

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201432002**  
Release Date: 8/8/2014  
Index Number: 367.00-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:INTL:B04  
PLR-123908-13

Date:  
May 1, 2014

**Legend**

US Co =  
  
State A =  
  
Business B =  
  
Foreign Sub 2 =  
  
Country C =  
  
Foreign Sub 1 =  
  
Country D =  
  
FDE3 =  
  
Country E =  
  
FDE 2 =

x% =

y% =

FDE1 =

Parent =

Country F =

Country G =

Year 1 =

FA =

Dear :

This letter responds to your request for rulings dated May 15, 2013, regarding certain Federal income tax consequences, under the Internal Revenue Code of 1986, as amended (the "Code"), and the regulations thereunder, of a proposed transaction. Additional information was received in a letter dated April 23, 2014. The information provided in that request is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the ruling request. Verification of the information, representations, and other data may be required as part of the audit process.

#### SUMMARY OF FACTS

US Co is a State A LLC treated as a domestic corporation for U.S. tax purposes. US Co is currently constructing a facility in State A in order to conduct Business B.

All the shares of US Co are held by Foreign Sub 2, a Country C entity classified as a foreign corporation for U.S. tax purposes. All the shares of Foreign Sub 2 are held by Foreign Sub 1, a Country D entity also classified as a foreign corporation for U.S. tax purposes. Foreign Sub 1 also holds all the interests in FDE3, a Country E entity disregarded for U.S. tax purposes. FDE2 holds x% of the outstanding shares of Foreign Sub 1; the remaining y% of the outstanding shares of Foreign Sub 1 is held by other investors. FDE2 is a Country C entity disregarded for U.S. tax purposes, and x% represents a majority interest in the shares of Foreign Sub 1. FDE1, also a Country C entity disregarded for U.S. tax purposes, holds all the interests in FDE2. Parent, a Country F entity classified as a foreign corporation for U.S. tax purposes, holds all the interests in FDE1.

### PROPOSED TRANSACTION

In order to help fund the cost of expanding its Business B operations, Parent intends to conduct stock offerings of Foreign Sub 2. However, based on its own analysis and the recommendations of its financial advisers, Parent believes the stock offerings would be better effectuated under Country G law. Accordingly, and in anticipation of the stock offerings, in year 1 FDE3 formed FA, a Country G corporation.

In order to carry out the stock offerings in Country G, Parent will convert Foreign Sub 2 into FA in what it intends will qualify as a reorganization under section 368(a)(1)(F) of the Code ("F reorganization"). Specifically,

- 1) Foreign Sub 1 will contribute all its shares of Foreign Sub 2 to FDE3;
- 2) FDE3 will contribute all the shares of Foreign Sub 2 to FA in exchange for additional shares of FA;
- 3) Foreign Sub 2 will make an entity classification election pursuant to Treas. Reg. § 301.7701-3(c) to be treated as an entity disregarded for U.S. tax purposes, effective two days after FDE3's contribution of the shares of Foreign Sub 2 to FA.

After the F reorganization, Parent intends to initiate offerings of FA shares, in exchange for cash, in the following manner:

- 4) A private placement by FA of its only class of common stock ("FA Private Placement") with an unrelated private investor for no more than 20 percent of such outstanding stock.
- 5) An initial public offering ("FA IPO") by FA of its only class of common stock on a Country G stock exchange. After the FA IPO, the private investor that acquired FA shares in the FA Private Placement and the public shareholders

of FA will together hold no more than 49 percent of the outstanding shares of FA.

## REPRESENTATIONS

Parent has represented that

- 1) Foreign Sub 1's contribution of the Foreign Sub 2 shares to FA followed by the election to treat Foreign Sub 2 as a disregarded entity will qualify as an F reorganization.
- 2) After the proposed transaction, Foreign Sub 1 has no plan or intention to dispose of any of the FA shares it receives pursuant to the F reorganization.

## LAW

In an F reorganization of a foreign corporation, there is considered to exist: (i) a transfer of assets by the foreign transferor corporation to the acquiring corporation in exchange for stock (or stock and securities) of the acquiring corporation and the assumption by the acquiring corporation of the foreign transferor corporation's liabilities; (ii) a distribution of such stock (or stock and securities) by the foreign transferor corporation to its shareholders (or shareholders and security holders); and (iii) an exchange by the foreign transferor corporation's shareholders (or shareholders and security holders) of their stock (or stock and securities) for stock (or stock and securities) of the acquiring corporation. See, e.g., Treas. Reg. § 1.367(b)-2(f).

Section 7874 provides rules for expatriated entities and their surrogate foreign corporations. An expatriated entity is a domestic corporation (or domestic partnership) with respect to which a foreign corporation is a surrogate foreign corporation, and any United States person related to such domestic corporation (or domestic partnership) (within the meaning of sections 267(b) or 707(b)(1)). Section 7874(a)(2)(A).

A foreign corporation constitutes a surrogate foreign corporation if three conditions are satisfied. First, the foreign corporation completes, after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation. Section 7874(a)(2)(B)(i). Second, after the acquisition at least 60 percent of the stock of the foreign corporation (by vote or value) is held by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation. Section 7874(a)(2)(B)(ii). Third, after the acquisition the expanded affiliated group that includes the foreign corporation does not have substantial business activities in the foreign country in which, or under the law of which, the foreign corporation is created or organized, when compared to the total business activities of the expanded affiliated group. Section 7874(a)(2)(B)(iii). Similar rules apply if a foreign

corporation acquires substantially all the assets of a trade or business of a domestic partnership.

Where the former shareholders of the acquired domestic corporation hold at least 60 percent, but less than 80 percent, of the stock of the foreign acquirer, the domestic corporation shall include its inversion gain in its income for the year of the acquisition. Section 7874(a)(1). The corporation's inversion gain means:

[T]he income or gain recognized by reason of the transfer during the applicable period of stock or other properties by an expatriated entity, and any income received or accrued during the applicable period by reason of a license of any property by an expatriated entity--

- (A) as part of the acquisition described in subsection (a)(2)(B)(i), or
- (B) after such acquisition if the transfer or license is to a foreign related person.

Section 7874(d)(2). Where the former shareholders of the domestic corporation receive 80 percent or more of the foreign acquiring corporation by reason of their ownership of the domestic corporation, the foreign acquiring corporation shall be treated as a domestic corporation for all purposes of the code. Section 7874(b).

Section 7874(c)(1) defines an expanded affiliated group as an affiliated group as defined in section 1504(a) but without regard to section 1504(b)(3), except that section 1504(a) shall be applied by substituting "more than 50 percent" for "at least 80 percent" each place it appears.

Under section 7874(c)(2), certain stock of the foreign corporation is not taken into account in determining ownership under section 7874(a)(2)(B)(ii) ("Ownership Fraction"): (A) stock of the foreign corporation held by members of the expanded affiliated group that includes the foreign corporation, and (B) stock of the foreign corporation sold in a public offering related to the acquisition described in section 7874(a)(2)(B)(i).

In discussing the expanded affiliated group rule in section 7874(c)(2)(A), the General Explanation prepared by the Joint Committee on Taxation provides:

[I]f a U.S. parent corporation converts an existing wholly owned U.S. subsidiary into a new wholly owned controlled foreign corporation, all stock of the new foreign corporation would be disregarded, with the result that the transaction would not meet the definition of an inversion under the provision.

Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress, (JCS-5-05), at 344 (May 2005).

Treasury Reg. § 1.7874-4T(b) provides that, subject to an exception, disqualified stock is treated as stock described in section 7874(c)(2)(B) and therefore is not included in the denominator of the Ownership Fraction. Treasury Reg. § 1.7874-4T(c) defines disqualified stock to include stock of the foreign acquiring corporation that is transferred in exchange for nonqualified property. Nonqualified property includes cash. Treas. Reg. § 1.7874-4T(i)(7)(i).

Treasury Reg. § 1.7874-5T(a) provides that stock of a foreign corporation described in section 7874(a)(2)(B)(ii) will not cease to be so described as a result of a subsequent transfer of the stock by the former shareholder that received such stock, even if the subsequent transfer is related to the acquisition described in section 7874(a)(2)(B)(i).

## RULINGS

Based solely on the information and representations submitted in the taxpayer's ruling request, we rule as follows:

- 1) The FA shares treated as received by Foreign Sub 2 in the section 361(a) exchange in connection with the F reorganization will be described in section 7874(a)(2)(B)(ii) and will not cease to be so described as a result of Foreign Sub 2's section 361(c) distribution of such shares that is deemed to occur as a result of the F reorganization. Treas. Reg. § 1.7874-5T(a).
- 2) Shares issued by FA pursuant to the FA Private Placement and the FA IPO will not be included in the denominator of the Ownership Fraction. Section 7874(c)(2)(B) and Treas. Reg. § 1.7874-4T(b).
- 3) The FA shares treated as issued in exchange for the shares of US Co pursuant to the F reorganization will be excluded from both the numerator and the denominator of the Ownership Fraction. Section 7874(c)(2)(A) and Treas. Reg. § 1.7874-1(b).
- 4) The Ownership Fraction will be zero over zero. Accordingly, the requirement described in section 7874(a)(2)(B)(ii) will not be satisfied, and FA will not be a surrogate foreign corporation within the meaning of section 7874(a)(2)(B).

## CAVEATS

Except as expressly provided above, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including whether the reorganization qualifies as a reorganization within the meaning of section 368(a)(1)(F) of the Code.

Section 897(c)(1)(A)(i) provides that any interest in a domestic corporation is a U.S. real property interest unless the taxpayer establishes that such corporation was at no time a U.S. real property corporation during the five year period ending on the date of disposition. Accordingly, unless Foreign Sub 2 establishes that US Co was not a U.S. real property holding corporation within the five year period ending on the date of the transfer of the US Co stock, the transfer of the stock of US Co by Foreign Sub 2 to FA is subject to the rules of section 897(e), section 1.897-6T(b) and section 1445.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Charles P. Besecky  
Branch Chief, Branch 4  
(International)

cc: