

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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to: Team Manager: LB&I: RFTH:1354  
(Retail, Food, Transportation, and Healthcare Industry)

from:  
Senior Technical Reviewer, Branch 4  
(International)

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subject: Application of Section 367(d)(2)(A)(ii)(II)

This Chief Counsel Advice responds to your request for assistance. In accordance with section 6110(k)(3), this advice may not be used or cited as precedent.

LEGEND

Parent =

Sub 1 =

Sub 2 =

Foreign HoldCo =

Foreign DE1 =

Foreign DE2 =

Foreign DE3 =

Target =

Foreign NewCo =

Business X =

Intangible Property =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Country A =

Country B =

a% =

b% =

\$ c =

d% =

e% =

\$ f =

\$ g =

Accounting Firm =

Law Firm =

## FACTS

Parent, a publicly traded domestic corporation, wholly owns Sub 1 and Sub 2, also domestic corporations. Sub 1 and Sub 2 are members of Parent's consolidated group. Sub 1 conducts Business X through numerous foreign and domestic subsidiaries. Sub 2 wholly owns Foreign HoldCo, a foreign corporation organized under the laws of Country A. Sub 2 wholly owns Foreign HoldCo through Foreign DE1, a Country B entity disregarded for U.S. tax purposes. Foreign HoldCo owns all the interests of Foreign DE2, a Country A entity disregarded for U.S. tax purposes, which in turn owns all the interests of Foreign DE3, another Country A entity disregarded for U.S. tax purposes.

Prior to the transactions at issue, Target, a domestic corporation unrelated to Parent, also conducted Business X.

On Date 1, in an effort to expand its Business X, Parent announced that it would acquire all the stock of Target. Pursuant to a series of transactions,<sup>1</sup> Foreign DE3 acquired a% of the stock of Target in exchange for cash, and Sub 1 acquired the remaining b% of Target stock for cash. In addition, Sub 1 contributed \$ c to Target in exchange for newly issued Target stock. After these steps, Sub 1 and Foreign HoldCo (through Foreign DE2 and Foreign DE3) owned d% and e%, respectively, of the stock of Target.

On Date 2 and Date 3, pursuant to a series of transactions,<sup>2</sup> Target underwent an outbound reorganization described in section 368(a)(1)(F).<sup>3</sup> As a result of the reorganization, Target ceased to exist as a domestic corporation and converted to a foreign corporation ("Foreign NewCo"). Pursuant to the reorganization, Target was deemed to have transferred its assets, including the Intangible Property (which is described in section 936(h)(3)(B)), to Foreign NewCo.

Target's U.S. taxable year ended on Date 3 as a result of the reorganization.<sup>4</sup> After the reorganization, Sub 1 and Foreign HoldCo (through Foreign DE2 and Foreign DE3) owned d% and e%, respectively, of the stock of Foreign NewCo.

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<sup>1</sup> The detailed steps of the transactions are set forth in a Date 4 opinion letter issued to Parent by Accounting Firm, and in a Date 5 notice of proposed adjustment.

<sup>2</sup> Id.

<sup>3</sup> Target underwent the outbound reorganization prior to the end of the subsequent quarter of Foreign HoldCo's taxable year with the intent that the Parent consolidated group could avoid an income inclusion under section 956. The inclusion would have resulted from Foreign HoldCo holding the stock of Target, a domestic corporation, that constitutes U.S. property under section 956(c)(1)(B). Parent's Date 4 opinion letter at p. 76–78.

<sup>4</sup> Treas. Reg. § 1.367(a)-1T(e).

On its final federal income tax return, for the year ending Date 3, Target reported no income under section 367(d) as a result of its deemed transfer of the Intangible Property to Foreign NewCo.<sup>5</sup> Parent, however, reported \$ f of deemed royalty income under section 367(d) with respect to the deemed transfer on its Year 1 federal income tax return. This position was consistent with the advice provided to Parent by Accounting Firm in an opinion letter dated Date 4, which concluded that the regulations under section 367(d) were ambiguous but that it would be prudent for Parent to report the entire section 367(d) deemed royalty in its income.<sup>6</sup>

On Date 5, the Internal Revenue Service (Service) issued a notice of proposed adjustment to Parent, informing it that it had underreported its section 367(d) deemed royalty income from Foreign NewCo in Year 1 for Target's transfer of the Intangible Property. In its protest filed on Date 6, Parent asserted that its reported section 367(d) deemed royalty reflected an appropriate arms-length charge for the Intangible Property. Parent also argued, in the alternative, that because Target, the U.S. transferor of the Intangible Property, went out of existence in connection with the transfer, neither Target, nor Parent, nor any other taxpayer was required to report the section 367(d) deemed royalty relating to the Intangible Property. On Date 7, the Service issued a second notice of proposed adjustment to Target asserting that Target must recognize gain on the Intangible Property under section 367(d)(2)(A)(ii)(II), and proposing an adjustment of \$ g to Target's federal income tax return for the year ending Date 3. Parent, through its authorized representative Law Firm, responded to the arguments raised in the Date 7 notice of proposed adjustment in a letter dated Date 8.

This memorandum addresses the application of section 367(d) to Target's deemed transfer of the Intangible Property to Foreign NewCo as a result of the reorganization. It also responds to certain arguments made in Law Firm's Date 8 letter.

## LAW AND ANALYSIS

### **I. Exchanges Described in Section 351 or 361 – Overview of Subchapter C Rules**

As explained in greater detail below in section III of this memorandum, section 367(d)(1) applies if a U.S. person transfers intangible property to a foreign corporation in an exchange described in section 351 or 361. These two exchanges differ in many respects and, accordingly, different subchapter C provisions apply to them. Neither the statute nor the regulations under section 367(d) explicitly provide separate rules for each of these two types of exchanges. Nevertheless, section 367(d) applies to them differently. Thus, in order to properly apply section 367(d), it is important to analyze and

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<sup>5</sup> Target did report gain with respect to certain other assets under section 367(a). This memorandum does not address the treatment of assets other than the Intangible Property and, accordingly, does not address the application of section 367(a) to such other assets.

<sup>6</sup> Parent's Date 4 opinion letter at p. 68.

understand the application of the subchapter C rules that apply to the two types of transactions that give rise to exchanges described in section 351 or 361. The following provides a general overview of these exchanges in the context of a transfer of property by a U.S. person (U.S. transferor) to a foreign corporation (TFC).

#### A. Section 351 Exchange

In a section 351 exchange, the U.S. transferor transfers property to the TFC in exchange for stock of the TFC. Although the U.S. transferor realizes gain or loss in this exchange, section 351 provides that the U.S. transferor will not recognize gain or loss on the exchange if certain requirements are satisfied. In a typical section 351 exchange, the U.S. transferor will not go out of existence pursuant to the transaction. Accordingly, the U.S. transferor will have only a single exchange, will remain in existence, and will hold the TFC stock after the exchange.

#### B. Section 361 Exchange

A section 361 exchange occurs in connection with an asset reorganization described in section 368(a)(1).<sup>7</sup> In contrast with a section 351 exchange, which typically only involves a single exchange by the U.S. transferor, an asset reorganization involves both an exchange and a distribution by the U.S. transferor. The exchange and distribution are each analyzed separately for purposes of determining whether gain or loss is recognized under the subchapter C rules.

In a typical asset reorganization, the U.S. transferor (or “target”) transfers, or is treated as transferring, assets to TFC in exchange for TFC stock. The U.S. transferor then distributes, or is treated as distributing, the stock of TFC to the shareholders of the U.S. transferor and goes out of existence. The U.S. transferor’s shareholders exchange, or are treated as exchanging, their U.S. transferor stock for the TFC stock. Thus, the U.S. transferor is involved in both an exchange and a distribution. Even though the exchange and distribution occur pursuant to the same overall transaction (that is, a reorganization), each transfer is analyzed separately under the subchapter C rules (as well as under the international provisions, as discussed below in Section II of this memorandum).

Section 361(a) and (b) provide rules regarding the recognition of gain or loss on the U.S. transferor’s exchange of property for the TFC stock, and section 361(c) provides rules regarding the recognition of gain or loss on the U.S. transferor’s distribution of the TFC stock to the U.S. transferor’s shareholders. Sections 354 and 356 govern the

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<sup>7</sup> There are two general categories of transactions to which section 361 applies: acquisitive and divisive reorganizations. Because Target’s reorganization is acquisitive, this discussion will only address acquisitive reorganizations and will not consider divisive reorganizations.

recognition of gain or loss to the shareholders of the U.S. transferor on their exchange of the U.S. transferor stock for TFC stock.

## II. Characterization of the Reorganization

### A. Section 368(a)(1)(F) Reorganizations Involving Foreign Corporations

It is important to note that that even though a reorganization described in section 368(a)(1)(F) can be viewed as involving a single corporation for some purposes,<sup>8</sup> the U.S. transferor is treated as having both an exchange and a distribution in an outbound reorganization, such as the one at issue here. Both the exchange and the distribution must be analyzed separately for purposes of applying the international provisions, including section 367(d). It is particularly important to analyze the exchange and distribution separately when a U.S. person transfers assets to a foreign corporation because the transfer often represents the government's last chance to tax the transferred assets before they leave U.S. taxing jurisdiction. For this reason, the regulations under section 367(a) explicitly set forth the separate steps of an outbound reorganization under section 368(a)(1)(F):

In every reorganization under section 368(a)(1)(F), where the transferor corporation is a domestic corporation and the acquiring corporation is a foreign corporation, there is considered to exist –

(1) A transfer of assets by the transferor corporation to the acquiring corporation under section 361(a) in exchange for stock of the acquiring corporation and the assumption by the acquiring corporation of the transferor corporation's liabilities;

(2) A distribution of the stock (or stock and securities) of the acquiring corporation by the transferor corporation to the shareholders (or shareholders and security holders) of the transferor corporation; and

(3) An exchange by the transferor corporation's shareholders (or shareholders and security holders) of the stock of the transferor corporation for stock (or stock and securities) of the acquiring corporation under section 354(a).<sup>9</sup>

Several other authorities addressing cross-border asset reorganizations make clear that the reorganization is analyzed as two separate and distinct transfers for purposes of the international provisions of the Code. In Revenue Ruling 89-103,<sup>10</sup> the Service ruled that a conversion of a foreign corporation to a domestic corporation qualified as a reorganization under section 368(a)(1)(F) and is treated as: (1) a transfer by the foreign target corporation under section 361(a) of all of its assets and liabilities to a new

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<sup>8</sup> H.R. Rep. No. 760, 97th Cong., 2d Sess. 540, 541 (1982).

<sup>9</sup> Treas. Reg. § 1.367(a)-1T(f). See also Rev. Rul. 87-27, 1987-1 C.B. 134. Likewise, the regulations under section 367(b) contain a similar provision. Treas. Reg. § 1.367(b)-2(f) (inbound and foreign-to-foreign reorganizations).

<sup>10</sup> 1989-2 C.B. 65.

domestic corporation in exchange for stock of the domestic corporation; and (2) a distribution by the foreign target corporation under section 361(c) of the stock of the domestic corporation to the foreign target corporation's shareholders in exchange for their stock of the foreign target corporation.<sup>11</sup>

Importantly, this revenue ruling also makes clear that international provisions of the Code may apply to one or more of the transfers that occur pursuant to the reorganization. For example, the ruling provides that section 897(e)(1) may deny nonrecognition treatment under section 361(a) or (b) with respect to the transfer of U.S. real property interests by the foreign target corporation to the domestic corporation, and section 897(d)(1) may deny section 361(c) nonrecognition treatment to the foreign target corporation on its distribution of the stock of the domestic corporation if it constitutes a U.S. real property interest.<sup>12</sup> The fact that section 897 contains two provisions that each apply to one of the transfers that takes place pursuant to the reorganization demonstrates the importance of treating the reorganization as two separate transfers, each of which must be analyzed separately to determine its own independent tax consequences.

In summary, these authorities make clear that the various transfers or steps occur, or are deemed to occur, in connection with the reorganization to ensure that the international provisions – along with other Code provisions – properly apply to the transaction. These concerns are particularly important when property is transferred from a domestic corporation to a foreign corporation pursuant to the reorganization. Thus, section 367(d) must be applied by separately taking into account both the U.S. transferor exchange under section 361(a) or (b), as well as the U.S. transferor's distribution under section 361(c), even though they both occur pursuant to a single reorganization described in section 368(a)(1)(F).

## B. Target's Reorganization

Target underwent an outbound reorganization under section 368(a)(1)(F) pursuant to which it converted from a domestic corporation (Target) to a foreign corporation (Foreign NewCo). As a result of the reorganization, the following separate steps are deemed to occur:

1. Target transfers its assets to Foreign NewCo under section 361(a) in exchange for Foreign NewCo stock and the assumption by Foreign NewCo of Target's liabilities;
2. Target distributes the stock of Foreign NewCo to Target's shareholders (Sub 1 and Foreign HoldCo) pursuant to section 361(c); and

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<sup>11</sup> *Id.*; see also Rev. Rul. 88-25, 1988-1 C.B. 116; Rev. Rul. 87-66, 1987-2 C.B. 168.

<sup>12</sup> Rev. Rul. 89-103.

3. Target's shareholders (Sub 1 and Foreign HoldCo) exchange their Target stock for stock of Foreign NewCo pursuant to section 354.<sup>13</sup>

The tax consequences of each of these steps must be analyzed separately. Because Target's assets include the Intangible Property, the deemed transfer of the Intangible Property under section 361, as described in the first step above, is subject to section 367(d).<sup>14</sup>

### III. Application of Section 367(d)

Unlike section 367(b), which generally provides a broad grant of authority for regulations to set forth operative rules, section 367(d) sets forth self-executing and operative rules that apply to outbound transfers of intangible property. Section 367(d) does, however, provide a grant of authority to the Secretary to issue regulations that could modify the results that obtain under the statute. Therefore, when analyzing a transfer subject to section 367(d), one must first analyze the transaction under the statutory provisions, and then determine whether the regulations modify the result mandated by the statute.

#### A. The Statute and Legislative History

##### 1. *In General*

Once it is determined that a transfer is subject to section 367(d), section 367(d)(2)(A) applies to the U.S. person that transferred the intangible property ("U.S. Transferor"):

(A) IN GENERAL. If paragraph (1) applies to any transfer, the United States person transferring such property shall be treated as—

(i) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and

(ii) receiving amounts which reasonably reflect the amounts which would have been received—

(I) annually in the form of such payments over the useful life of such property,

or

(II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.

The amounts taken into account under clause (ii) shall be commensurate with the income attributable to the intangible.

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<sup>13</sup> Treas. Reg. § 1.367(a)-1T(f); Rev. Rul. 87-27, 1987-1 C.B. 134. Parent agrees that as a result of the reorganization, these three steps are deemed to occur. Law Firm's Date 8 letter at p. 6. Parent's Date 4 opinion letter also describes the transaction in this manner. Parent's Date 4 opinion letter at pp. 34–36.

<sup>14</sup> Parent agrees that Target's transfer of the Intangible Property to Foreign NewCo under section 361 is subject to section 367(d). Parent's Date 4 opinion letter at p. 74; Law Firm's Date 8 letter at p. 4.



Section 367(d)(2)(A) can be viewed as containing, in effect, two operative provisions. The first provision, provided in section 367(d)(2)(A)(i), characterizes the transaction. It provides that despite nonrecognition treatment accorded under section 351 or 361, the U.S. transferor is treated as having sold the intangible property in exchange for contingent payments.

The second provision, provided in section 367(d)(2)(A)(ii), sets forth what amounts are required to be reported under the statute. It provides that the contingent payments that the U.S. transferor is treated as receiving pursuant to the first provision must be taken into account in one of two ways. Section 367(d)(2)(A)(ii)(I) (the "General Rule") provides that the U.S. transferor is treated as receiving amounts which reasonably reflect the amounts which would have been received annually over the useful life of the intangible property ("General Rule Amounts"). Section 367(d)(2)(A)(ii)(II) ("Disposition Rule") then provides that, in the case of a direct or indirect disposition of the intangible property, the U.S. transferor is treated as receiving the amount that would have been received upon a disposition of such property ("Disposition Rule Amount").<sup>15</sup> Thus, the Disposition Rule requires the U.S. transferor to recognize an amount based on the value of the intangible at the time of the disposition.

Under the Disposition Rule, the property is disposed of directly when, for example, the transferee foreign corporation disposes of the intangible property it received in the transaction. An indirect disposition occurs, for example, when the U.S. transferor disposes of the stock of the transferee foreign corporation. This is made clear in the legislative history:

The conferees intend that disposition of (1) the transferred intangible by a transferee corporation, or (2) the transferor's interest in the transferee corporation will result in recognition of U.S.-source ordinary income to the original transferor. The amount of U.S.-source ordinary income will depend on the value of the intangible at the time of the second transfer.<sup>16</sup>

Thus, under the Disposition Rule, if the U.S. transferor disposes of the stock of the transferee foreign corporation, the U.S. transferor must recognize an amount that reasonably reflects a lump-sum amount that would have been received at the time of the disposition.

The policy underlying the Disposition Rule is straightforward. It operates as a backstop to the General Rule, ensuring that the U.S. transferor reports full compensation for the transferred intangible. The U.S. transferor can take into account the General Rule Amounts only so long as it continues to indirectly hold the intangible property by

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<sup>15</sup> The flush language following these rules further provides that these amounts "shall be commensurate with the income attributable to the intangible." The application of the commensurate with income provision to the transaction at issue is beyond the scope of this memorandum.

<sup>16</sup> H.R. Rep. No. 98-861, 98<sup>th</sup> Cong., 2d Sess., at 955 (1984) (Conf. Rep.).

retaining its interest in the transferee foreign corporation. But if the intangible property is directly or indirectly disposed of, the U.S. transferor can no longer take into account the amounts required to be reported by the statute under the General Rule. Thus, the Disposition Rule requires the U.S. transferor to take into account the Disposition Rule Amount to ensure that full compensation for the intangible is properly taken into account by the U.S. transferor.

In summary, the General Rule treats the U.S. transferor as receiving amounts that reasonably reflect amounts that would have been received annually over the useful life of the property. Thus, in order for the General Rule to apply, the U.S. transferor must remain in existence such that it can take the General Rule Amounts into account. Moreover, the General Rule can only apply only if the U.S. transferor retains the stock of the transferee foreign corporation. If the U.S. transferor goes out of existence or otherwise does not retain the stock of the transferee foreign corporation, then the Disposition Rule, by its terms, applies.

## *2. Application to Target*

As described above in section II.B. of this memorandum, Target is treated as transferring the Intangible Property to Foreign NewCo, a foreign corporation, in a section 361 exchange. Accordingly, section 367(d) applies to the transfer. Under the General Rule, Target would be treated as receiving the General Rule Amounts. However, immediately after the section 361 exchange, Target is treated as distributing the stock of Foreign NewCo to its shareholders (Sub 1 and Foreign HoldCo) pursuant to section 361(c) and going out of existence. This distribution constitutes a disposition of the stock of Foreign NewCo. As a result, the Disposition Rule applies and requires Target to report the Disposition Rule Amount. The application of the Disposition Rule in this case is appropriate. Absent the application of the Disposition Rule, upon going out of existence Target would be unavailable to be treated as receiving the General Rule Amounts. In such a case, the Disposition Rule should apply to require the U.S. transferor to report the Disposition Rule Amount at the time of the distribution.

Parent asserts that Target's distribution of the Foreign NewCo stock to its shareholders is not an indirect disposition of the Intangible Property because "the distribution is a transaction in which no gain or loss was recognized and the distribution was made to related parties."<sup>17</sup> Parent concludes that "there is no immediate recognition of section 367(d) royalties as a result."<sup>18</sup> Under this argument, therefore, a distribution constitutes a disposition only if gain or loss is recognized, or the distribution is to an unrelated party.

This argument is incorrect. Parent cites no authority or support for its position that the section 361(c) distribution does not constitute a disposition. Nor does Parent provide any reasoning or analysis as to why a disposition should be interpreted to have such a

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<sup>17</sup> Law Firm's Date 8 letter at p. 6.

<sup>18</sup> *Id.*

special, limited meaning. Nothing in the statute or regulations supports this interpretation. To the contrary, a distribution constitutes a disposition without regard to whether it qualifies for nonrecognition treatment or is made to an unrelated party. Indeed, if the Disposition Rule only applied to transfers to unrelated parties, as Parent asserts, there would be no need for the regulations under section 367(d) to provide any exceptions to the Disposition Rule for transfers to related parties, as discussed below in Section III.B. of this memorandum.

The Code uses the term “disposition” generally to refer to any transaction that satisfies the realization requirement, the most basic determination of whether an event has occurred that should be given effect for federal tax purposes. For example, section 1001(b) defines “amount realized” in terms of the amount that is received “from the sale or other disposition of property.” This indicates that the term “disposition” encompasses much more than a taxable sale, a construction made clear by the Supreme Court.<sup>19</sup> Once a transaction has satisfied the realization requirement, the various recognition and nonrecognition provisions of the Code provide whether the taxpayer is required to recognize gain or loss on the transaction.<sup>20</sup> Thus, the threshold question of whether a transfer is a disposition in which gain or loss is realized precedes the determination of whether it qualifies for nonrecognition treatment. Indeed, section 7701(a)(45) provides that “[t]he term ‘nonrecognition transaction’ means any disposition of property in a transaction in which gain or loss is not recognized in whole or in part for purposes of subtitle A” (emphasis added). Thus, rather than treating transfers as dispositions only if gain or loss is recognized, the Code generally treats all transfers as dispositions and then provides nonrecognition treatment for some of them.<sup>21</sup>

Similarly, the fact that the distribution was made to a related party is not relevant in determining whether the distribution constitutes a disposition. Various provisions apply to dispositions depending on whether they are between related persons,<sup>22</sup> but nothing suggests that a transfer constitutes a disposition only if it is between unrelated persons.

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<sup>19</sup> *Cottage Savings Inc. v. Commissioner*, 499 U.S. 554, 559 (1991) (“The parties agree that the exchange of participation interests in this case cannot be characterized as a ‘sale’ under § 1001(a); the issue before us is whether the transaction constitutes a ‘disposition of property’.”). The Court’s holding in *Cottage Savings* turned on whether the exchange of two similar properties constituted a disposition, an issue not relevant to this case.

<sup>20</sup> Section 1001(c) (“Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.”).

<sup>21</sup> As another example, section 1245 requires the inclusion of ordinary income in certain cases where “section 1245 property is disposed of.” That section contains exceptions for certain nonrecognition exchanges (e.g., those under section 332, 351, or 361). As section 1245 only applies to dispositions of property, if nonrecognition transfers were not “dispositions” there would be no need for Congress to provide an exception for them. See also section 897. Section 897(a) requires a nonresident alien individual or foreign corporation to take into account gain or loss “from the disposition of a United States real property interest.” Section 897(e) then provides an exception for nonrecognition transactions only where certain conditions are satisfied.

<sup>22</sup> For example, section 267(a) disallows losses on certain transfers of property to related persons. See also section 707(b) (disallowing losses on sales between related partnerships); section 1239 (recharacterizing gain as ordinary income on sales between related persons).

Finally, the plain meaning of the term “disposition” is not limited to transactions upon which gain is recognized or that involve unrelated parties. The definition of “disposition” in Black’s Law Dictionary simply reads “[t]he act of transferring something to another’s care or possession, esp. by deed or will; the relinquishing of property.”<sup>23</sup> Terms in a statute that are not specifically defined carry their ordinary meanings.<sup>24</sup>

In summary, a distribution constitutes a disposition without regard to whether gain or loss is recognized on the distribution, or whether the distributee is related. Therefore, Target’s distribution of the Foreign NewCo stock under section 361(c) constitutes a disposition. Accordingly, the statutory language of section 367(d) (*i.e.*, the Disposition Rule) unambiguously requires Target to take into account the Disposition Rule Amount at the time of the distribution of the Foreign NewCo stock to its shareholders (Sub 1 and Foreign HoldCo). Although this result is mandated without exception by a straightforward application of the statute, it must next be determined whether the regulations modify or otherwise affect this result.

#### B. Regulations under Section 367(d)

Consistent with the statute, the regulations under section 367(d) provide that the amounts required to be reported under the statute must be taken into account under either the General Rule or the Disposition Rule.<sup>25</sup> In addition, the regulations contain three rules that modify the Disposition Rule as it applies to indirect dispositions of the intangible property as a result of transfers of the stock of the transferee foreign corporation.<sup>26</sup> Thus, it must be determined whether any of these rules modify the result that obtains under the statute that Target is treated as receiving the Disposition Rule Amount at the time of the section 361(c) distribution of the Foreign NewCo stock to its shareholders.

##### *1. Subsequent Transfer of Transferee Foreign Corporation Stock to an Unrelated Person (Treas. Reg. § 1.367(d)-1T(d))*

Treasury Reg. § 1.367(d)-1T(d)(1) provides that if a U.S. person transfers intangible property that is subject to section 367(d) to a foreign corporation in an exchange

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<sup>23</sup> Black’s Law Dictionary (9th ed. 2009).

<sup>24</sup> *Crawford v. Metro. Gov’t of Nashville and Davidson County*, 555 U.S. 271, 276 (2009); *see also, e.g., Perrin v. United States*, 444 U.S. 37, 42 (1979); *Robinson v. Napolitano*, 554 F.3d 358, 365 (3d Cir. 2009).

<sup>25</sup> Treas. Reg. § 1.367(d)-1T(a).

<sup>26</sup> Treas. Reg. §§ 1.367(d)-1T(d), (e)(1), and (e)(3). Treas. Reg. § 1.367(d)-1T(a) makes clear that these paragraphs are implementing the Disposition Rule of the statute by stating that they “provide rules for cases in which there is a later direct or indirect disposition of the intangible property transferred.”

described in section 351 or 361, and within the useful life of the intangible property the U.S. transferor subsequently disposes of the stock of the transferee foreign corporation to a person that is not a related person (within the meaning of § 1.367(d)-1T(h)), then the U.S. transferor is treated as having simultaneously sold the intangible property to the person acquiring the stock of the transferee foreign corporation and recognizes full gain on the transferred intangible, measured as the difference between its fair market value on the date of the subsequent transfer and the U.S. transferor's original basis in the intangible as of the date of the original transfer. This treatment is consistent with the Disposition Rule in that it requires the U.S. transferor to take into account the Disposition Rule Amount, with certain adjustments to ensure the appropriate amount is taken into account.

This rule, by its terms, only applies to transfers of the transferee foreign corporation stock to unrelated persons. Here, Sub 1 and Foreign HoldCo are related, within the meaning of Treas. Reg. § 1.367(d)-1T(h), to Target. Accordingly, this rule does not apply and, as a result, does not modify the result under the Disposition Rule that Target is treated as receiving the Disposition Rule Amount at the time the stock of Foreign NewCo is distributed to Sub 1 and Foreign HoldCo under section 361(c).

It is important to note that this provision does not purport to set forth the only case in which the Disposition Rule applies. In other words, it does not preempt the application of the Disposition Rule provided under the statute. Indeed, this rule only explains how the Disposition Rule applies to a particular transfer – that is, where the transferee foreign corporation stock is transferred to an unrelated person. The Disposition Rule also applies to transfers of the transferee foreign corporation stock to related persons.<sup>27</sup> For this reason, the regulations provide two exceptions to the Disposition Rule in certain cases in which the transferee foreign corporation stock is transferred to related persons; in all other cases, the Disposition Rule applies to transfers of transferee foreign corporation stock to both related and unrelated persons. Thus, the next question is whether Target's transfer of Foreign NewCo stock to its shareholders in the section 361(c) distribution is described in, and eligible for, one of these two exceptions that apply to transfers made to related persons provided in Treas. Reg. § 1.367(d)-1T(e)(1) and (3).

## *2. Subsequent Transfer of Transferee Foreign Corporation Stock to a Related U.S. Person (Treas. Reg. § 1.367(d)-1T(e)(1))*

### (a) In General

Treasury Reg. § 1.367(d)-1T(e)(1) applies if a U.S. person transfers intangible property that is subject to section 367(d) to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that U.S.

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<sup>27</sup> If the Disposition Rule only applied to transfers to unrelated persons there would be no need for the related-person exceptions provided in Treas. Reg. § 1.367(d)-1T(e)(1) or (3), discussed below.

transferor subsequently transfers the stock of the transferee foreign corporation to U.S. persons that are related to the U.S. transferor (within the meaning of Treas. Reg. § 1.367(d)-1T(h)). In such a case, each such related U.S. person is treated as having received (with the stock of the transferee foreign corporation) a right to receive a proportionate share of the General Rule Amounts which would otherwise be deemed to be received by the U.S. transferor under Treas. Reg. § 1.367(d)-1T(c). In addition, because this rule requires that related U.S. persons take into account these amounts under the General Rule, the Disposition Rule Amount the U.S. transferor must take into account under the Disposition Rule is correspondingly reduced.<sup>28</sup>

This is the only rule in the regulations or statute that provides that a person other than the U.S. transferor is treated as receiving the General Rule Amounts or the Disposition Rule Amount. In all other cases, the U.S. transferor must take into account all required amounts under either the General Rule or the Disposition Rule.<sup>29</sup>

The scope and policy underlying this exception can best be understood through examples.<sup>30</sup>

*Example 1.* UST, a domestic corporation, transfers intangible property to TFC, a foreign corporation, solely in exchange for TFC stock pursuant to a section 351 exchange. After this exchange, UST transfers all of the TFC stock to USS, a domestic corporation wholly owned by UST, solely in exchange for USS stock in a section 351 exchange.

In this example, UST's transfer of the intangible property to TFC in the section 351 exchange is subject to section 367(d). Accordingly, as a result of the section 351 exchange, UST would be required to take into account the General Rule Amounts. However, UST's transfer of the TFC stock to USS constitutes a disposition. As a result, UST would be required to take into account the Disposition Rule Amount at such time, unless an exception applies. Because USS is a U.S. person that is related to UST, the exception in Treas. Reg. § 1.367(d)-1T(e)(1) applies and treats USS as having received, with the TFC stock, a right to receive the General Rule Amounts. Because a related U.S. person can continue to take into account the General Rule Amounts, this rule correspondingly reduces the amount that UST is deemed to receive under the Disposition Rule as a result of the disposition.<sup>31</sup>

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<sup>28</sup> Treas. Reg. § 1.367(d)-1T(e)(1)(iii).

<sup>29</sup> This is also the case for "direct" dispositions of the intangible property by the transferee foreign corporation. See Treas. Reg. § 1.367(d)-1T(f)(1)(i) (requiring the U.S. transferor of the intangible property, or a person treated as such under Treas. Reg. § 1.367(d)-1T(e)(1), to recognize gain).

<sup>30</sup> These examples are provided for illustrative purposes only and do not represent actual examples from the regulations under section 367(d).

<sup>31</sup> Treas. Reg. § 1.367(d)-1T(e)(1)(iii).

This exception can also apply to section 361(c) distributions of the transferee foreign corporation stock in connection with certain, but not all, outbound asset reorganizations.

*Example 2.* USP, a domestic corporation, owns all the stock of UST, a domestic corporation. UST transfers intangible property to TFC, a newly formed foreign corporation, in exchange solely for TFC stock in a section 361 exchange pursuant to a reorganization described in section 368(a)(1)(F). In connection with the reorganization, UST transfers the TFC stock to USP in a distribution described in section 361(c). USP exchanges its UST stock for TFC stock in a section 354 exchange.

In this example, UST's transfer of the intangible property to TFC in the section 361 exchange is subject to section 367(d). Accordingly, as a result of the section 361 exchange, UST would be required to take into account the General Rule Amounts. However, UST's distribution of the TFC stock to USP pursuant to section 361(c) constitutes a disposition. As a result, UST must take into account the Disposition Rule Amount at such time, unless an exception applies. The exception in Treas. Reg. § 1.367(d)-1T(e)(1) applies in this case because UST transfers the TFC stock to USP, a related U.S. person. Accordingly, USP is treated as having received, along with the TFC stock, the right to receive the General Rule Amounts that UST would have taken into account. Correspondingly, the Disposition Rule Amount UST must take into account is reduced.<sup>32</sup>

These two examples demonstrate that this exception applies to a transfer of the transferee foreign corporation stock only where the transferee foreign corporation stock is transferred to a related U.S. person that can be treated as receiving the General Rule Amounts going forward. It is only when the stock is transferred to such a U.S. person that this exception reduces the Disposition Rule Amount. Thus, consistent with the statute, this exception ensures that full compensation for the intangible is taken into account – either by the U.S. transferor as the Disposition Rule Amount, or as General Rule Amounts by a related U.S. person that receives the transferee foreign corporation stock in the disposition.

#### (b) Application to Target's Section 361(c) Distribution

In the transaction at issue, Target was deemed to have transferred stock of Foreign NewCo to its shareholders, Sub 1 and Foreign HoldCo. The exception provided in Treas. Reg. § 1.367(d)-1T(e)(1) applies to Target's distribution of the Foreign NewCo stock to Sub 1, a U.S. person that is related to Target within the meaning of Treas. Reg. § 1.367(d)-1T(h). Accordingly, Sub 1 is treated as having received, with the Foreign NewCo stock, a right to receive a proportionate share of the General Rule Amounts that

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<sup>32</sup> *Id.*

would otherwise be deemed to be received by Target. In addition, Target reduces the Disposition Rule Amount it is treated as receiving with respect to this transfer.<sup>33</sup>

This exception does not, however, apply to Target's distribution of the Foreign NewCo stock to Foreign HoldCo because Foreign HoldCo is not a U.S. person. Accordingly, Target is treated as receiving the Distribution Rule Amount with respect to the distribution of the Foreign NewCo stock to Foreign HoldCo at the time of the distribution, unless the exception in Treas. Reg. § 1.367(d)-1T(e)(3) applies.

### *3. Subsequent Transfer of Transferee Foreign Corporation Stock to a Related Foreign Person (Treas. Reg. § 1.367(d)-1T(e)(3))*

#### (a) In General

Treasury Reg. § 1.367(d)-1T(e)(3) provides:

If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers any of the stock of the transferee foreign corporation to one or more foreign persons that are related to the transferor within the meaning of paragraph (h) of this section, then the U.S. transferor shall continue to include in its income the deemed payments described in paragraph (c) of this section in the same manner as if the subsequent transfer of stock had not occurred. The rule of this paragraph (e)(3) shall not apply with respect to the subsequent transfer by the U.S. person of any of the remaining stock to any related U.S. person or unrelated person.

The scope and policy underlying this exception can best be understood through an example.

*Example 3.* UST, a domestic corporation, transfers intangible property to TFC, a foreign corporation wholly owned by UST, solely in exchange for TFC stock pursuant to a section 351 exchange. After this exchange, UST transfers all of the TFC stock to FN, a newly formed foreign corporation, solely in exchange for FN stock, pursuant to a section 351 exchange.

In this example, UST's transfer of the intangible property to TFC in the section 351 exchange is subject to section 367(d). Accordingly, as a result of the section 351 exchange, UST would be required to take into account the General Rule Amounts. As a result of UST's transfer of the TFC stock to FN, UST is treated as receiving the Disposition Rule Amount. However, because FN is a foreign person related to UST, Treas. Reg. § 1.367(d)-1T(e)(3) may change this result. In this case, UST's transfer of

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<sup>33</sup> Id.



the TFC stock to FN in exchange for FN stock qualifies for the exception because UST can continue to include in its income the General Rule Amounts in the same manner as if the transfer of the TFC stock to FN had not occurred.

As with the exception described above on transfers to a related U.S. person, the application of the exception under Treas. Reg. § 1.367(d)-1T(e)(3) to this fact pattern is consistent with the statutory framework, as well as Congressional intent, of ensuring that all of the amounts required to be reported under the statute are taken into account either under the General Rule or the Disposition Rule. UST, the U.S. transferor, remains in existence and the TFC stock is held by a related foreign person. Accordingly, UST can continue to take into account the General Rule Amounts such that the statutory requirement that the Disposition Rule apply to all dispositions need not apply. Thus, the regulations appropriately modify the result under the statute to allow UST to continue to take into account the General Rule Amounts.

(b) Application to Target's Section 361(c) Distribution

In the transaction at issue, Target transferred stock of Foreign NewCo to Foreign HoldCo and immediately went out of existence. Because the Foreign NewCo stock was transferred to Foreign HoldCo, a related foreign person, it appears at first glance to satisfy the predicate condition necessary for the application of the operative rule of Treas. Reg. § 1.367(d)-1T(e)(3). The operative rule provides:

[T]he U.S. transferor shall continue to include in its income the deemed payments described in [the General Rule] in the same manner as if the subsequent transfer of stock had not occurred.

The operative rule requires the U.S. transferor to continue to take into account the General Rule Amounts as if there had been no disposition of the transferee foreign corporation stock. This operative rule cannot be applied in this case because Target, the U.S. transferor, has gone out of existence. By its express terms, this exception only applies if the transfer of the transferee foreign corporation stock is to a related foreign person and the U.S. transferor continues to include the General Rule Amounts in its income. It is only in this case that the Disposition Rule will not apply to the transfer. In other words, this exception will apply and turn off the Disposition Rule only to the extent two requirements are satisfied. First, the transferee foreign corporation stock must be transferred to a related foreign person. Second, the U.S. transferor must continue to take into account the General Rule Amounts.

Parent asserts that Treas. Reg. § 1.367(d)-1T(e)(3) applies to Target's distribution of the Foreign NewCo stock to Foreign HoldCo and, as a result, there is no disposition that causes Target to take into account the Disposition Rule Amount. This argument appears to interpret the rule to apply in all cases where the transferee foreign corporation stock is transferred to a related foreign person. Under this interpretation, neither Target nor any related U.S. person would be treated as receiving compensation

for the transferred intangible; all of the amounts required to be reported under the statute would simply escape the application of section 367(d).

This argument is incorrect. Contrary to Parent's assertion, this exception does not apply to all transfers of transferee foreign corporation stock to related foreign persons, without regard to the treatment of the U.S. transferor. Instead, this rule, by its terms, requires the U.S. transferor to continue to take into account the General Rule Amounts as if the transfer did not occur.

Parent's argument, in effect, attempts to apply the second part of the operative rule without regard to the application of the first part. That is, Parent asserts that the U.S. transferor is treated "as if the subsequent transfer of stock had not occurred," even though the first part of the rule – "the U.S. transferor shall continue to include in its income the deemed payments" – is not satisfied, and in fact cannot be satisfied, because the U.S. transferor immediately goes out of existence in the reorganization. Such piecemeal and selective interpretation of the exception is incorrect. The provision must be construed in its entirety.<sup>34</sup>

This reading is not only incorrect as a technical matter, but it is also contrary to clear Congressional intent. As illustrated in the example above, the exception is premised on the U.S. transferor continuing to take into account the General Rule Amounts as if the disposition did not occur. That is, it turns off the Disposition Rule only to the extent the General Rule can continue to apply to the U.S. transferor. Parent's interpretation, on the other hand, would cause the amounts required to be reported under the statute to escape taxation entirely. The payments would not be subject to taxation under the General Rule or the Disposition Rule. Nothing in the statute, legislative history, or regulations supports this nonsensical result. In fact, and as noted above, the entire construct of the statute and regulations is designed to ensure the opposite occurs -- that all of the amounts required to be reported under the statute are treated as received under either the General Rule or the Disposition Rule. The Disposition Rule is turned off only when these amounts can continue to be treated as received either by the U.S. transferor (under this exception) or by a U.S. person related to the U.S. transferor (under the exception in Treas. Reg. § 1.367(d)-1T(e)(1)). Accordingly, Parent's argument that Treas. Reg. § 1.367(d)-1T(e)(3) causes the U.S. transferor to avoid taking into account the Disposition Rule Amount, as mandated by the statute, cannot prevail. Instead, Target must take into account the Disposition Rule Amount at the time of the section 361(c) distribution of Foreign NewCo stock to Foreign HoldCo.

Parent also cites a 1997 private letter ruling as support for its view that the Disposition Rule should not apply in the context of an outbound reorganization.<sup>35</sup> This ruling does

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<sup>34</sup> See *Barnes Transportation Co., Inc. v. Commissioner*, 14 T.C. 123, 126 (1950) ("It is a cardinal rule of construction that a statute is to be construed as a whole, and not as if each of its provisions was independent and unaffected by others."); *Alexander v. Casden Pipe Line Co.*, 290 U.S. 484, 496 (1934); *Helvering v. New York Trust Co.*, 292 U.S. 455 (1934).

<sup>35</sup> PLR 9731039 (Aug. 1, 1997).

not affect the case at hand. First, private letter rulings cannot be used or cited as precedent.<sup>36</sup> Second, the ruling does not address the question at issue here and, in fact, its analysis is consistent with the conclusion here. In the ruling, the intangible property is transferred pursuant to a section 351 exchange, not a section 361 exchange as is the case here. In addition, the ruling addresses the subsequent transfer of the stock of the transferee foreign corporation to another foreign corporation in a section 361(a) exchange, not the distribution of the transferee foreign corporation stock to a domestic corporation (Sub 1) and a foreign corporation (Foreign HoldCo) pursuant to a section 361(c) distribution as is the case here. These are different transactions involving different parties and different exchanges. Finally, despite addressing a different issue in a different transaction, the ruling provides that the Disposition Rule does not apply to the extent the stock of a foreign corporation that indirectly holds the intangible property is transferred to a related U.S. person that remains in existence following the transfer. This is entirely consistent with the conclusion here that Target is eligible for the exception under Treas. Reg. § 1.367(d)-1T(e)(1) for its distribution of Foreign NewCo stock to Sub 1, a related U.S. person that remains in existence, but subject to the Disposition Rule with respect to the distribution of the Foreign NewCo stock to Foreign HoldCo, a foreign person. Thus, the ruling does not in any way support Parent's position that the Disposition Rule does not apply.

In summary, Treas. Reg. § 1.367(d)-1T(e)(3) does not apply to Target's section 361(c) distribution of Foreign NewCo stock to Foreign HoldCo. This exception does not change the fact that Target (the U.S. transferor) must be treated as receiving the Disposition Rule Amount in cases not addressed by the exception. This exception, which is intended to ensure that the amounts required to be reported under the statute are treated as General Rule Amounts, simply cannot be used to assert that the amounts required under the statute are not treated as received under either the General Rule or the Disposition Rule, as Parent asserts here.

### C. Absence of Applicable Exception under the Regulations

Parent appears to contradict its assertion that the exception under Treas. Reg. § 1.367(d)-1T(e)(3) applies to Target's distribution of Foreign NewCo stock to Foreign HoldCo by stating that "neither section 367(d) nor the regulations under section 367(d) address what happens when the U.S. transferor either ceases to be a U.S. corporation or otherwise goes out of existence."<sup>37</sup> Thus, according to Parent, there is a "gap" in the statutory and regulatory scheme that the courts will construe against the Service and in favor of the taxpayer, "even if the court's failure to fill the gap leads to what may appear to be a windfall to the taxpayer from a policy perspective."<sup>38</sup> Parent concludes that no

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<sup>36</sup> Section 6110(k)(3); see also, e.g., *Blue Lake Rancheria v. United States*, 653 F.3d 1112, 1119 (9th Cir. 2011), *Lucky Stores, Inc. v. Comm'r.*, 153 F.3d 964, 967 n.5 (9th Cir. 1998).

<sup>37</sup> Law Firm's Date 8 letter at p. 9.

<sup>38</sup> *Id.*

royalty income must be taken into account at all under section 367(d) as a result of the reorganization.<sup>39</sup>

Parent is incorrect in asserting that the statute does not address the case at hand. As discussed above in section III.A of this memorandum, the Disposition Rule unambiguously provides that Target's distribution of the Foreign NewCo stock under section 361(c) is a disposition and, as a result, requires Target to be treated as receiving the Disposition Rule Amount at the time of the distribution. This result is reinforced by the accompanying legislative history.<sup>40</sup> Parent is correct, however, in asserting that the regulations do not address Target's distribution of Foreign NewCo stock to Foreign HoldCo.<sup>41</sup> As discussed above, none of the three rules in the regulations applies to Target's distribution of Foreign NewCo stock to Foreign HoldCo. Thus, the Disposition Rule, as provided in the statute, applies to the distribution and the regulations neither provide an exception to the Disposition Rule, nor a rule confirming the application of the Disposition Rule, to such distribution.

This does not create an ambiguity or "gap." Regulations can be issued to fill a "gap" left by the statute,<sup>42</sup> but the absence of a regulation addressing a transaction expressly covered by the statute does not create a gap. The silence of a regulation on a particular point addressed by the statute cannot give rise to an implication that the statute does not apply to that case. Regulations do not need to expressly confirm, or restate, a statutory rule in order for the statutory rule to apply.<sup>43</sup> Indeed, section 367(d) provides the opposite – that is, the rules set forth in the statute apply "except to the extent provided in regulations." Thus, the regulations can only modify the result that obtains under the statute. The absence of a regulation that modifies – or even confirms – a statutory provision does not negate or render inapplicable the statutory provision. To the contrary, the statutory provision (the Disposition Rule, in this case) applies in the absence of an applicable regulation modifying or confirming its application.

Further, the cases cited by Parent do not support its contention that any ambiguity in the rules should be interpreted in a manner that renders section 367(d) entirely inapplicable to the transaction.<sup>44</sup> Those cases specifically addressed an ambiguity in the underlying statute and concluded that such ambiguity must be resolved by Congress. No statutory

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<sup>39</sup> *Id.* at p. 4.

<sup>40</sup> H.R. Rep. 98-861, fn. 16, *supra*.

<sup>41</sup> As discussed above in section III.B.2. of this memorandum, the exception in Treas. Reg. § 1.367(d)-1T(e)(1) does apply to Target's distribution of the Foreign NewCo stock to Sub 1.

<sup>42</sup> *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 842–43 (1984) (quoting *Morton v. Ruiz*, 415 U.S. 199, 231 (1974)).

<sup>43</sup> This is in contrast to the uncertain application of statutory provisions that are to be implemented through regulations, where such regulations are not issued. See, e.g., *International Multifoods Corp. v. Commissioner*, 108 T.C. 579, 587 (1997); *Estate of Neumann v. Commissioner*, 106 T.C. 216, 221 (1996); *First Chicago Corp. v. Commissioner*, 88 T.C. 663, 669 (1987), *aff'd*, 842 F.2d 180 (7th Cir.1988).

<sup>44</sup> Law Firm's Date 8 letter at p.9, fn. 8.

ambiguity exists here, and the Congressional intent clearly indicates that Target should be subject to the Disposition Rule on its distribution of the Foreign NewCo stock to Foreign HoldCo. Indeed, in one of the cases that Parent cites, the court's decision was partly based on the grounds that the competing argument would have effectively read the Code provision at issue out of the statute.<sup>45</sup> That is precisely what Parent is seeking to do with respect to section 367(d) here. Further, that case involved a taxpayer seeking interest due on a refund issued by the Service. It does not follow that the equity principles discussed in that case should be extended as to allow a taxpayer to intentionally plan into what it perceives as an ambiguous provision so that it may entirely avoid the application of section 367(d).

Parent has also cited language in the preamble to regulations issued in 1998 under section 367(a)<sup>46</sup> in an attempt to show that the Service agrees with Parent's characterization of the law.<sup>47</sup> This position is erroneous. Specifically, the preamble states: "The regulations under section 367(d) do not address the tax consequences when the U.S. transferor goes out of existence pursuant to the transaction."<sup>48</sup> First, preambles to regulations unrelated to the regulations at issue are not authoritative and have no relevance.<sup>49</sup> Further, the provision cited by Parent refers specifically to the interplay of section 367(d) and indirect stock transfers governed by Treas. Reg. § 1.367(a)-3(d). The 1998 regulation was focused on indirect stock transfers under section 367(a), not section 367(d), and so its preamble discussion should not be read as an authoritative statement about the operation of section 367(d) to the transaction at issue here. Even if the language did bear on this issue, it is consistent with the position that the statutory Disposition Rule, and not the regulations, applies to the distribution of

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<sup>45</sup> *Coca-Cola Co. v. United States*, 87 Fed. Cl. 253, 259 (Fed. Cl. 2009).

<sup>46</sup> This Treasury Decision did add a minor rule under section 367(d) that defines a transfer by reference to regulations under section 367(a). This rule is not relevant to the matter at hand.

<sup>47</sup> T.D. 8770, 1998-2 C.B. 3, at 5.

<sup>48</sup> In its discussion of the 1998 preamble, Parent asserts that it is the Service's view that "the current statutory scheme does 'not address the tax consequences when the U.S. transferor goes out of existence pursuant to the transaction.'" Law Firm's Date 8 letter at p. 9, fn. 7 (emphasis added). In fact, as noted above, the preamble language that Parent references states that the "regulations under section 367(d) do not address the tax consequences when the U.S. transferor goes out of existence." T.D. 8770, 1998-2 C.B. 3, at 5. (emphasis added). In the preceding paragraph of the preamble, which discusses the interaction of section 367(d) and the indirect stock rules, the preamble does state that "the exact manner in which section 367(d) operates is less certain." However, a statement regarding the interaction of section 367(d) with the indirect stock transfer rules under section 367(a) is not relevant to the matter at hand. *Id.*

<sup>49</sup> *Hawaii v. Office of Hawaiian Affairs*, 556 U.S. 163, 175 (2009) ("[A]s the preamble is no part of the act, and cannot enlarge or confer powers, nor control the words of the act, unless they are doubtful or ambiguous, the necessity of resorting to it to assist in ascertaining the true intent and meaning of the legislature is in itself fatal to the claim set up.") (quoting *Yazoo & M. V. R. Co. v. Thomas*, 132 U.S. 174, 188 (1889)) (emphasis added); see also, e.g., *El Comité Para El Bienestar De Earlimart v. Warmerdam*, 539 F.3d 1062, 1070 (9th Cir. 2008); *Nat'l Wildlife Fed'n v. EPA*, 286 F.3d 554, 569 (D.C. Cir. 2002) ("The preamble to a rule is not more binding than a preamble to a statute . . . . Where the enacting or operative parts of a statute are unambiguous, the meaning of the statute cannot be controlled by language in the preamble.") (internal citations omitted).

Foreign NewCo stock to Foreign HoldCo. As stated above, it is true that none of the disposition rules in the section 367(d) regulations applies to Target's distribution of Foreign NewCo stock to Foreign HoldCo under section 361(c). It is the Disposition Rule of the statute that addresses this distribution. Nothing in this preamble suggests that the Disposition Rule does not apply to distributions of transferee foreign corporation stock to related foreign persons. Moreover, nothing in this preamble can be read as expressing the view that outbound asset reorganizations should be allowed to escape the application of section 367(d). Even if there were an ambiguity in the applicable regulations, such ambiguity must be resolved in a manner that gives effect to the meaning and purpose of the statute.<sup>50</sup> Parent's interpretation is contrary to both the meaning and the purpose of section 367(d).

Finally, Parent cites several private letter rulings that address certain issues that arise in the context of outbound asset reorganizations.<sup>51</sup> Parent asserts that because these rulings do not address the application of section 367(d), that taxpayers must "fill in the gaps left by the Service." These private letter rulings have no bearing on the issue at hand. Rulings that address issues arising in outbound reorganizations other than under section 367(d) simply cannot be interpreted to provide an exception to, or otherwise affect the application of, the Disposition Rule under the statute.

#### D. Relevance of Notice 2012-39

Parent argues that the Service is attempting to apply Notice 2012-39<sup>52</sup> (the "Notice"), retroactively.<sup>53</sup> This is not correct. Although the Notice does provide guidance under section 367(d) applicable to outbound asset reorganizations, by its terms it only applies to transactions occurring on or after July 13, 2012, a date that is several years after the transaction at issue. The Service is not relying on the Notice to support the application of section 367(d) to this transaction, but rather the Service is relying on the plain language of the statute. Because Target's section 361(c) distribution of the Foreign NewCo stock to its shareholders constitutes an indirect disposition of the Intangible Property, the Disposition Rule of the statute applies on its face. Applying the statute to

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<sup>50</sup> *Abbott Laboratories v. United States*, 84 Fed. Cl. 96, 107 (2008) ("this court is loathe to impute to Congress, and ultimately, the Treasury Department, a desire to produce such a counterintuitive result without at least some clearer textual support."); *Caldera v. J.S. Alberici Constr. Co.*, 153 F.3d 1381, 1383 (Fed. Cir. 1998) ("Statutes trump conflicting regulations"); *Progressive Corp. & Subsidiaries v. United States*, 970 F.2d 188, 192-93 (6th Cir. 1992) ("a construction that thwarts the statute which the regulation implements is impermissible"); *Estate of Schwartz v. Commissioner*, 83 T.C. 943, 954-55 (1984) (noting, in interpreting an ambiguous regulation, that "[t]he statutory language does not use the additional words found in the regulation thereunder that create the ambiguity ... The statutory language thus avoids and clarifies the ambiguity found in the regulation, and thereby obviates the need to invalidate the regulation.").

<sup>51</sup> Law Firm's Date 8 Letter at p. 10.

<sup>52</sup> 2012-31 I.R.B. 95.

<sup>53</sup> Law Firm's Date 8 Letter at pp. 10-12.

a transaction that occurred prior to the Notice is not in any way applying the Notice retroactively.

Nothing in the Notice suggests that all of the rules described therein reflect changes from current law. Indeed, the Notice expressly provides otherwise by stating that “[n]o inference is intended as to the treatment of transactions described in this notice under current law, and the IRS may challenge such transactions under applicable Code provisions or judicial doctrines.”<sup>54</sup> Moreover, the Service issued the NOPA several months prior to the issuance of the Notice and therefore could not have applied or even referenced the Notice if it were so inclined.

Some of the rules set forth in the Notice are consistent with, and therefore only reflect a confirmation of, prior law. For example, the Notice is consistent with the statutory Disposition Rule as it applies to section 361(c) distributions of transferee foreign corporation stock to foreign persons. Under both the statute and the Notice, such distributions require the U.S. transferor to take into account the Disposition Rule Amount at the time of the disposition. The Notice does, however, include some rules that reflect changes from prior law. For example, the rules described in the Notice modify the application of the exception under Treas. Reg. § 1.367(d)-1T(e)(1) so that it would only apply to section 361(c) distributions to domestic corporations (both related and unrelated), but not to U.S. Individuals, as is the case under the current regulations. In summary, the Service is not applying the Notice retroactively but is instead doing what it explicitly reserved the right to do in the Notice -- that is, to apply the Code to a prior transaction.

## CONCLUSION

Target’s section 361(c) distribution of Foreign NewCo stock pursuant to the reorganization is an indirect disposition of the Intangible Property. Accordingly, the plain language of section 367(d), along with its legislative history, make clear that the Disposition Rule requires Target to take into account the Disposition Rule Amount at the time of the distribution, unless an exception under the regulations would modify this result.

The exception under Treas. Reg. § 1.367(d)-1T(e)(1) applies to Target's 361(c) distribution of the Foreign NewCo stock to Sub 1, a related U.S. Person. Thus, Sub 1 is treated as receiving, along with the Foreign NewCo stock, a right to receive a

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<sup>54</sup> Notice 2012-39, 2012-31 I.R.B. 95, at § 5. See *Hinck v. U.S.*, 64 Fed.Cl. 71, 80 (2005) (“While that report continues that ‘[t]he Committee believes that it is appropriate for the Tax Court to have jurisdiction to review IRS’ failure to abate interest with respect to certain taxpayers,’ it hastens to add that ‘[n]o inference is intended as to whether under present law any court has jurisdiction to review IRS’ failure to abate interest.’ Accordingly, if anything, the legislative history of the 1996 Act indicates that Congress went to great pains to foreclose any assertion that, in affording jurisdiction to the Tax Court, it was *sub silentio* altering the prior decisional law involving justiciability”). See *Hadley v. Comm’r*, 819 F.2d 359, 360 (2d Cir.1987) (holding similar “no inference” language in legislative history indicates lack of intent to change the impact of the prior law).

proportionate share of the General Rule Amounts that would have been received by Target, and Target reduces the Disposition Rule Amount it is treated as receiving with respect to the transfer. The exception under Treas. Reg. § 1.367(d)-1T(e)(1) does not, however, apply to Target's distribution of Foreign NewCo stock to Foreign HoldCo because Foreign HoldCo is not a U.S. Person. The exception under Treas. Reg. § 1.367(d)-1T(e)(3) also does not apply to Target's distribution of Foreign NewCo stock to Foreign HoldCo because Target goes out of existence pursuant to the transaction. As a result, Target cannot continue to take into account the General Rule Amounts, as is required under the exception. Thus, because neither of the exceptions provided in the regulations applies, under the Disposition Rule Target must take into account the Disposition Rule Amount with respect to the Foreign NewCo stock distributed to Foreign HoldCo at the time of the distribution.

This treatment of Target's section 361(c) distributions of the Foreign NewCo stock is not only correct as a technical matter, but is also consistent with the policy underlying the statute because it ensures that all of the amounts are properly taken into account by Target, the U.S. transferor, or Sub 1, a related U.S. person.

Please call \_\_\_\_\_ if you have any further questions.