)-1T(b)(4)(i)(A).

Section 304(a)(1) generally provides that if one or more persons are in control of each of two corporations, and in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control, then such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock.

Section 317(a) provides that for purposes of Part I of subchapter C of the Code, which includes section 304, the term "property" is defined as money, securities, and any other property other than stock of a corporation making the distribution (or rights to acquire such stock).

Legislative history to section 304 provides that "where the reorganization provisions apply, including those governing the treatment of exchanges by shareholders pursuant to a plan of reorganization, the rules of section 304(a) providing treatment as a stock redemption would not apply." See H.R. Rep. No. 98-432 Pt. 2, 1625 (1984).[15]

II. ANALYSIS

Section 367(a)(1) does not apply to characterize the Outbound Stock Transfer as an acquisition to which section 304 applies. Instead, sections 367(a)(1) and 1001 apply to cause Corporation X to recognize an amount of gain equal to the excess of the fair market value of the Corporation Z stock over such stock's basis.

Treasury Reg. §1.367(a)-1T(b)(4)(i)(A) does not cause the Outbound Stock Transfer to be characterized as an acquisition to which section 304 applies. This regulation applies only for purposes of determining the character and source of the gain that is recognized under section 367(a)(1). It does not affect the characterization of the underlying transaction as an exchange to which section 354 applies.[16]

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[15] See also H. R. Rep. No. 432, 98th Cong., 1st Sess. at 1625 (1983) (in explaining the scope of section 304(b)(3), which coordinates sections 304 and 351, the House stated that "only the nonrecognition provision governing transfers to a corporation in which the shareholders have 80% control (Sec. 351) would be made inapplicable to exchanges involving controlled corporations treated as redemptions. Thus, where the reorganization provisions apply, including those governing the treatment of exchanges by shareholders pursuant to a plan of reorganization, the rules of Section 304(a) providing treatment as a stock redemption would not apply.") and Rev. Rul. 2004-83; 2004-31 IRB 157 (section 304 does not override section 368(a)(1)(D) reorganization treatment).

[16] This is consistent with Prop. Treas. Reg. §1.367(a)-1T(b)(4)(i)(C) (clarifying that gain recognized because of section 367(a)(1) does not cause a nonrecognition exchange to be characterized as something other than that nonrecognition exchange), 73 Fed. Reg. 49278, at 49288 (August 20, 2008).

Nor does the fact that Taxpayer stock in the hands of Corporation Y is property, within the meaning of section 317(a), cause the Outbound Stock Transfer to be characterized as an acquisition to which section 304 applies. Section 367(a)(1) only disregards the corporate status of Corporation Y for purposes of determining the extent to which gain is recognized by Corporation X in connection with its transfer of the Corporation Z stock to Corporation Y in the section 354 exchange; the application of section 367(a)(1) to the Outbound Stock Transfer does not preclude reorganization treatment. For example, although gain may be recognized under section 367(a)(1), other provisions that apply to reorganizations, such as sections 358, 362, and 381, may still apply to the transaction. See, e.g., Treas. Reg. §1.367(a)-1T(b)(4)(i)(B) (gain recognized under section 367(a)(1) is reflected in basis as determined under section 362). Because section 367(a)(1) does not deny a transaction's status as a reorganization, Congress' intent that section 304 does not override reorganization treatment means that the Outbound Stock Transfer should not be characterized as an acquisition to which section 304 applies.

III. CONCLUSION

The application of section 367(a)(1) to the Outbound Stock Transfer does not cause the transfer to be characterized as an acquisition to which section 304 applies.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.