Leveraging Outbound Transfers of Corporate Stock and Other Property
Navigating Sect. 367 Gain Recognition Agreements and Sect. 6038B Regs in Cross-Border Transactions

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Today’s faculty features:
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Leveraging Outbound Transfers of Corporate Stock and Other Property:

Navigating Section 367 Gain Recognition Agreements and Section 6038B Regulations in Cross-Border Transactions

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Scope of Section 367(a)

- Section 367(a) is the gatekeeper for tax-free treatment of all outbound transactions.
- Section 367(a) broadly applies to all transfers of property to a foreign corporation.
- Transfer of partnership interest is treated as a transfer of partner’s proportionate share of partnership property.
Section 367(a): In or Out

Scope of 367(a) includes:

- Certain Section 351 transactions for both domestic and foreign corporations (formation of corporations, contributions by controlling shareholders).
- Section 368 reorganizations involving foreign corporations.
- Transfers of domestic and foreign stock and securities to foreign corporations.
- Indirect (such as triangular reorganizations and reverse subsidiary mergers) and constructive transfers of stock and securities to foreign corporations.
- Outbound liquidations of domestic corporations into foreign parents (chiefly governed by 367(e) with similar principles).
General Principles of Section 367(a)

- If the transaction fails tax-free treatment under Section 367(a), gain, but not loss, is recognized. Notably, the amount of gain is not offset by any losses. 1.367(a)-1T(b)(1); -1T(b)(3).

- Direct transfers of property (other than stock and securities) to a foreign corporation are generally taxable, unless they qualify for the 367(a)(3) foreign trade or business exception.

- Under the 367(a) anti-inversion rules, transfers of domestic stock to a foreign corporation are generally taxable, unless (i) the transferors receive less than 50% of Foreign Acquirer, (ii) there is no Control Group, (iii) the active foreign trade or business test is satisfied including the substantiality requirement, and (iv) the U.S. Transferor complies with reporting requirements (including GRAs).

- Transfer of foreign stock or securities to a foreign corporation generally qualify as tax free, provided 5% shareholders comply with reporting requirements (including GRAs).

- Complex indirect stock transfer and coordination rules apply to certain
  - Triangular “A,” “B” and “C” reorganizations.
  - Asset Reorganizations (“C” or “D” reorganizations) followed by Section 351 Pushdowns.
  - Successive Section 351 Pushdown transactions.
Limited Exceptions for Section 367(a)

- Recapitalizations under 368(a)(1)(E).
- Foreign-to-Foreign Asset Reorganizations such as “D” Reorganizations.
- Foreign-to-Foreign “F” Reorganizations.
- Transfers to Foreign Partnerships.
Transfers of Assets (other than Stock and Securities)

- Tax-free if assets qualify for the 367(a)(3) foreign trade or business exception (except for certain assets).
- Can include U.S. assets, as long as primary managerial and operational activities are conducted outside the U.S., as defined in 1.367(a)-2T(b)(2).
- Have to comply with reporting under 6038B, but no GRA (except if there is an indirect stock transfer).
- Subsequent transfer of assets by transferee is taxable (unless it qualifies as a cascading Section 351 or Section 721 transfer).
Assets Taxable under Section 367(a)

- Depreciated property used in the U.S.. 1.367(a)-4T.

- Inventory; deferred amounts under installment obligations and receivables; foreign currency and foreign currency obligations (other than certain ordinary course obligations denominated in local foreign currency); and leased tangible property (other than used in a trade or business). 1.367(a)-5T.

- Amount of gain included in income related to foreign currency and foreign currency obligations is limited to net gain. 1.367(a)-5T(d)(3).

- Intangibles (other than goodwill or going concern value) are generally taxable under 1.367(d)-1T(b).

- Losses of a Foreign Branch must be recaptured under 1.367(a)-6T.
Dispositions of Assets by Foreign Acquirer Following Transfer

- If the foreign transferee transfers or disposes of the assets as part of the same transaction as the transfer, the initial transfer of 367(a)(2) assets is taxable.

- Generally treated as part of the same transaction if (i) completed within 6 months of initial transaction or (ii) under step transaction principles. No safe harbor for transfers completed after 6 months. 1.367(a)-2T(c)(1).

- However, a subsequent transfer qualifying as a Section 351 contribution or Section 721 contribution can qualify as tax-free. 1.367(a)-2T(c)(2).

- Cascading Section 351 transfers are treated as both an asset transfer and an indirect stock transfer.
Dispositions of Assets by Foreign Acquirer Following Tax-Free Transfer

- In a cascading transaction, the U.S. Transferors qualify for tax-free treatment if: (i) each transfer qualifies as a tax-free Section 351 or Section 721 transfer, (ii) the transferor receives either common stock or is a general partner in the transferee partnership, and (iii) the bottom-tier entity uses the assets in the active conduct of a foreign trade or business. 1.367(a)-2T(c)(2).

- In a cascading Section 351 transaction, U.S. transferors are treated as indirectly transferring stock of Foreign Controlled Corporation to Foreign Acquirer. 1.367(a)-3(d)(1)(vi). This triggers a requirement to file a GRA with respect to the built-in gain in Foreign Controlled.
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Asset Reorg with Domestic Transferor

- A “C” Reorganization Involving a Domestic Acquired Corporation and Foreign Acquirer is taxable, unless it qualifies for the limited exception described in 1.367(a)-7(c). (1.367(a)-7 regulations were finalized April 2013.)

- To qualify as tax-free, Domestic Acquired must: (i) be controlled by 5 or fewer domestic corporations under 367(a)(5); (ii) recognize certain gain; (iii) make basis adjustments in stock of FA received; (iv) satisfy reporting requirements; and (v) otherwise satisfy the requirements for outbound asset transfers.

- Transferor’s basis in FA stock is generally reduced so that its outside gain is at least equal to its attributable share of Domestic Acquired’s inside gain. Gain may be recognizes if insufficient basis.

- A transfer by a non-corporate transferor does not qualify for tax-free treatment because of repeal of General Utilities under Section 367(a)(5): assets are leaving U.S. corporate solution.
Reporting Requirements for Outbound Asset Reorganization

- Domestic Acquired must agree to report the transaction on its return and enter into an agreement similar to a GRA. 1.367(a)-7(c)(4). The deferred gain is triggered if a significant amount of the assets (generally 40%) is disposed of in one or more “gain recognition transactions” within 5 years of the transfer. 1.6038B-1(c)(6)(iii).

- Gain Recognition Transactions. Any disposition within 2 years of the transfer is presumed to be a gain recognition transaction. Exceptions apply to dispositions in the ordinary course of business and certain tax-free transactions such as Section 351 pushdowns.

- Each “control group member” (i.e., the U.S. corporate transferors that own Domestic Acquired) must include a statement electing non-recognition treatment on its return. 1.367(a)-7(c)(5)(ii).

- Domestic Acquired and control group members must enter into an agreement describing certain aspects of the transaction and produce the agreement on demand by the IRS. 1.367(a)-7(c)(5)(iv).

- Non-willful failures to comply will be deemed not to have occurred, if taxpayer (i) files amended tax return with necessary information and explanatory statement and (ii) notifies its auditor (if any). 1.367(a)-7(e)(2)(ii).
Requirements for Tax-Free transfers of Domestic Stock under 1.367(a)-3(c)

- U.S. Transferors may only receive 50% or less of vote and value of Foreign Acquirer.
  - U.S. transferors includes U.S. Persons who transfer stock of the domestic corporation.
  - All shareholders are presumed to be U.S..
  - May use Ownership Statement to establish non-U.S. status.

- 50% or less of vote and value of Foreign Parent is owned by the Control Group, which includes:
  - U.S. officers and directors of U.S. Target.
  - U.S. 5% shareholders of U.S. Target.

- Options may be deemed exercised for purposes of the 50% vote and value test or the Control Group test.

- Must satisfy Active Trade or Business Test.
Active Trade or Business Test under 1.367(a)-3(c)

- Foreign Acquirer ("FA") or an affiliate must be engaged in an active trade or business outside the U.S. (as defined in 1.367(a)-2T(b)(2)) for 36-month period before transfer. FA must have no intention to dispose of foreign business.

- May include a 36-month foreign trade or business acquired by FA at the time of or prior to the exchange, except:
  - Cannot include any trade or business owned by the U.S. target or an affiliate within the 36-month period before the exchange.
  - Cannot include any acquisition if the principal purpose was to satisfy active trade or business test.

- FA must satisfy Substantiality Test.
  - Deemed satisfied if fair market value of FA is at least as much as U.S. Target.
  - Cannot include any of the following assets acquired within 36 months of transfer: (i) passive assets, (ii) assets owned by U.S. Target or its affiliates, and (iii) any assets acquired for purposes of Substantiality Test. (Note new skinny-down rules under Notice 2014-52.)

- Notably, there is no requirement for FA's foreign trade or business to constitute a set percentage of FA's value for the substantiality test. FA may only have a nominal foreign trade or business.

- If the taxpayer is in “substantial compliance,” may apply for a PLR. 1.367(a)-3(c)(9).
Reporting Requirements for Tax-Free Transfer of Domestic Stock

- 5% Shareholders must file GRAs and comply with Section 6038B.
- If 10% or more of the vote or value of the domestic target corporation is transferred by U.S. persons, the U.S. company must attach a special statement described under 1.367(a)-3(c)(6).
Transfers of Foreign Stock and Securities

- Pursuant to 1.367(a)-3(b), a transfer of foreign stock is generally tax-free provided shareholders comply with GRA and other reporting requirements. No restriction on ownership of FA.

- 5% shareholders must file GRAs and comply with Section 6038B.

- May be subject to 367(b) and the preservation of Section 1248 amounts.
Indirect Stock Transfers: Triangular Reorganizations and Pushdowns

- Under 1.367(a)-3(d), triangular reorganizations and pushdowns may be treated as indirect stock transfers.
- Forward or Reverse Triangular mergers.
- Triangular “B” and “C” reorganizations.
- An asset reorganization followed by a Section 351 pushdown.
- Successive Section 351 pushdowns.
Reverse Triangular Merger as Indirect Stock Transfer, 1.367(a)-3(d)(e), Ex. 11

- D merges into Z, with Z surviving. V exchanges its Z stock for 55% of the stock of F.

- V is treated as indirectly transferring its Z stock to F. No gain recognition if V files GRA. No gain under 367(b) because F is a CFC and 1248 amounts are preserved.

- D is treated as transferring all its assets to Z. Under 367(a)(5), D does not satisfy control requirement and therefore recognizes all gain.

- If Z is domestic, V’s indirect transfer of stock is taxable.
Leveraging Outbound Transfers of Corporate Stock and Other Property
Navigating Section 367 Gain Recognition Agreements and Section 6038B Regulations in Cross-Border Transactions

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2014 Gain Recognition Agreement ("GRA") Regulations

Background

• On November 18, 2014, the Internal Revenue Service ("IRS") issued final and temporary regulations (T.D. 9704) under Section 367 and Section 6038B regarding the failure to timely file gain recognition agreements ("GRAs") and other documents related to the transfer of stock or securities by US persons to foreign corporations, and the failure to satisfy other reporting obligations associated with certain transfers of property to foreign corporations ("2014 GRA Regulations").¹

• The 2014 GRA Regulations amended and adopted proposed regulations issued on January 31, 2013 ("Proposed Regulations").

Key Changes

• Withdrawal of 2010 GRA Directive

• Willful standard of relief for GRA non-compliance

• Section 6038B compliance clarified in cases where GRA is filed

• Willful standard of relief for non-compliance with other Section 367(a) transfers
GRA Requirements

- General rule of §367(a) taxes US transferors of property to a foreign corporation ("TFC") pursuant to certain non-recognition exchanges (i.e., §332, 351, 354, 356 or 361). Reg. §1.367(a)-3(b), (c).

- Reg. §1.367(a)-3(b) exception for certain outbound transfers of foreign stock or securities
  - 5% shareholders can file a GRA to avoid §367(a) gain.
  - Less than 5% shareholders do not recognize §367(a) gain.

- Reg. §1.367(a)-3(c) exception for certain outbound transfers of domestic stock or securities
  - Under the §367(a) anti-inversion rules, if (1) US transferors receive 50% or less of TFC stock, (2) there is no Control Group, (3) active trade or business test (including the substantiability requirement) is satisfied, and (4) US target company complies with reporting requirements, then GRA rules described above should apply.

- Reg. §1.367(a)-8(c)(2) terms of GRA
  - GRA includes a description of the outbound transfer, the transferred stock or securities (i.e., FMV, adjusted basis, recognized gain), the TFC, etc.
  - US transferor agrees to include in income gain realized but not recognized with respect to transferred stock if a gain recognition event ("GRE") occurs within 5 years
    - A GRE is an event which requires gain to be recognized under a GRA
    - Default rule provides that GRA gain is reported in year of initial transfer
    - US transfer may elect in GRA to instead report GRA gain in year of GRE
    - If GRA gain results in additional tax liability, interest is charged at §6621 rates for period beginning on date tax return for the taxable year of initial transfer was due until the date additional tax is paid
  - Agreement to extend SOL for 8 years
  - Annual certification
GRA Triggering Events and Exceptions

- Under Reg. §1.367(a)-8(j), triggering events include:
  - Disposition of transferred stock or securities.
  - Disposition of substantially all the assets of the transferred corporation.
  - Disposition of transferred partnership interests.
  - Consolidation or deconsolidation of U.S. transferor.
  - Failure to comply.
  - Disposition of stock of acquiring corporation in indirect stock transfers.

- Under Reg. §1.367(a)-8(k), the exceptions to triggering events include:
  - Tax-free pushdowns of stock of TFC to a corporation or partnership, including “B” reorganizations and spin-offs.
  - Tax-free liquidation of U.S. transferor.
  - Tax-free transfers of transferred stock to corporation or partnership if US transferor enters into a new GRA.
  - Certain asset reorganizations and triangular reorganizations if US transferor enters into a new GRA.
  - Consolidation and deconsolidation of U.S. transferor if the U.S. transferor enters into a new GRA.
  - Certain inter-company transactions.

- Under Reg. §1.367(a)-8(o), certain taxable dispositions of TFC stock or assets of certain domestic transferred corporations, and certain tax-free inbound distributions of transferred stock, terminate or reduce the amount of gain subject to the GRA without the punitive interest charge.
**Example 1**

- A and B are unrelated US persons
- A realizes $80 million gain and B realizes $5 million gain on the transfer, which otherwise qualifies for non-recognition treatment under §351
- **Does A recognize gain under §367(a)?**
  - If A does not file a GRA, then A must recognize $80 million built-in gain
  - If A files a GRA, then A does not recognize gain
  - If FC1 stock within 5 years, then A must recognize $80 million GRA gain plus interest accrued from date of initial transfer
- **Does B recognize gain under §367(a)?**
  - No, because B owns less than 5% of FC2
- **Do A or B have any other reporting requirements?**
§6038B Requirements

- Under §6038B, a US transferor of property in a §367(a) transfer is required to file Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation." Reg. §1.6038B-1(b)(2)(iv).

- US transferor of foreign stock or securities subject to §367(a)
  - 5% shareholders that file a GRA must also file Form 926 (completing Parts I and II, providing FMV, AB and gain recognized with respect to transferred stock in Part III, and providing statement that a GRA is being filed pursuant to Reg. §1.367(a)-8). Reg. §1.6038B-1(b)(2)(iv). See Appendix I.
  - Less than 5% shareholders generally are not required to file Form 926. Reg. §1.6038B-1(b)(2)(i)(A)(1).

- U.S. transferor of property to a foreign partnership in a §721 contribution
  - Form 8865, “Return of U.S. persons with respect to certain foreign partnerships" required if:
    - 10% or greater partners; or
    - Value of property contributed during 12-month period ending on date of transfer exceeds $100,000.

- Consequences of non-compliance with §6038B
  - Penalty equal to 10% of FMV of transferred stock, up to a maximum of $100,000 unless failure due to intentional disregard. Reg. §1.6038B-1(f)(1).
Example 1 (cont'd)

- Do A or B have any other reporting requirements?
  - Under §6038B, A must file Form 926
  - B is not required to file Form 926 because it owns less than 5% of FC2

- What if A fails to file Form 926?
  - If A's failure was not due to intentional disregard, subject to penalty of $100,000
  - However, if A's failure was due to intentional disregard, subject to penalty of $9 million (10% x $90 million)

- Can A obtain relief from §6038B penalty?
  - Yes, but only if A can demonstrate that the failure was due to reasonable cause and not willful neglect and A:
    - Promptly files an amended return which includes the Form 926 and a written reasonable cause statement; and
    - Delivers copies to the Director of Field Operations International, Large Business & International.
Example 1 (cont'd)

- What if A files a Form 926 but not a GRA?
  - Under §367 regulations, A must recognize $80 million built-in gain; AND
  - Under §6038B, A is subject to penalty of $100,000, or $9 million (if intentional). Reg. §1.6038B-1(f).

- Can A obtain relief if failure to comply was not due to reasonable cause?
  - Under Reg. §1.367(a)-8(p), A can obtain relief from §367(a) gain recognition if A can demonstrate that the failure to file a GRA was not willful and A:
    - Promptly files an amended return which includes the GRA and a written statement explaining the reasons for failure to comply; and
    - Delivers copies to the Director of Field Operations International, Large Business & International
  - A still subject to $100,000 penalty under §6038B if failure not due to reasonable cause, even if not intentional. Reg. §1.367(a)-2(f)(2)(i).

- How can A demonstrate that failure to file a GRA was not willful?
Willful Standard of Relief for GRA Non-Compliance

  • The 2010 GRA Directive permits taxpayers to remedy, without having to demonstrate reasonable cause, unfiled or deficient GRA documents associated with a timely filed initial GRA or a timely filed document purporting to be an initial GRA.

• Determination made by Director of Field Operations International, Large Business & International

• Based on all facts and circumstances

• Meaning of "willful"
  • Gross negligence, reckless disregard or willful neglect
  • "Available upon request"
  • Consider GRA filing history and implementation of procedural filing safeguards
  • Examples of Treas. Reg. section 1.367(a)-8(p)(3)
Examples of Treas. Reg. section 1.367(a)-8(p)(3)

• DC, a domestic corporation, wholly owns FS and FA, each a foreign corporation. In Year 1, pursuant to a transaction qualifying both as an exchange under section 351 and a reorganization under section 368(a)(1)(B), DC transferred all the FS stock to FA solely in exchange for voting stock of FA (FS Transfer). The fair market value of the FS stock exceeded DC’s tax basis in the stock at the time of the FS transfer.

• Example 1. Failure to file GRA due to accidental oversight.

• Facts. DC filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock. DC, through its tax department, was aware of the requirement to file a GRA in order for DC to avoid recognizing gain with respect to the FS Transfer under section 367(a)(1), and had the experience and competency to properly prepare the GRA. DC had filed many GRAs over the years and had never failed to timely file a GRA. However, although DC prepared the GRA with respect to the FS Transfer, it was not filed with DC’s tax return for the year of the FS Transfer due to an accidental oversight. During the preparation of the following year's tax return, DC discovered that the GRA was not filed. DC filed an amended return to file the GRA and complied with the procedures set forth under paragraph (p)(2) of this section promptly after it became aware of the failure.

• Result. Based on facts, including that failure to timely failed GRA was an isolated and accidental oversight, the failure to timely file is not a willful failure to file.
Examples of Treas. Reg. section 1.367(a)-8(p)(3)

- Example 2. Course of conduct taken into account.
- Facts. DC filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock, but failed to file a GRA. DC, through its tax department, was aware of the requirement to file a GRA in order for DC to avoid recognizing gain with respect to the FS Transfer under section 367(a)(1). DC had not consistently and in a timely manner filed GRAs in the past, and also had an established history of failing to timely file other tax and information returns for which it was subject to penalties. In a year subsequent to Year 1, DC transferred stock of another foreign subsidiary with respect to which DC had a built-in gain (FS2) to FA in a transaction that qualified as both a reorganization under section 368(a)(1)(B) and an exchange described under section 351 (FS2 Transfer). DC was required to recognize gain on the FS2 Transfer under section 367(a)(1) unless DC timely filed a GRA as required by paragraph (d)(1) of this section and complied with the requirements of this section during the term of the GRA. DC reported no gain on the FS2 Transfer on its tax return, but failed to file a GRA. At the time of the FS2 Transfer, DC was already aware of its failure to file the GRA required for the prior FS Transfer, but had not implemented any safeguards to ensure that it would timely file GRAs for future transactions. DC filed an amended return to file the GRA for the FS2 Transfer and complied with the procedures set forth under paragraph (p)(2) of this section promptly after it became aware of the failure. DC asserts that its failure to timely file a GRA with respect to the FS2 Transfer was due to an isolated oversight similar to the one that occurred with respect to the FS Transfer. At issue is DC's failure to timely file a GRA for the FS2 Transfer.
- Result. Based on facts, including DC's history of failing to file required tax and information returns in general and GRAs in particular, and its failure to implement safeguards to ensure that it would timely file GRAs, the failure to timely file a GRA with respect to the FS2 Transfer rises to the level of a willful failure to timely file.
Examples of Treas. Reg. section 1.367(a)-8(p)(3)

• Example 3. Available upon request.

• Facts. DC timely filed its tax return for the year of the FS Transfer, reporting no gain with respect to the exchange of the FS stock. DC was aware of the requirement to file a GRA to avoid recognizing gain under section 367(a)(1), including the requirement to provide the basis and fair market value of the transferred stock. However, DC filed a purported GRA that did not contain the fair market value of the FS stock. Instead, the GRA was filed with the statement that the fair market value information was "available upon request." Other than the omission of the fair market value of the FS stock, the GRA contained all other information required by this section.

• Result. Because DC omitted the fair market value of the FS stock from the GRA, the GRA was not completed in all material respects. Accordingly, there is a failure to timely file the GRA. Furthermore, because DC knowingly omitted such information, DC's omission is a willful failure to timely file a GRA.
Other Changes

Clarification of certain terms used in the GRA regulations

- Transferee foreign corporation
  - "The transferee foreign corporation also includes a corporation designated as the transferee foreign corporation in the case of a new gain recognition agreement entered into under this section." Reg. §1.367(a)-8(b)(1)(xiv).

- Transferred corporation
  - "The transferred corporation also includes a corporation designated as the transferred corporation in the case of a new gain recognition agreement entered into under this section." Reg. §1.367(a)-8(b)(1)(xv).

Extension of SOL period

- Begins when taxpayer furnishes GRA information to the Director of Field Operations International, Large Business & International

Willful standard extended to other Section 367(a) transfers

- Outbound transfers of assets for use in the active conduct of a trade or business outside the United States. See Reg. §1.367(a)-2.

- Outbound transfers of assets by a domestic target corporation in an exchange described in Section 361. See Reg. §1.367(a)-7.
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Considerations for Avoiding GRAs

Two methods to avoid GRA requirements:

• (1) Check-the-box election.
• (2) Transfer to foreign hybrid entity.
Check-the-Box Election

**Current Structure**

![Diagram showing the current structure of DC1, FC1, and FC2.]

**Facts**

- DC1, a US corporation, owns all of the stock of two foreign corporations, FC1 and FC2.
- DC1 plans to transfer all of its FC1 stock to FC2.
Check-the-Box Election

Proposed Transaction

Pursuant to a prearranged plan:

• **Step 1.** DC1 transfers all of its FC1 stock to FC2.

• **Step 2.** A check-the-box ("CTB") election is filed to classify FC1 as a disregarded entity of FC2 for US tax purposes effective **two days after** Step 1.
Check-the-Box Election

US Tax Treatment

  - FC1 is treated as transferring all of its assets to FC2 in exchange for FC2 stock, and
  - Immediately thereafter, FC1 is treated as distributing its FC2 stock to DC1 in liquidation of FC1.
- Pursuant to Reg. §1.367(a)-3(a)(2)(ii), DC1's transfer of FC1 stock is not subject to §367(a) because:
  - FC1 stock is transferred in a §354 exchange pursuant to an asset reorganization, and
  - There is no indirect transfer under Reg. §1.367(a)-3(d).

Other Considerations

  - Where CTB election effective immediately prior to the transfer, DC1 treated as transferring FC1 assets to FC2 in a §351 exchange subject to 367(a) outbound asset transfer rules (i.e., active T/B, 367(d) intangibles, etc.).
Check-the-Box Election

• But see Telephone Answering Serv. Co. v. Com’r, 63 T.C. 423 (1974), aff’d, 546 F.2d 423 (4th Cir. 1976) (D reorganization under liquidation-reincorporation doctrine).

• Notice 2003-46.
  • Withdrawal of Prop. Reg. §301.7701-3(h) (extraordinary transaction regulations), which would have disallowed a CTB election if stock of a checked entity was transferred during the period beginning one day before and ending 12 months after the effective date of the CTB election.
  • IRS considering whether an outbound transfer of CFC stock followed by actual or deemed liquidation of the CFC should trigger a GRA filing requirement.
  • File CTB election in timely manner. See P.L.R. 200607016 (Feb. 17, 2006) (request to file late CTB election denied).
Transfer to Foreign Hybrid Entity

Facts

- DC1, a US corporation, owns all of the stock of FC1, a foreign corporation. DC1 also owns \(<80\)% of the stock of FC2, a foreign corporation.
- DC1 plans to transfer all of its FC1 stock to FC2.
Transfer to Foreign Hybrid Entity

**Proposed Transaction**

Pursuant to a prearranged plan:

- **Step 1.** A CTB election is filed to classify FC2 as a partnership or disregarded entity for US tax purposes.
- **Step 2.** DC1 transfers all of its FC1 stock to FC2.

**US Tax Treatment**

**Step 1**

- Inbound liquidation of FC2 subject to §367(b).
- Deemed dividend from FC2 to DC1 of all earnings and profits amount. Reg. §1.367(b)-3(b)(3)(i).
  - All earnings and profits amount does not include PTI. Reg. §1.367(b)-2(d)(2)(ii).
  - Deemed dividend may qualify for preferential 23.8% rate as QDI. Reg. §1.367(b)-2(e)(2).
  - Deemed dividend may carry indirect FTCs. Reg. §1.367(b)-2(e)(4), Ex.1.
- FC2’s remaining E+P disappears and DC1 receives a carryover basis - § 334(b)(2)
- DC1 may elect to instead recognize gain on FC2 stock. Reg. §1.367(b)-3T(b)(4).
  - DC1 reduces the FC2 attributes carried over to extent all earnings and profits amount exceeds gain recognized, in following order: (1) NOL carryovers, (2) capital loss carryovers, (3) basis of former FC2 assets. Reg. §1.367(b)-3T(b)(4)(B).
Transfer to Foreign Hybrid Entity

**Step 2**

- Since FC2 is not a corporation, DC1’s transfer of FC1 stock to FC2 is not subject to §367(a).
- Instead, the transfer is (1) disregarded, if DC1 owns 100% of FC2, or (2) treated as a §721(a) contribution, if DC1 owns less than 100% of FC2, but DC1 must comply with §6038B reporting requirements.

**Other Considerations**

- This strategy may be best utilized when FC2 is newly formed or recently acquired by DC1.
- What if DC1 transfers FC1 stock to FC2 and files a GRA, and two years later files a CTB election for FC1 several days prior to selling FC1 stock? FTC planning?
- File CTB election in a timely manner. See P.L.R. 200607016 (Feb. 17, 2006) (request to file late CTB election denied).
Appendix I - Form 926

### Part I - U.S. Transferor Information

<table>
<thead>
<tr>
<th>Name of transferor</th>
<th>Identifying number</th>
<th>Identifying number</th>
</tr>
</thead>
<tbody>
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</table>

1. If the transferor was a corporation, complete questions 1a through 1c.
   a. If the transferor was a section 367(a)(2) or (b) transferor, was the transferor controlled (under section 368(a)) by 5 or fewer domestic corporations?  
   Yes No
   b. Did the transferor remain in existence after the transfer?  
   Yes No
   If not, list the controlling shareholder(s) and their identifying number(s):  
   Controlling shareholder | Identifying number
<table>
<thead>
<tr>
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</table>

e. If the transferor was a member of an affiliated group filing a consolidated return, was it the parent corporation?  
   Yes No
   If not, list the name and employer identification number (EIN) of the parent corporation:
   Name of parent corporation | EIN of parent corporation
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</table>

d. Have basis adjustments under section 357(a)(2) been made?  
   Yes No

2. If the transferor was a partner in a partnership that was the actual transferor (but is not treated as such under section 367), complete questions 2a through 2c.

   a. List the name and EIN of the transferor’s partnership:
      Name of partnership | EIN of partnership
      |----------------------|------------------|
      |                     |                  |

### Part II - Transferee Foreign Corporation Information

3. Name of transferee (foreign corporation) | Identifying number, if any
<table>
<thead>
<tr>
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4. Address (including country) | Reference ID number (see instructions)
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</table>

5. Country code of country of Incorporation or organization (see instructions)

6. Foreign law characterization (see instructions)

7. Is the transferee foreign corporation a controlled foreign corporation?  
   Yes No

### Part III - Information Regarding Transfer of Property

<table>
<thead>
<tr>
<th>Date of transfer</th>
<th>Description of property</th>
<th>Fair market value on date of transfer</th>
<th>Cost or other basis</th>
<th>Gain recognized on earlier</th>
</tr>
</thead>
<tbody>
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</table>

### Supplemental Information Required To Be Reported

A CRA is being filed pursuant to Treas. Reg. section 1.367-1(e).
Leveraging Outbound Transfers of Corporate Stock and Other Property:

Navigating Section 367 Gain Recognition Agreements and Section 6038B Regulations in Cross-Border Transactions

Jon Van Loo
jon.vanloo@dechert.com

March [], 2015
Consider Alternative Forms of Transaction

- Transfer of intangible property might be structured as a license.
- Transfer of tangible property might be structured as a lease.
- Consider taxable sale of property.
Checking the Box on Foreign Controlled in Outbound Asset Reorg

- The “C” Reorganization is treated as an Asset Transfer.
- Foreign Acquirer then drops down assets to Foreign Controlled.
- Because Foreign Controlled is a disregarded entity, the dropdown is not an indirect stock transfer.
- No GRA is required, but still need to comply with 1.367(a)-2 and 1.367(a)-7.
Comparing Anti-Inversion Rules under Section 367(a) and Section 7874

- Contrasting rules for determining size of Foreign Acquirer under Section 367(a) and Section 7874.
  - Section 7874 excludes certain “cash boxes” under Notice 2014-52 and stock that is newly issued for cash or other passive assets under 1.7874-4T.
  - Substantiality test under Section 367(a) excludes any passive assets and certain other assets acquired within 36 months of transfer.

- In Notice 2014-52, IRS announced intention to create rules under Section 7874 and Section 367(a) disregarding certain “skinny down” transactions that reduce the size of Domestic Target in inversions.
  - Includes all distributions, including tax-free Section 355 spin-offs, completed outside the ordinary course of business during the preceding 36 months.
  - Non-ordinary course distributions are defined as all distributions in excess of 110% of the average of distributions over the 36-month period preceding the year of the distribution.
For further information, visit our website at dechert.com.

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