Federal Bar Association
Tax Conference

Section 956
Issues & Developments

March 6, 2015

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Agenda

- Background
- Meaning of “obligation”
- Intellectual property
- Partnerships
- Anti-abuse rule
- Alternating loan structures
- CFC pledges / guarantees
- Judicial Doctrine – *Barnes Group*
- Notice 2014-52

Background

Section 956

- A US shareholder recognizes a subpart F inclusion based on its "§ 956 amount" with respect to CFC (§ 951(a)(1)(B))

"§ 956 amount" equals the lesser of the US shareholder's:

- Pro rata share of US property held by CFC on its quarter-ends over § 959(c)(1)(A) PTI; or
- Share of CFC's "applicable earnings" (current and accumulated E&P, less current-year distributions of E&P and § 959(c)(1) PTI)

- US property held by CFC measured by CFC's adjusted basis in US property (§ 956(a))

US Property

- **Tangible property** located in the United States
  - Exception for property purchased in the United States for export to a foreign country
- **Stock** of a domestic corporation
  - Exception for stock of domestic corporation *other than* a US shareholder or corporation in which US shareholders own at least 25% of the total combined voting power
- **Obligations** of a United States person
  - Exception for certain trade or service receivables to the extent ordinary and necessary to carry on the trade or business of the CFC and the US person
- Rights to use **certain intellectual property** in the United States
- **Trade or service receivables** acquired from a related US person and obligor is a US person (regardless of whether related)

Policy Behind § 956

- Intended to cover investments that are "substantially the equivalent of a dividend"
- House proposed broader rule that would have applied to earnings attributable to investments in any property, regardless of jurisdiction, other than property necessary for conduct of CFC's trade or business
- Others believed House rule would be unworkable and narrowed scope to investments in certain US property

“Obligation”

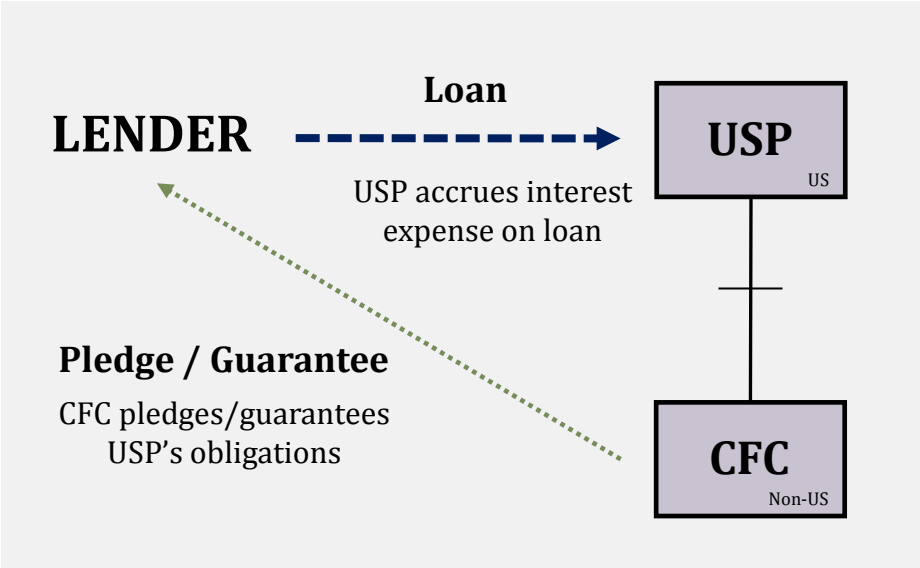
Definition

- § 956(c)(1)(C) says "US property" includes "an obligation of a United States person"
- Reg. § 1.956-2T(d)(2)(i) defines "**obligation**" for this purpose

> *the term "obligation" includes any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other indebtedness, whether or not issued at a discount and whether or not bearing interest*

- "Obligation" does not include (1) indebtedness arising from involuntary conversion of non-US property, or (2) obligations of a US person related to a CFC's provision of services to such person (generally if paid within 60 days)
- Reg excludes from definition of "US property" obligations of US persons arising in conx'n with property sales/processing transactions (if amount is ordinary/necessary)
- § 956(c)(2) excludes certain items from the definition of "US property," including an obligation of a domestic corporation that is neither (1) a US shareholder of the CFC, nor (2) 25% or more owned by US shareholders of the CFC

CCA 201436047 – Accrued/Unpaid Interest



Facts

- USP indirectly owned CFC
- Accrual basis taxpayers
- USP was borrower on various obligations
- Under § 956(d) and Reg. §1.956-2(c), CFC treated as pledging or guaranteeing USP's obligations and, therefore, as holding "US property"
- USP accrues but does not pay interest on obligations
- Stated interest on the obligations was unconditionally payable at least annually

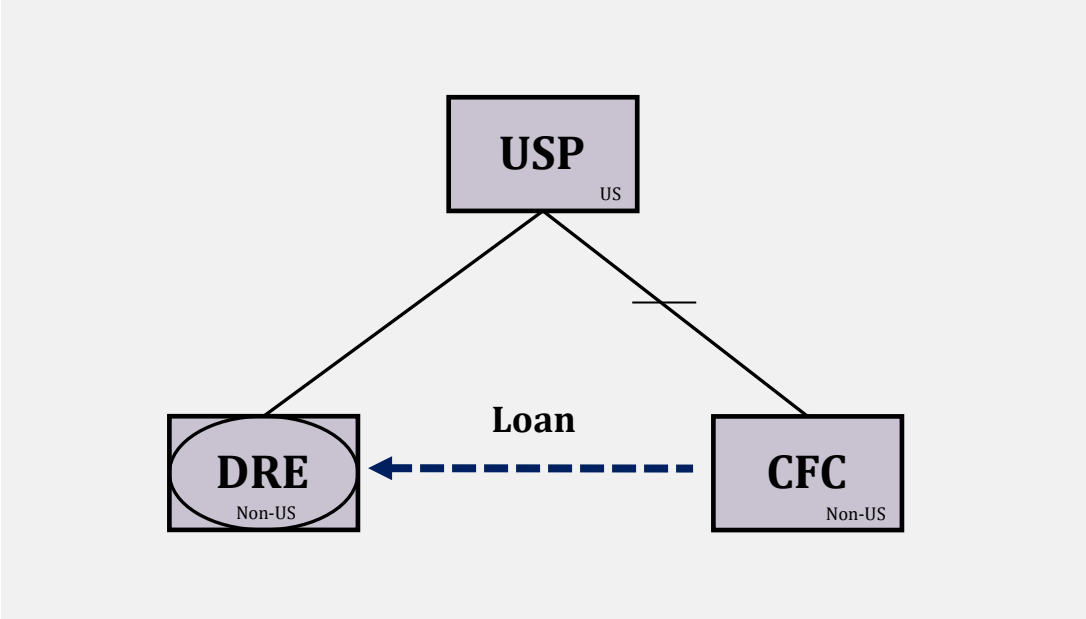
Conclusions

- IRS concluded that "obligation" *includes accrued but unpaid interest* on debt instrument
- "Obligation" includes, in addition to specifically identified items, "other indebtedness"
- Accrued but unpaid interest is treated as indebtedness for tax purposes, generally with AB equal to the amount of interest; thus, is treated as "US property" held by CFC (AB equal to amount of unpaid interest)

Other

- Is accrued/unpaid interest a *separate* obligation?

Whose Obligation?



- Is DRE's indebtedness an "obligation" of USP?
- Does it matter how the loan proceeds were used?

Intellectual Property

Intellectual Property

- § 956(c)(1)(D) provides that certain IP is considered "US property"
- More particularly, Reg. § 1.956-2(a)(1)(iv) states that "**US property**" includes

> *[a]ny right to the use in the United States of… [certain delineated IP]… which is acquired or developed by the [CFC] for use in the United States by any person.*

- Elements – to have US property, all of the following seemingly must be present:

> ❶ Right to Use – CFC must have *the right* to the use of delineated IP in the United States
>
> ❷ Delineated IP – must be a type of IP described in statute
>
> ❸ Use in the US – the CFC must have acquired/developed the right *for use in the United States* (by itself of by others)

- There is very little guidance on the topic

IP Rights Covered

- **Delineated IP** - § 956(c)(1)(D) provides that rights in the following types of intellectual property are covered:
  - Patents
  - Copyrights
  - Secret formula/process
  - Any other "similar" property
  - Invention (protected or not)
  - Model (protected or not)
  - Design (protected or not)
- Only *manufacturing intangibles*? Marketing intangibles (trade name, TM, goodwill)?
- **Right to Use** – filing with US PTO or Copyright Office (e.g., to secure US protection on a patent or copyright) presumably is sufficient but not necessary. Contractual rights to use an unprotected invention would also appear adequate.

Use of IP Rights

- **Use in the US** – § 956(c)(1)(D) indicates that final (critical) element is that the CFC must have acquired/developed the right for use in the United States (by CFC or others)

- This is the most controversial issue – why did CFC acquire/develop IP right, and *what* constitutes its *use* in the US?

- Reg. § 1.956-2(a)(1)(iv) provides:

> *Whether a right … has been acquired or developed for use in the United States by any person is to be determined from all the facts and circumstances of each case. As a general rule, a right actually used principally in the United States will be considered to have been acquired or developed for use in the United States in absence of affirmative evidence showing that the right was not so acquired or developed for such use.*

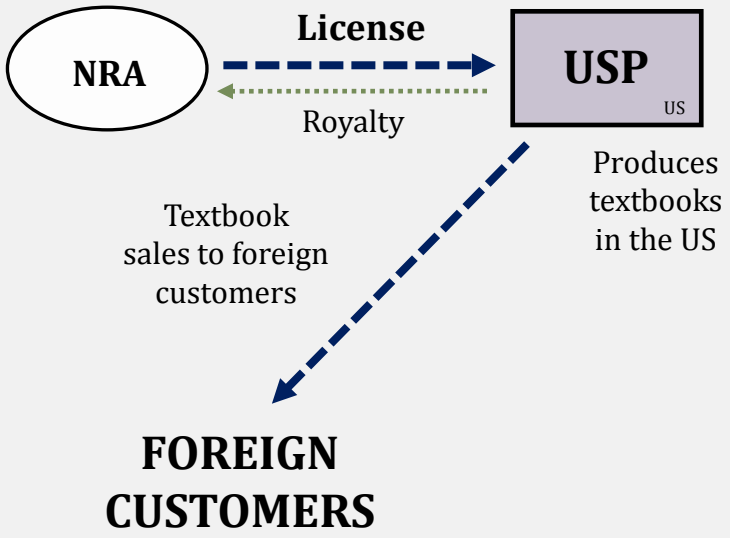
Use of IP Rights (cont.)

- **Reason for Acquiring/Developing** – § 956(c)(1)(D) provides that the CFC must have acquired/developed the right for use in the United States
  - **Subjective Standard –** how to determine intent in acquiring/developing?
    - Mere filing for US protection?
    - What if mix of anticipated use is 49% US / 51% ROW?
    - Post-acquisition/development changes?
  - **Course of Action** – intent can be demonstrated via course of action (i.e., objective facts can show intent for acquisition/development)
    - Was right actually used principally in the US?
    - Even so, taxpayer has ability to rebut (demonstrate intent)
  - **Issue Remains: What constitutes "use in the United States"?**

Determining Place of Use

- **Place of use?**
- **Analogy to sourcing rules?**
  - **Place of commercial exploitation** – RR 72-232 (copyrights) and RR 84-78 (copyrights)
  - **Place where activities related to intangible property are performed** – Sanchez (patents) and FSA 200222011 (copyrights)
  - **Place of legal protection** – RR 68-443 (trademarks)

Rev. Rul. 72-232 – Use of IP



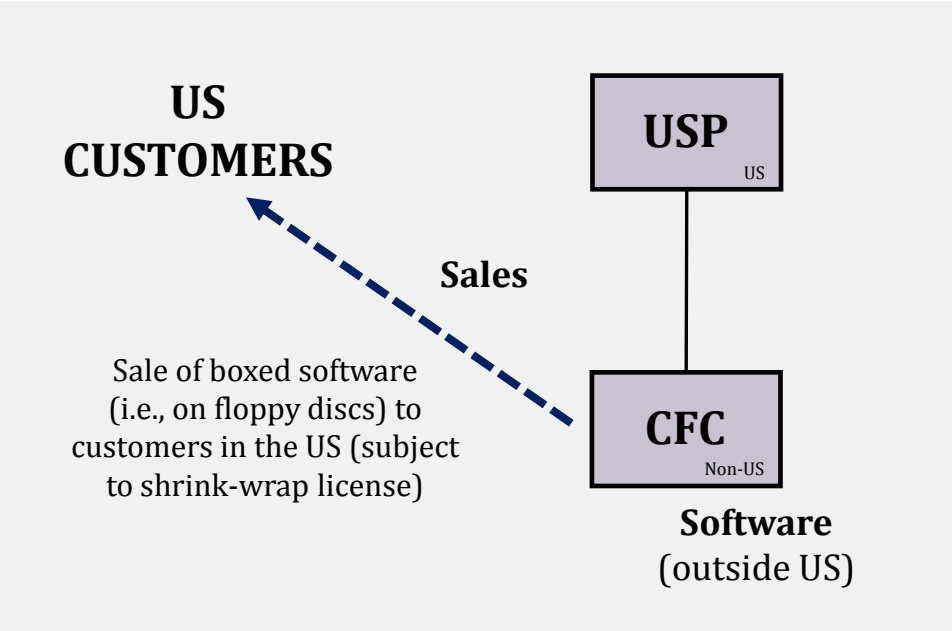
Facts

- NRA owned US and foreign copyrights to textbooks; textbooks had been designed for use in foreign countries (not US)
- USP manufactured textbooks in the US
- Textbooks sold exclusively outside US
- Question was whether US withholding required on USP's royalties to NRA

Analysis / Conclusions

- § 861(a)(4) provides that royalties are US source if paid for use/privilege of using copyrights in the US
- USP merely manufactured in the US – there were no US sales (i.e., no commercialization in the US)
- Because there were no US sales, no use of copyright in the US – foreign sales use foreign copyrights and not US copyright; thus, no withholding on royalties since they constitute foreign-source income

PLR 200229030 – Use in US?



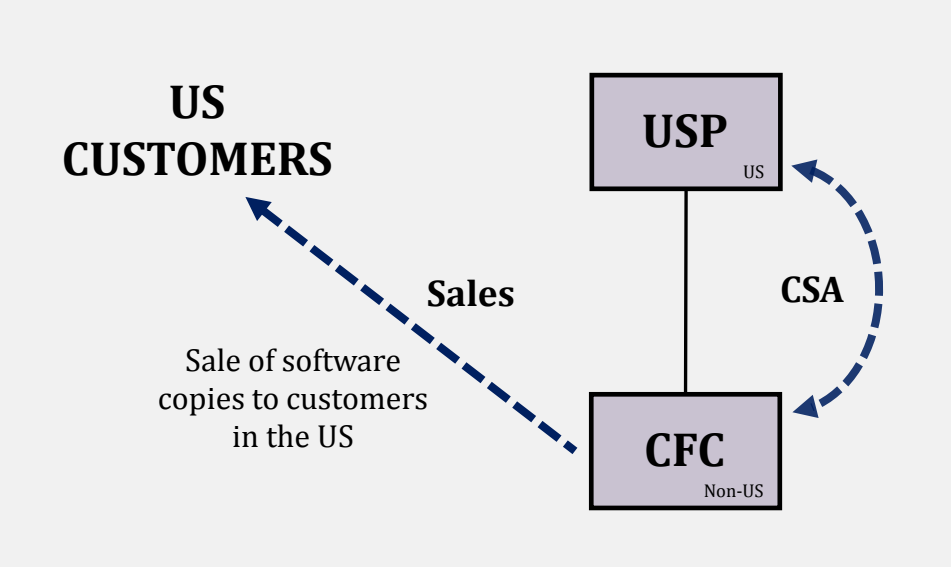
Facts

- CFC had copyright protection (US and foreign) on software program
- CFC held master disks outside US; used them to burn (outside the US) software on discs that were then sold as a product
- All inventory was held outside the US
- CFC sold software product to customers all around world (including in the US), with title passing outside the US; the sales are subject to shrink-wrap license (i.e., buyers have no IP rights in the software program)
- PLR issued April 17, 2002

Analysis / Conclusions

- Two § 956 rules implicated are "tangible property located in the US" and § 956(c)(1)(D) intangible property. Transactions involving software discs constitute a transfer of a copyrighted article (tangible property) and not of a copyright right; and because burdens/benefits pass it is a sale (not rental). See Reg. § 1.861-18. Thus, is not a license or lease.
- The software program is not a right to the use in the US (!) of a copyright within the meaning of § 956(c)(1)(D), and software, to extent it is transferred via discs (as sales), does not constitute tangible property located in US
- PLR was revoked as of Sept. 5, 2003 – see PLR 200411016

CCA 201106007 – Right vs. Actual Use



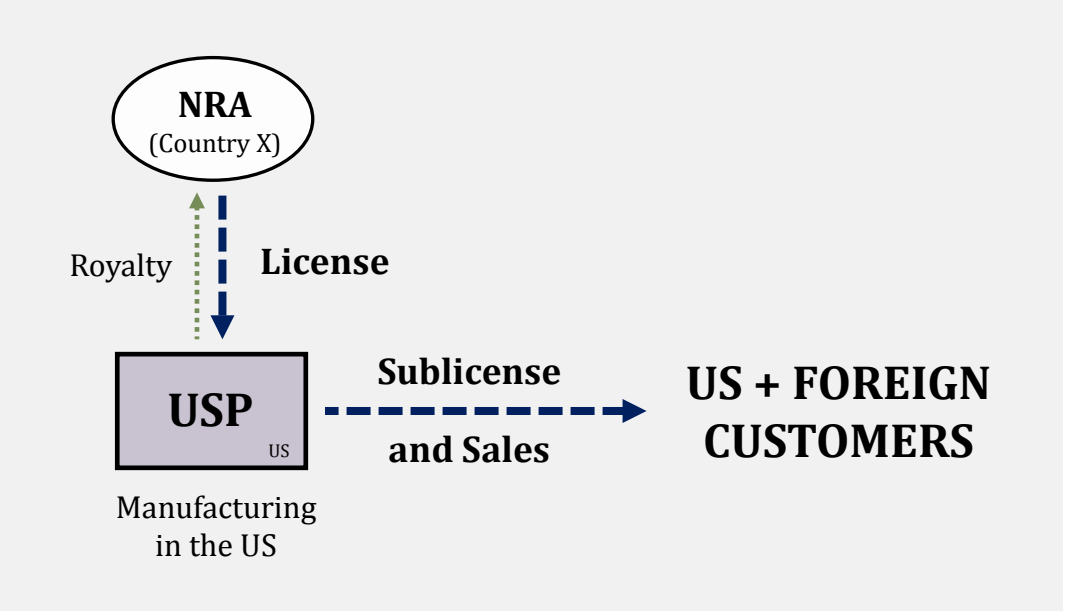
Facts

- USP distributed information technology products and services
- USP developed software in the US pursuant to a cost sharing agreement (CSA) with CFC
- Pursuant to CSA, CFC acquired rights to exploit copyrights in the US
- Upon development of software product, a final version of the software code was transferred to a "master" disk
- CFC reproduced and sold copies of software to end-users in the US

Conclusions

- IRS interpreted § 956(c)(1)(D) as applying upon development or acquisition of rights to use copyright rights in United States pursuant to the CSA, not upon actual use of copyright rights
- Thus, CFC has an amount of US property when it acquired or developed the rights to use copyright rights in the United States, but actual sales of software products to customers in the United States did not give rise to an amount of US property
- Amount of US property would depend on CFC's adjusted basis in the copyright rights

Sanchez v. CIR

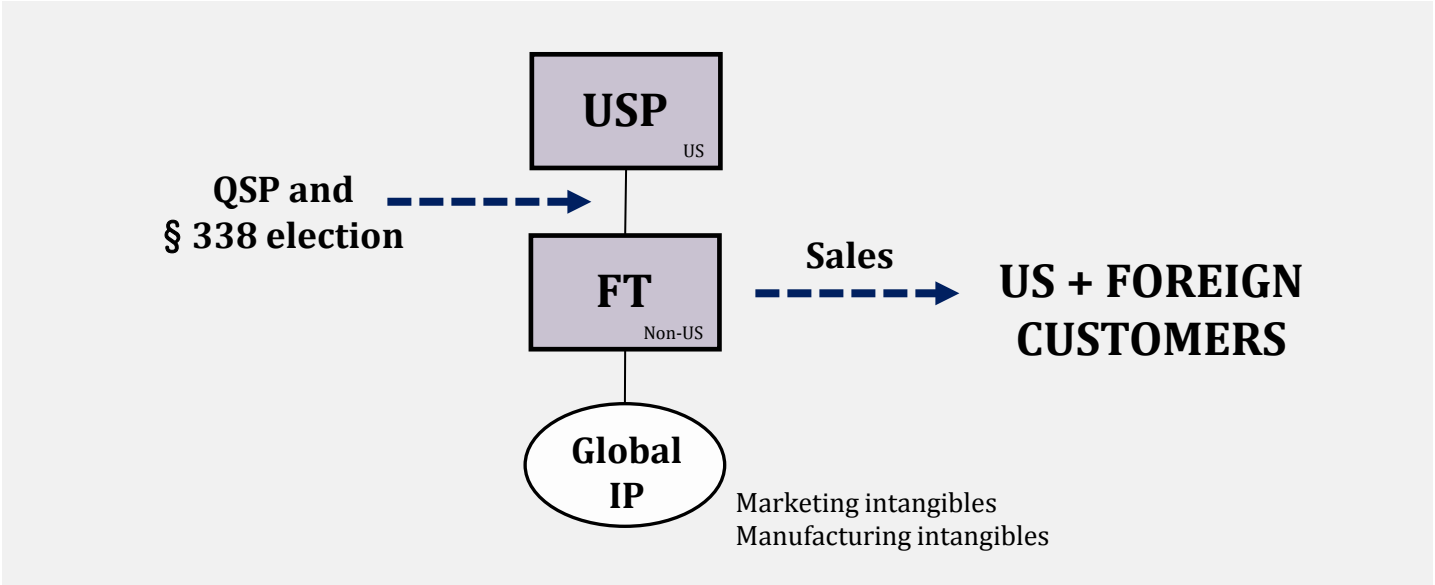


Sanchez v. CIR, 6 TC 1141 (1946), *aff'd* 162 F.2d 58 (2d Cir. 1947)

Facts

- NRA, a non-resident alien, licensed patents to USP, a US corporation, to make and sell refined sugar products
- Patents were owned in US and foreign countries
- USP sublicensed the patents and sold products to customers in the US and foreign countries
- Royalty income was US source, determined by reference to location where USP conducted its activities in exploiting right to sublicense patents and sell products (not location of customers)

Section 338(g) Election



Facts

- USP acquires FT via QSP and makes a section 338(g) election
- FT owns global IP (including US) such as marketing intangibles (TM, tradenames) and manufacturing intangibles (patents, copyrights)
- FT manufactures products outside the US and sells products to US and foreign customers

Other

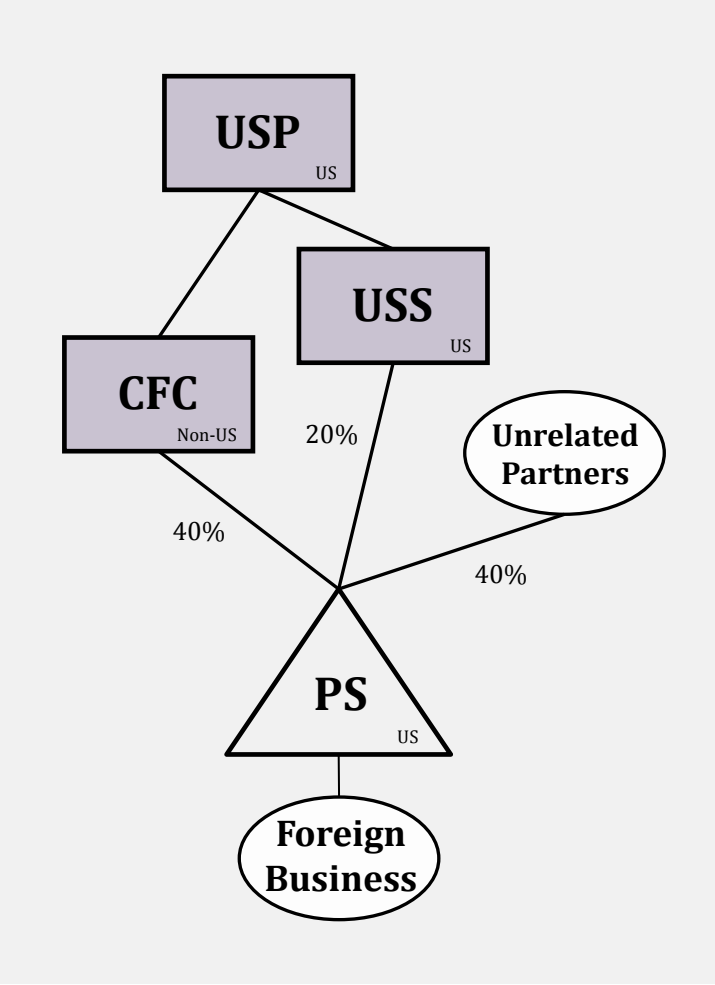
- Place where IP used?
- Marketing intangibles *versus* manufacturing intangibles?

Partnerships

§ 956 and Partnerships

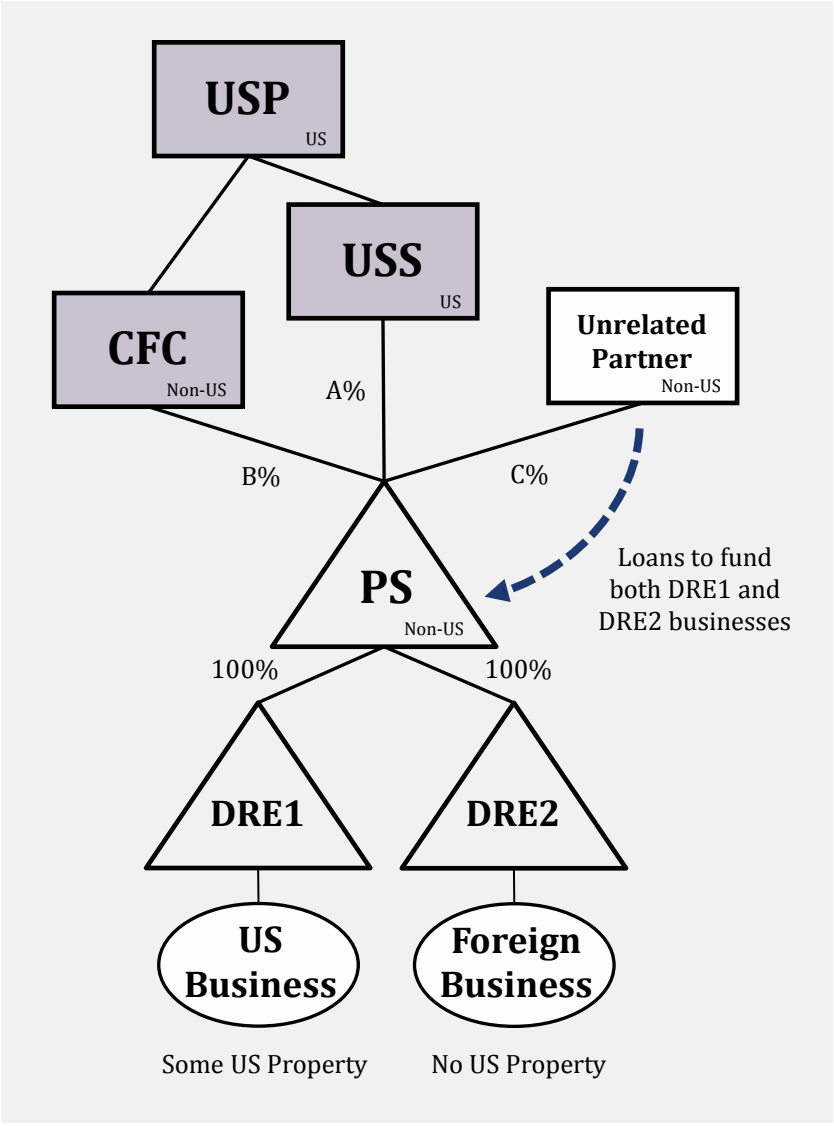
- Ownership through a partnership, versus transacting business with a partnership
- *Aggregate* or *entity* approach?
- US partnership – is a US person
- Foreign partnership – is a foreign person

Owning "US Property" Through a Partnership



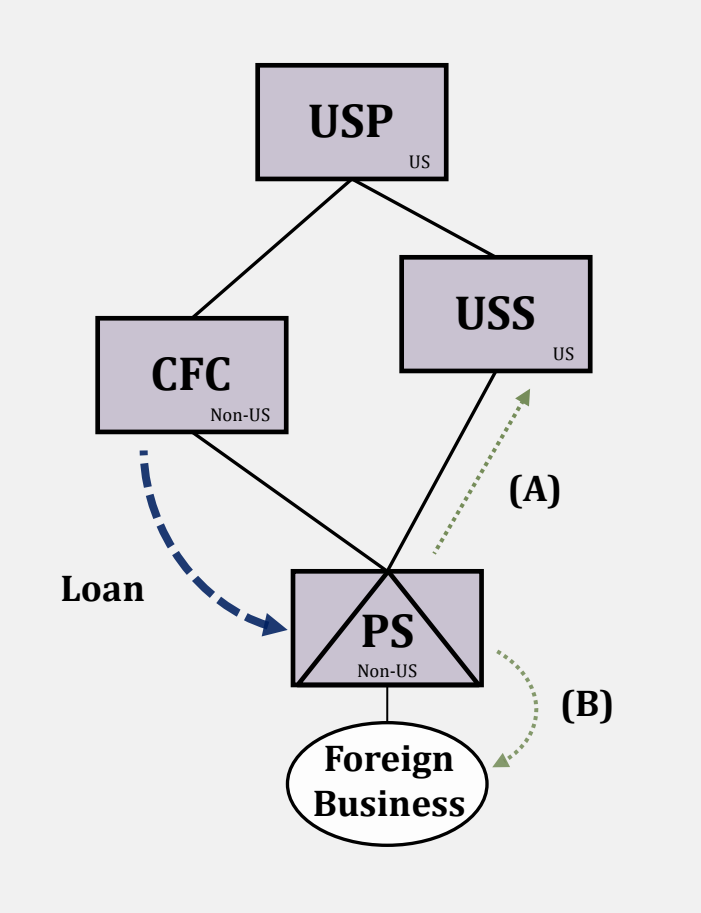
- § 956 causes USP to have a subpart F inclusion for its share of a CFC's investment in "US property"
- *Aggregate approach* – generally, you look though a partnership interest (i.e., to underlying assets) for purposes of determining the § 956 consequences of items held through a partnership. See Reg. § 1.956-2(a)(3); Rev. Rul. 90-112.
- In this example, CFC would be deemed to own 40% of the US property owned by PS
  - Must assess whether PS owns any "US property"
  - Rev. Rul. 90-112 indicates that § 956 amount is based on PS's basis in the "US property" (but capped by CFC's basis in its partnership interest)

PLR 200832024 – Owned Through a Partnership



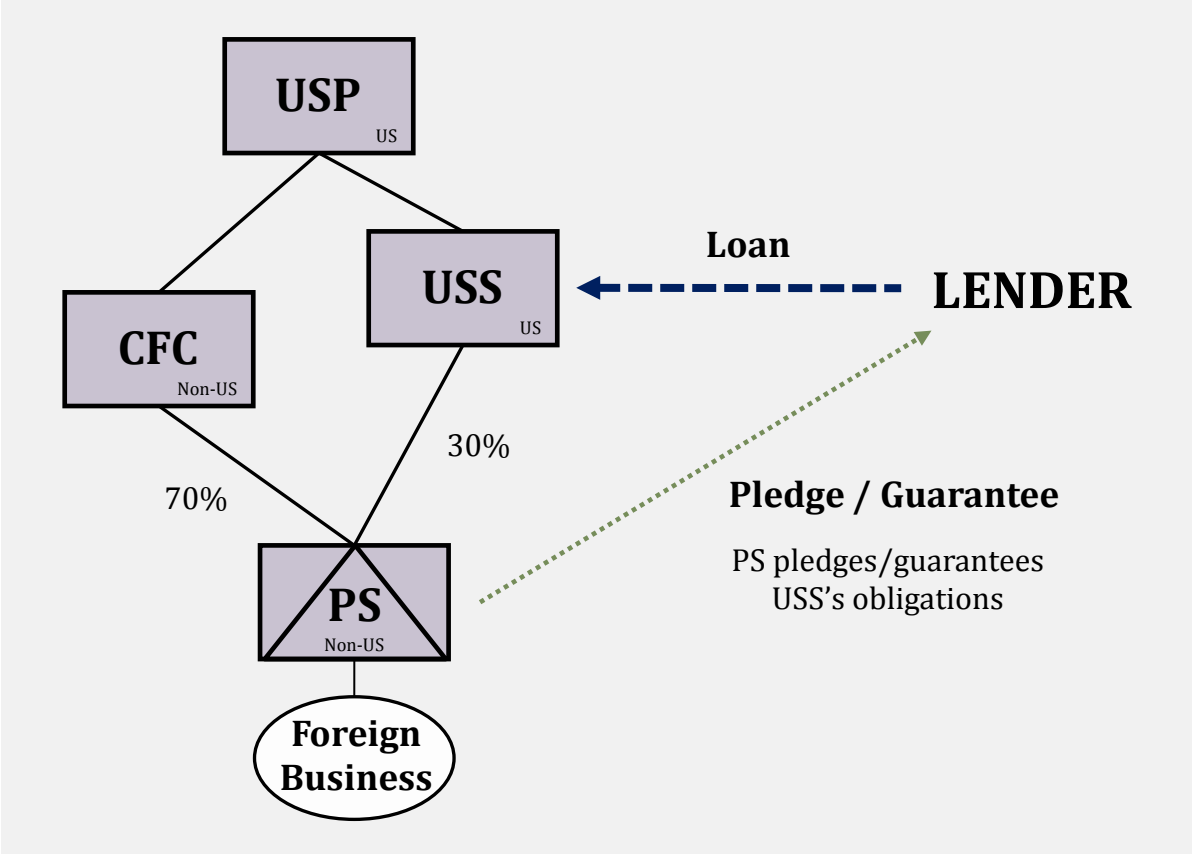
- USS, CFC and Unrelated Partner form JV by contributing cash to foreign PS, which uses the cash to acquire US Business from USP and Foreign Business from a related foreign corp
- US Business and Foreign Business will be held in DRE1 and DRE2, respectively; they will keep separate books and records and funds will not be loaned/transferred between the DREs
- PS agreement will provide that CFC will only have rights (income/gain/deduction/losses/liquidation) in DRE2 (and not in DRE1)
- Taxpayer makes "tough" reps – i.e., each DRE will independently operate (own employees); DRE2 assets will not serve at any time (even indirectly) as security for the performance of an obligation of a US person; businesses "will be conducted in substantially the same manner as prior to the formation of [PS]"
- IRS holds that Reg. § 1.956-2(a)(3) essentially looks at economic interests; thus, if a CFC that does not have an economic interest (directly/indirectly) in US property through a partnership, doesn't have interest in US property
- **What about loans to PS?**

Loans To a Partnership



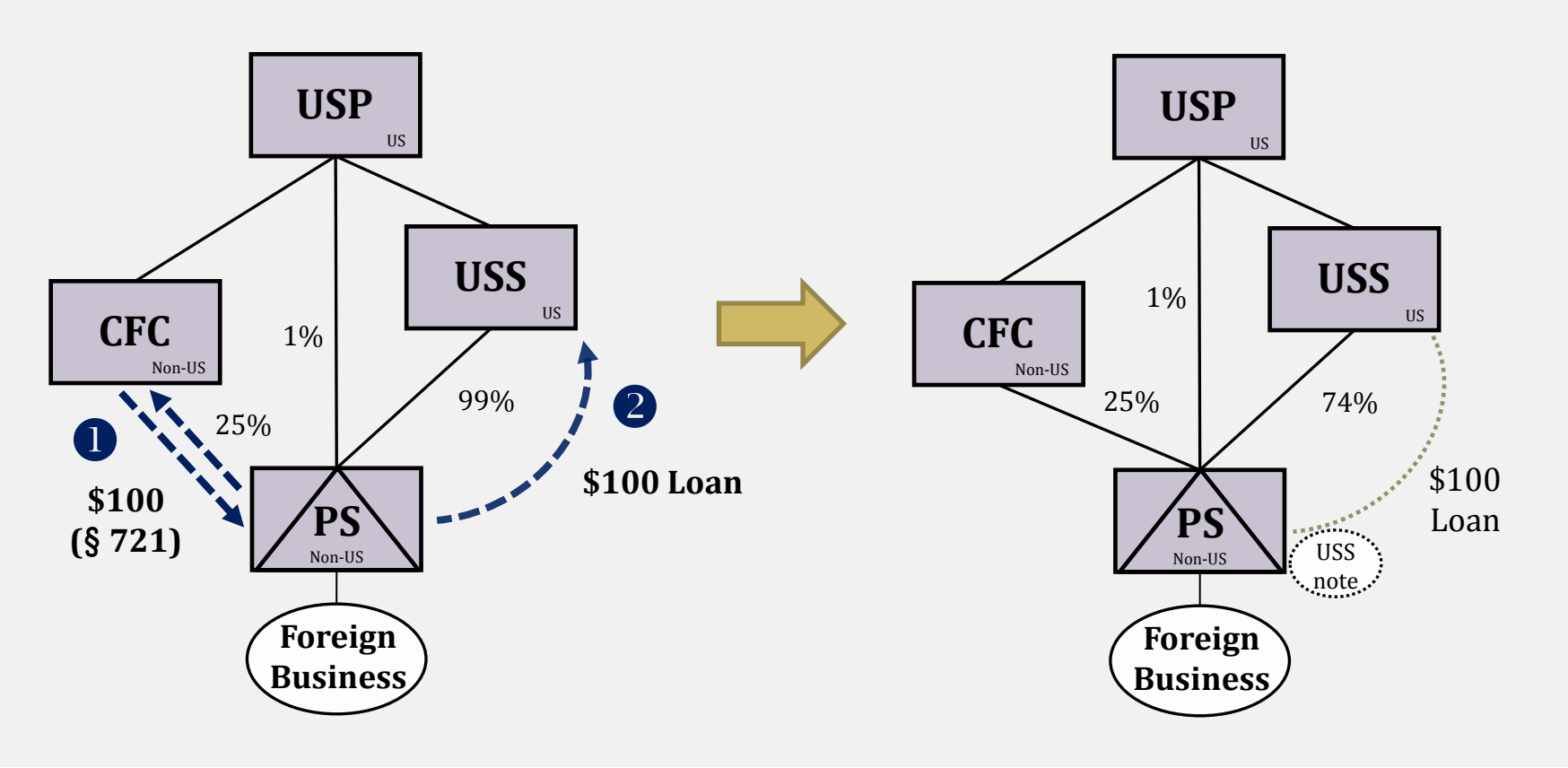
- What result if CFC lends money to a foreign partnership (PS) with a US partner (USS)?
- Automatically aggregate?
- Does it matter how funds are used (A or B)?
- Whose obligation? Liability for debt under foreign laws?
- **Regulations are pending**
  - What principles are driving the regs?

Pledge / Guarantee By a Partnership



- How do the pledge/guarantee rules work with partnerships?
- Is PS's pledge/guarantee deemed to be a pledge/guarantee by its CFC partner? If so, to what extent?

Funding Through Partnerships



- Is CFC's investment in "US property" limited to $25 under Reg. § 1.956-2(a)(3)'s aggregate rule?
- Is it something greater, even absent an anti-abuse rule?
- Application of the § 1.956-1T(b)(4) anti-abuse rule?

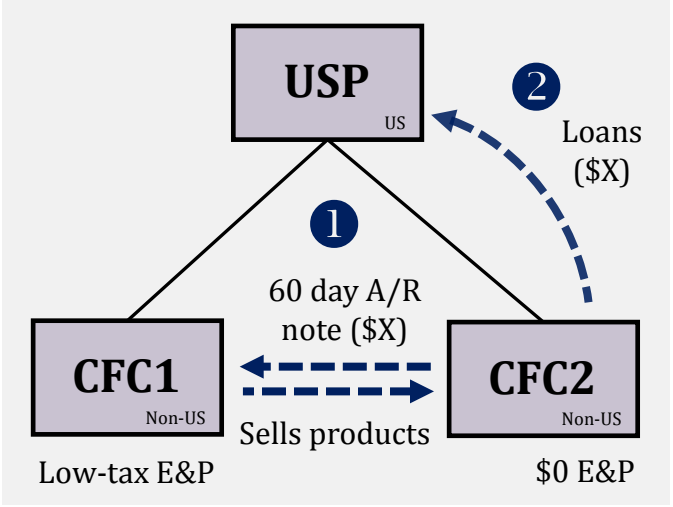
Anti-Abuse Rule

Anti-Abuse Rule

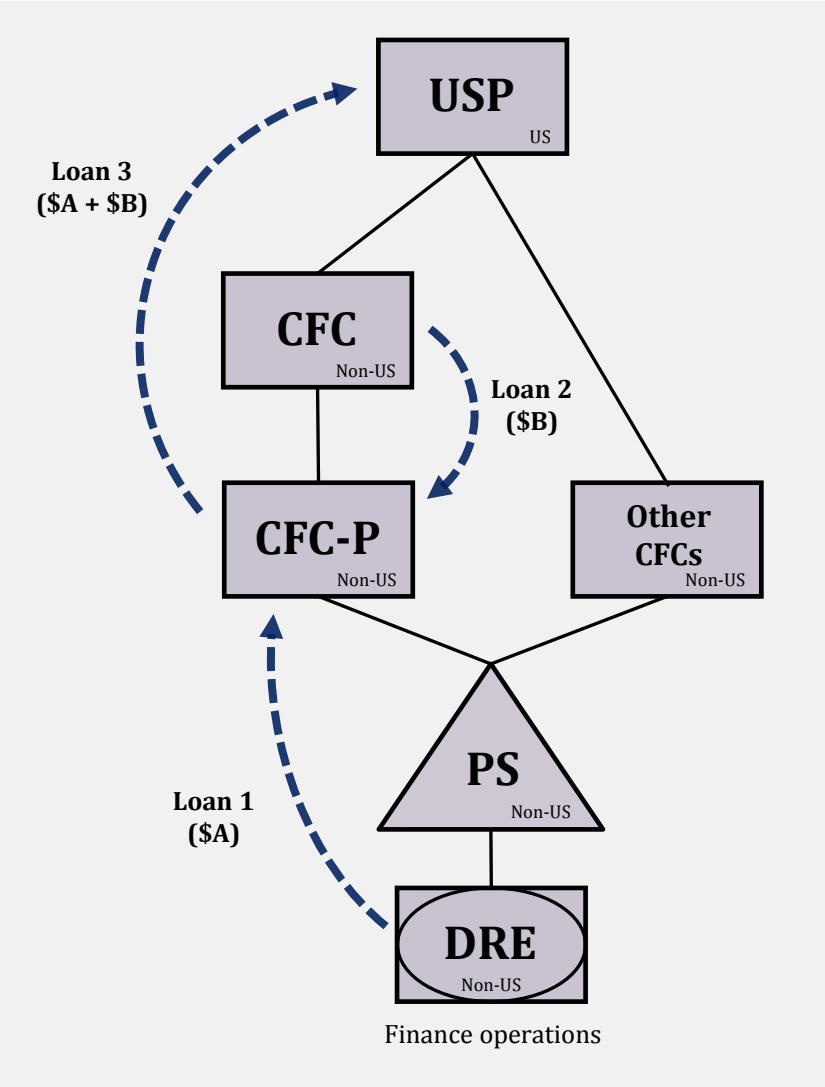
- § 956 regulations contain both nominee and formed or funded anti-abuse rules
- Reg. § 1.956-1T(b)(4)(i)(B) states that a CFC will be considered to hold indirectly:

> *at the discretion of the District Director, investments in US property acquired by any other foreign corporation that is controlled by the [CFC] if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application of section 956 with respect to the [CFC]*

- Examples:
  - CFC1 not considered to hold CFC2's investment in US property if CFC2 pays off the A/R according to its terms
  - If CFC2 does not pay off the A/R, CFC1 holds CFC2's US property because there was a transfer of funds to CFC2 a principal purpose of which was to avoid application of § 956 to CFC1
  - **What if CFC2 pays in 90 days?**



CCA 201420017 – Anti-Abuse Ruling #1



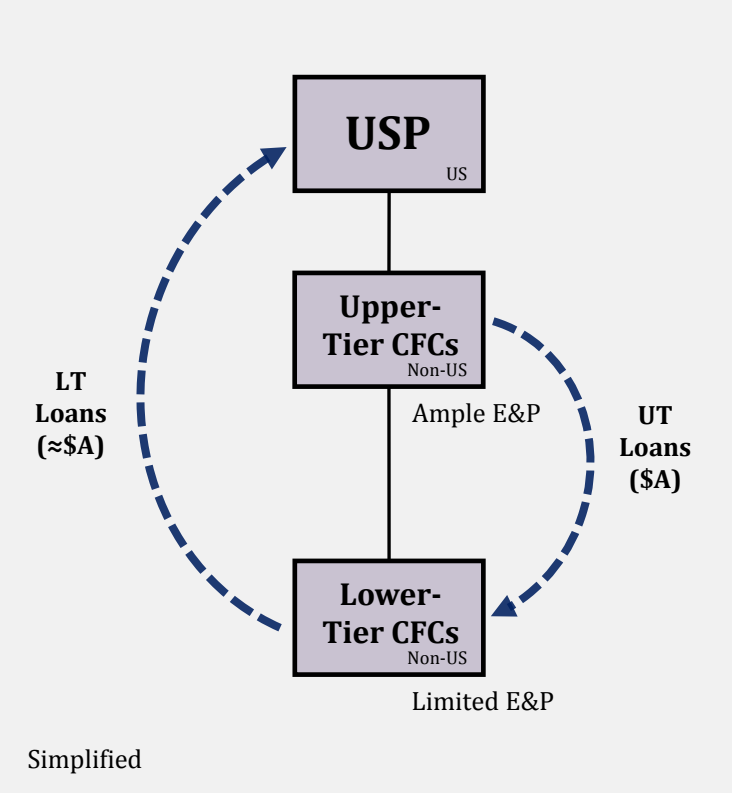
Facts

- All loans made same day (Loan 3 is aggregate); Loans 1 and 3 repaid at later date (but was left outstanding over quarter end and no "obligation" exception – e.g., Notice 88-108)
- USP reported § 956 inclusion based on Loan 3, limited by CFC-P's applicable E&P; however, USP's inclusion would've been larger if Loan 1 had been made directly to USP
- USP recognized that IRS might try to tie § 956 inclusion to E&P of PS's partners; but USP argued that the § 956 anti-abuse rule should not be applicable because Loan 1 was intended to fund CFC-P – i.e., *to facilitate (not avoid) § 956*
- Under Reg. § 1.956-2(a)(3), if CFC is partner in partnership that holds "US property" (if held directly by CFC) then CFC partner treated as holding its interest in the "US property"

Observations

- IRS says application of § 956 anti-abuse rule does not require that § 956 be avoided in entirety; instead, it turns on whether a principal purpose for funding the related foreign corporation is to avoid the application of § 956 *with respect to the funding CFC* (here, the "Other CFCs")
- Factors the IRS considered in applying the anti-abuse rule's principal-purpose test: (1) proximity in time (as b/t Loan 1 and Loan 3), (2) substantially reduced § 951 inclusion to USP vs. amount had DRE directly made the loan to USP, and (3) (implicitly) the use of loaned money (Loan 1)

CCA 201446020 – Anti-Abuse Ruling #2



- **Loan 5 – what is too closely-connected (temporally)?**
- **Unsettled interco (§ 482) amounts? Can passive activity really result in funding?**

Facts

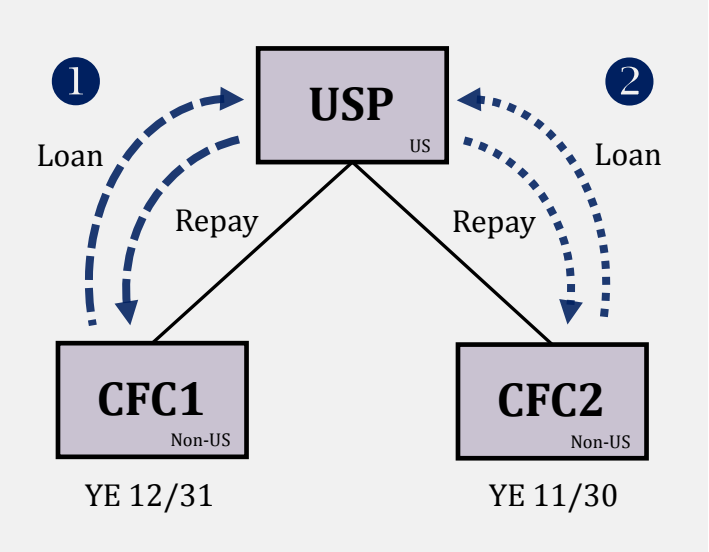
- Lower-Tier CFCs (LT CFCs) borrowed from Upper-Tier CFCs (UT CFCs), and then LT CFC's loaned virtually the same amount to USP on same day (or shortly thereafter)
- USP reported § 956 inclusion based on LT Loans, which was limited by E&P and PTI of LT CFCs (vs. ample E&P and little PTI available at UT CFCs); further, the FTCs claimed were significantly higher than if was inclusion via UT CFCs
- Period predates effective date of § 960(c)
- Taxpayer attempted to justify on basis that certain UT CFCs rendered interco Treasury/finance services to LT CFCs

Observations

- IRS says the § 956 anti-abuse rule focuses on the avoidance of § 956 with respect to the funding CFCs (here, the UT CFCs)
- Several factors indicated that the anti-abuse rule's principal-purpose test is implicated: (1) the § 956 amount was limited by LT CFC's E&P and PTI (vs. lots of E&P and little PTI in the UT CFCs), (2) UT CFC inclusion (vs. LT CFC inclusion) would have resulted in less than 20% of FTCs actually claimed, (3) use of funds (tracing shows UT CFCs provided most/all of the cash needed for LT CFCs to on-lend to USP), (4) lack of business purpose for LT CFCs' borrowing from UT CFCs, (5) proximity in time (LT CFCs didn't have use of funds for any significant length of time)

Alternating Loans

Alternating Loans



Hypothetical Loan Matrix

Period	CFC1	CFC2
Jan 19 – Mar 4	X	
Mar 5 – Apr 21		X
Apr 22 – June 8	X	
June 9 – July 26		X
July 27 – Sept 10	X	
Sept 11 – Oct 25		X
Oct 26 – Dec 7	X	
Dec 8 – Jan 18		X

Facts

- CFC1 and CFC2 switch off lending, using funds to run US operations (e.g., payroll, buybacks, etc.)
- CFC1 is internal bank and CFC2 is pool of cash
- No loans outstanding over quarter-end (there is no reliance on Notice 88-108) and no co-mingling of funds between CFCs

Analysis

- AM 2009-013 suggests that each obligation is treated as distinct so long as truly independent
- Potential risks: debt/equity, step-transaction (*Jacobs Engineering*; RR 89-73), substance-over-form, "funding" issues under § 956 anti-abuse rule, § 269, conduit, economic substance, indirect guarantees, APB 23, other?

Pledges / Guarantees

CFC Pledges and Guarantees

- **Direct pledge or guarantee** – obligation of a US person in respect of which a CFC has pledged assets or provided a guarantee will result in "US property" held by the CFC. *See* Reg. § 1.956-2(c)(1)

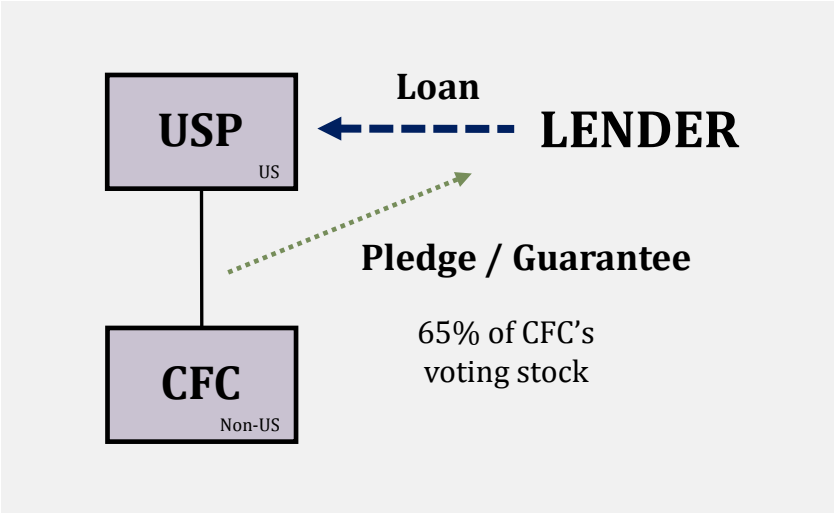
- **Indirect pledge or guarantee** – *see* Reg. § 1.956-2(c)(2)

  - If assets of CFC serve (at any time, and even though indirectly) as security for the performance of an obligation of a US person, the CFC will be considered a pledgor or guarantor of that obligation

  - Pledge of CFC stock will be considered an "indirect pledge" of CFC's assets if (1) at least 66⅔ percent of total combined voting power of all classes of CFC stock entitled to vote is pledged, *and* (2) there are certain negative covenants limiting CFC's discretion w/r/t disposition of assets and incurrence of liabilities

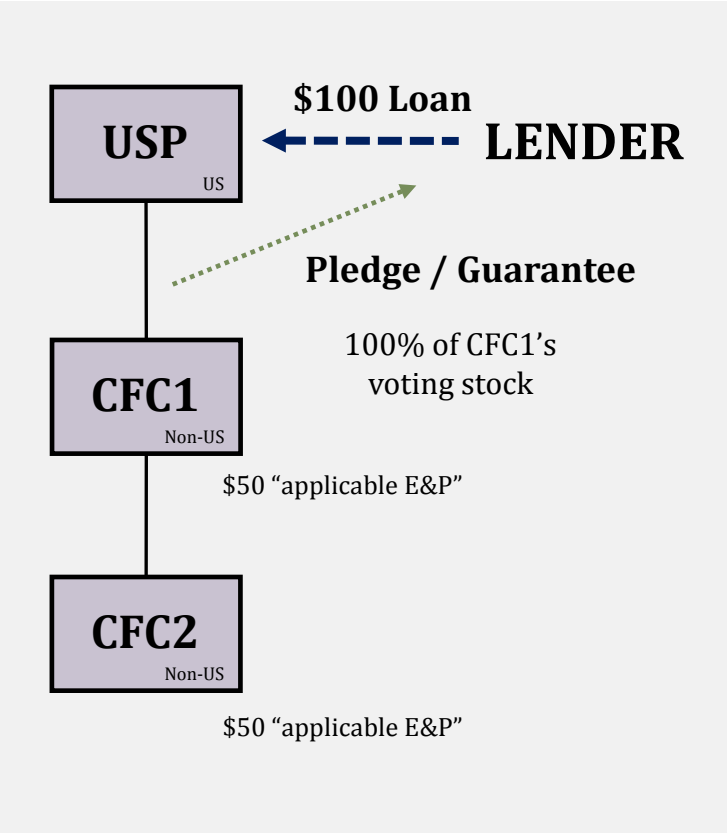
- **Amount to take into account** – unpaid principal amount of obligation w/r/t which the CFC is a pledgor/guarantor. Reg. § 1.956-1(e)(2)

Indirect Pledge (Base Case)



- USP owns CFC
- USP borrows from Lender, pledges 65% of CFC's voting stock *and* enters into (customary) negative covenants
- 66⅔ percent rule not literally a safe harbor, but effectively treated as one in practice
- **Hi / low vote structures?**

Tiered-CFCs w/ First-Tier Pledge



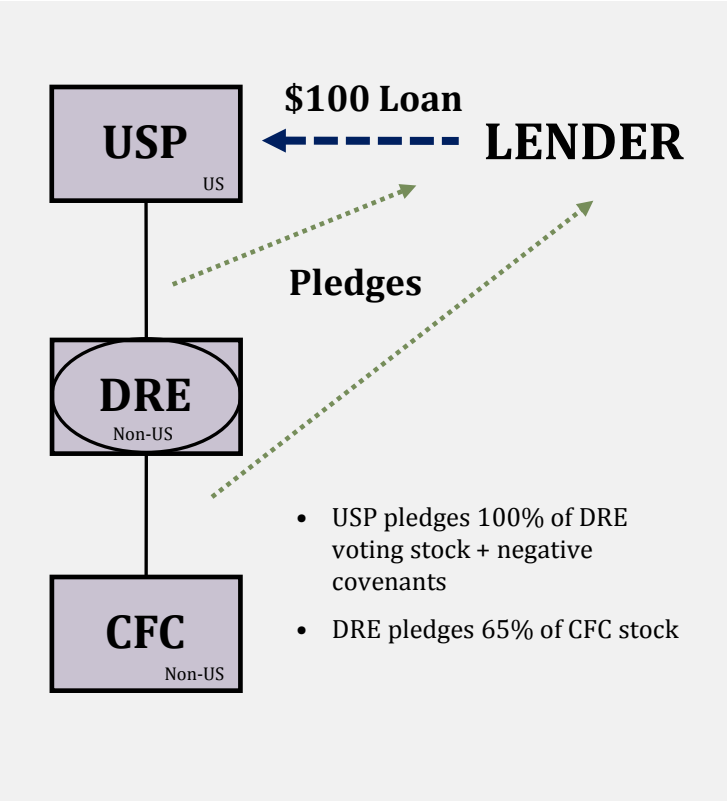
Facts

- USP owns CFC1, which owns CFC2
- USP borrows $100, and pledges 100% of CFC1 voting stock *and* enters into negative covenants

Observations

- CFC1 is treated as holding "US property" under indirect pledge rules
- What about CFC2?
  - CFC1 is treated as indirectly pledging its assets, which include stock of CFC2. Is this treated as an *actual* pledge of CFC2 stock for purposes of testing whether CFC2 *indirectly* pledged assets?
  - A 1994 CCA concludes that CFC2 is *not* treated as holding "US property" *provided* the value of CFC2 stock was not a "significant amount" of CFC1's total assets

Pledge of DRE



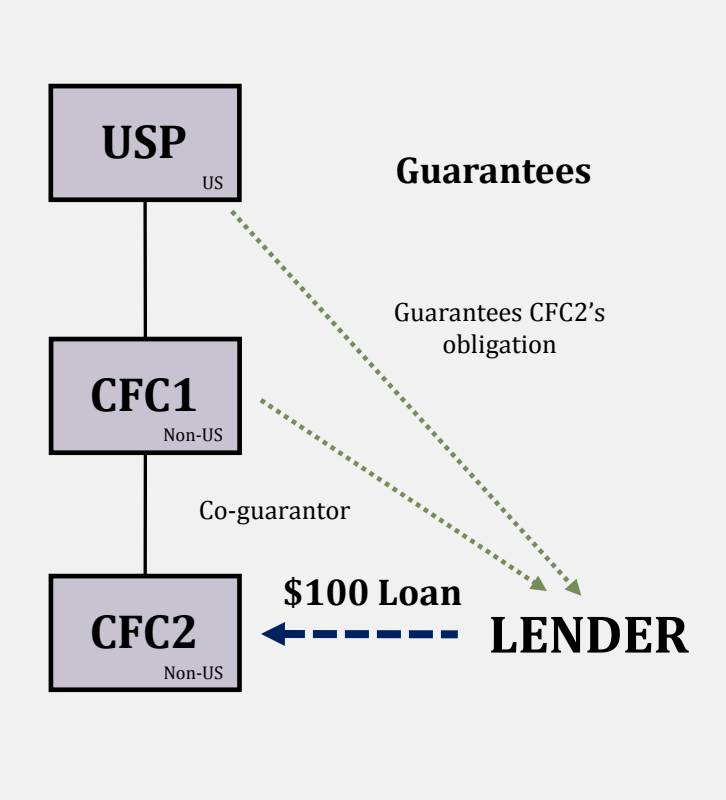
Facts

- USP owns DRE (a non-US company), which owns 100% of CFC
- USP borrows $100, and pledges 100% of DRE voting stock *and* enters into negative covenants
- DRE separately pledges 65% of CFC stock

Observations

- Is this treated as a pledge of 100% of CFC stock?
  - Lender only has security rights in respect of 65% of CFC stock
  - Impact of negative covenants granted by USP? Do they have any bearing on CFC's assets?
  - What if DRE has a lot of assets (i.e., in addition to the CFC stock)?
  - What if DRE were a partnership? Does US tax or local law classification matter?

Guarantee by USP as "Obligation"?



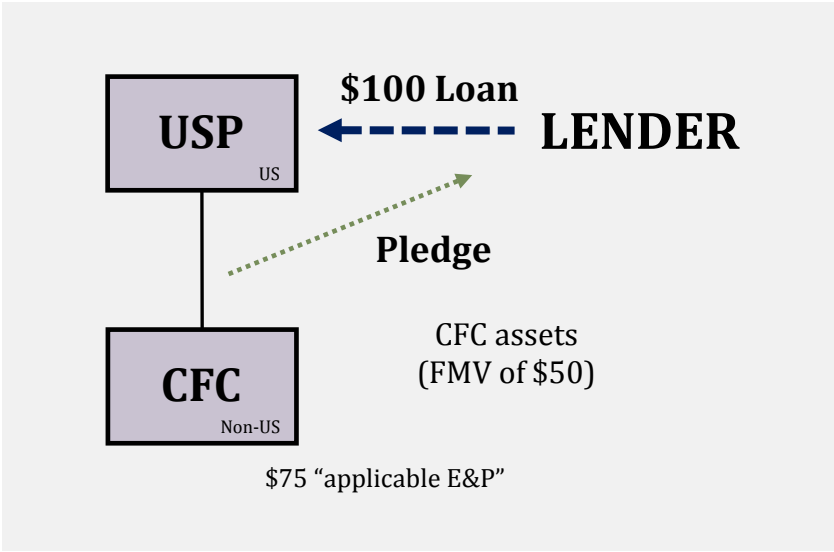
Facts

- USP owns CFC1, which owns CFC2
- CFC2 borrows $100 from unrelated Lender
- USP and CFC1 are co-guarantors on CFC2's obligation to Lender (or alternatively USP pledges CFC1's shares w/r/t CFC2's obligation)

Observations

- Does CFC1's co-guarantee or pledge of CFC1 shares with respect to USP's obligation pursuant to guarantee create an investment in US property?
  - TAMs from early 1980s hold that guarantee of CFC debt by US person did not constitute an "obligation" for § 956 purposes – there is no direct/indirect repatriation of CFC's E&P
- What if USP was treated as the borrower under Plantation Patterns analysis?

Amount of Inclusion?



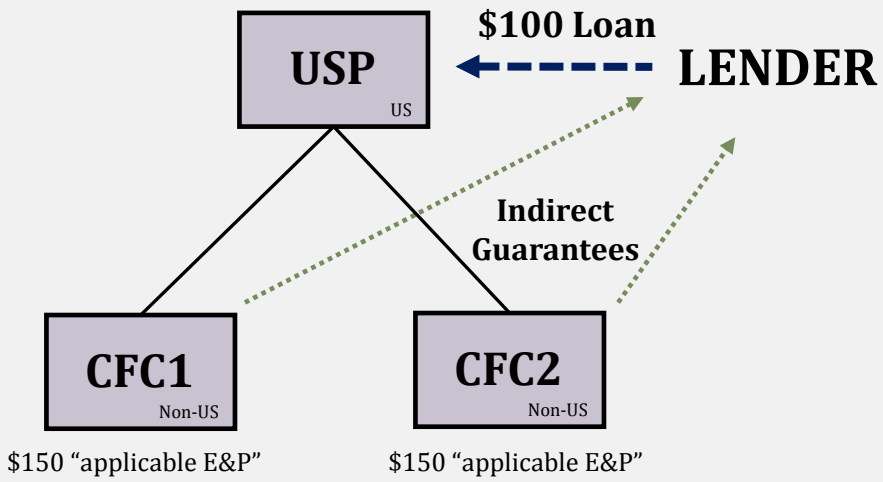
Facts

- USP borrows $100
- USP owns CFC
- CFC pledges assets with FMV of $50 with respect to USP's obligation
- CFC has $75 of applicable E&P

Observations

- Amount of "US property" equal to principal amount on underlying obligation of USP. See, e.g., Reg. § 1.956-2(c)(2) Ex. 3
- No correlation to value of CFC's assets pledged

Multi-Inclusion on Guarantees of 1 Obligation



CFC1 and CFC2 each effectively pledge assets

Facts

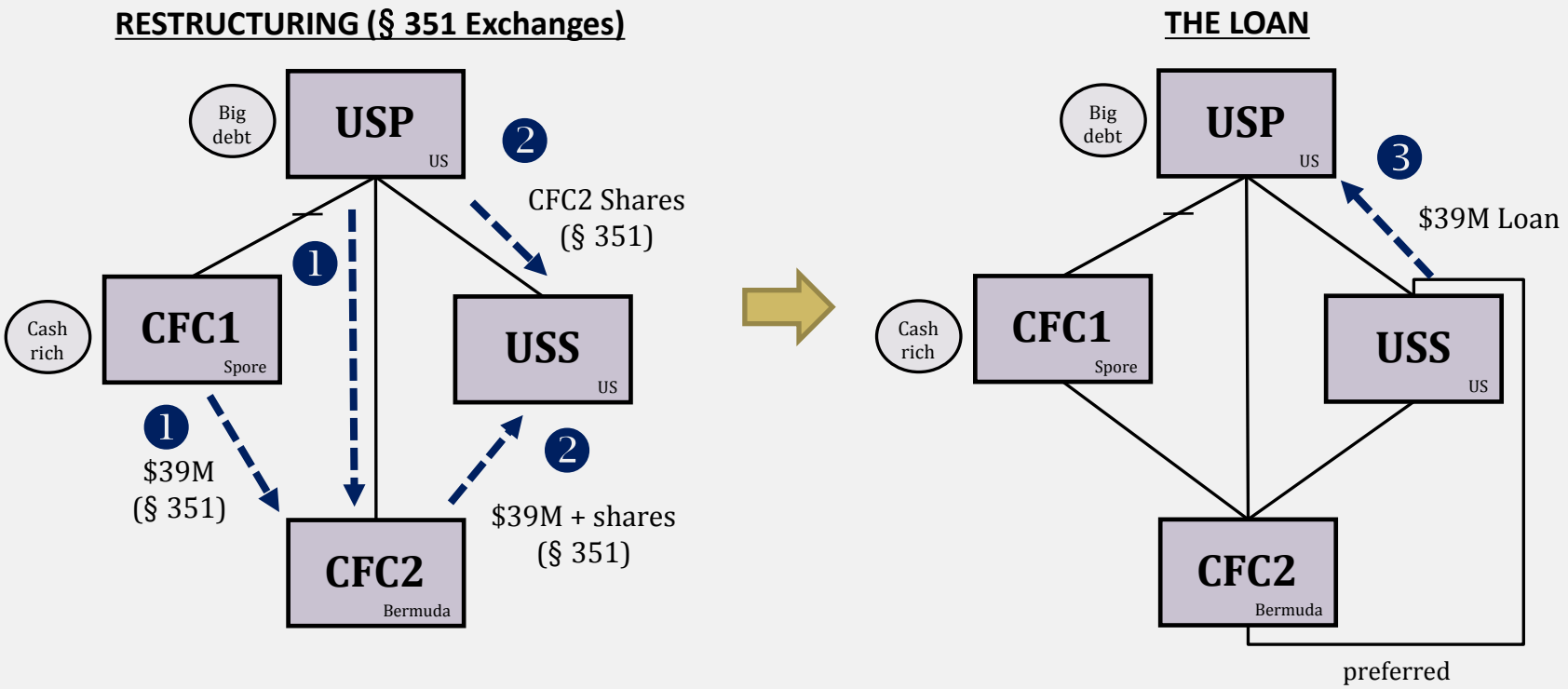
- USP borrows $100 from unrelated Lender
- CFC1 and CFC2 each pledge their assets with respect to USP's borrowing (promise to pay dividends, etc.)
- Each CFC1 and CFC2 has $150 of applicable E&P

Observations

- What is amount of inclusion ($100 / $200)?
- FSA 200216022 – 2002 release provided that each guarantee taken into account up to the *full amount of CFC's applicable E&P* ("nothing…prohibits joint and several CFC guarantors…from each being treated as repatriating its applicable [E&P] as a result of multiple guarantees of a single obligation of [USP]")
  - Result = multiple inclusions to USP
  - Inclusions can exceed the amount of USP's obligation to Lender
- FSA re-released in November 2005 – in "hazards" discussion (previously redacted), the FSA notes that triggering multiple repatriations from a single loan "could produce strange results" and thus "we believe the best answer" to computing the § 956 amount "is to prorate the amount of the loans indirectly guaranteed between the various CFCs involved"
- **Proration?**
  - By values of guarantees?
  - By E&P?

Judicial Doctrines

Barnes Group



- In the first § 351 exchange, USP contributed $200K and CFC1 contributed $39M to CFC2 in exchange for shares
- In the second § 351 exchange, USP contributed CFC2, and CFC2 contributed $39M plus some of its shares, to USS in exchange for USS shares

- USS loans $39M to USP
- CFC2's shares in USS constitute "US property" for § 956 purposes
- Taxpayer took position that CFC2's basis in USS shares was $0 under Rev. Rul. 74-503 (now revoked), so that the § 956 inclusion was $0

Barnes Group – Judicial Doctrine

- Barnes Group v. CIR, TC Memo 2013-109
  - Tax Court held against taxpayer – transactions should be stepped-together and characterized as a dividend from CFC1 to USP
  - Court stated (dicta?) that taxpayer could not rely on Rev. Rul. 74-503 because facts of ruling were not sufficiently similar and focused on lack of business purpose for including CFC2 in the structure
  - Court imposed accuracy-related penalty despite the fact that the taxpayer obtained an opinion from its tax adviser
- Barnes Group v. CIR, 114 AFTR 2d 2014-6521 (2d Cir. 2014)
  - Second Circuit affirmed Tax Court
  - Affirmed application of step-transaction doctrine, fact that taxpayer could not rely on Rev. Rul. 74-503 and imposition of accuracy-related penatly

Notice 2014-52

Notice 2014-52 – Anti-Inversion Rules

- Notice 2014-52 was issued September 22, 2014
- Purpose is to curb certain "tax avoidance transactions" post-inversion
- Regulations to be issued under section 956(e) and various other provisions. See Notice 2014-52, § 3.01(b)
- The section 956 regulations will apply to acquisitions of obligations or stock of a non-CFC foreign related person completed on/after September 22, 2014 (and during the § 7874 "applicable period"), but only if the inversion is completed on/after September 22, 2014
  - Preexisting transactions/obligations?

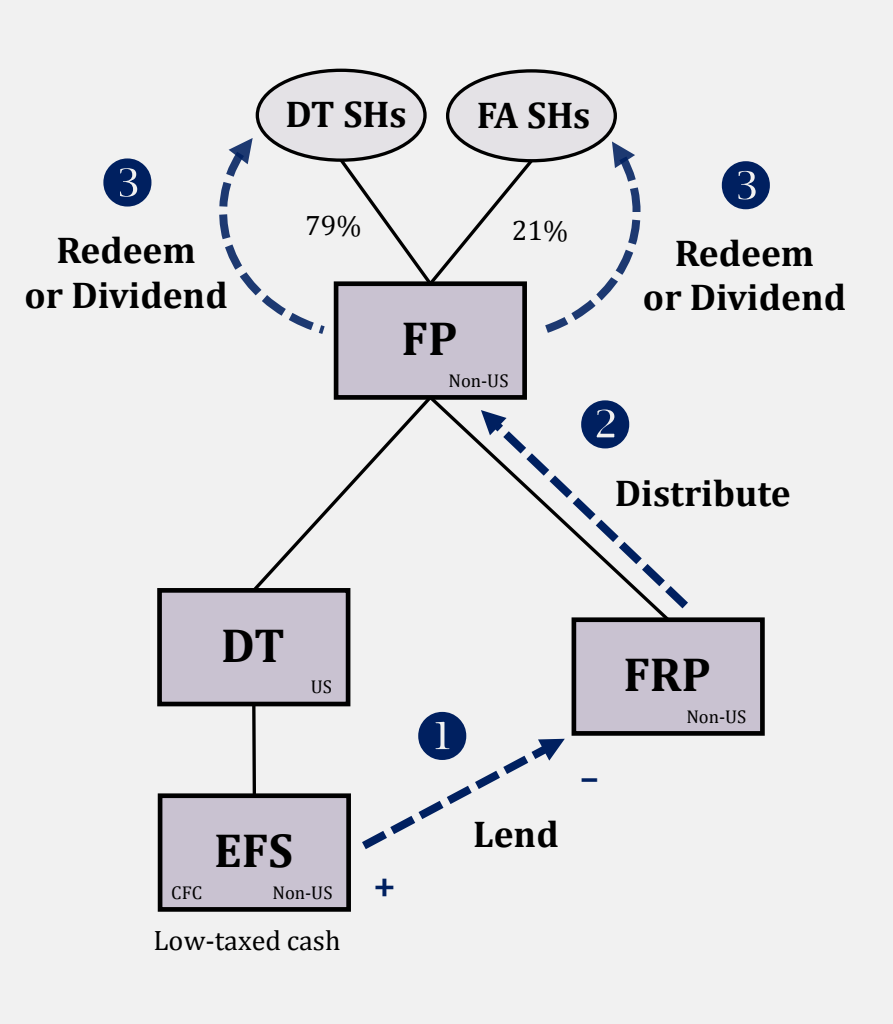
Inversion Notice – Simplified Overview

- Perceived Abuse
  - Access to low-taxed earnings of DT's CFCs without residual US taxation due to Congressionally-drawn parameters as to what constitutes "US property" for § 956 purposes; in essence, inversion allows group parent to do something (permanently) that could not be done absent the inversion
  - § 956(c)(1) defines "US property" and § 956(c)(2) prescribes exceptions thereto
- Notice Remedy
  - Focus on holdings / investments of "Expatriated Foreign Subs" (EFS)
    - EFS ≈ CFC in which DT was a USSH prior to the inversion
  - Rule: To extent EFS acquires stock or obligation of a "Foreign Related Person" (generally defined as a non-US person that is § 7874-related, excluding an EFS) during the "applicable period" (~10 years post-inversion), then solely for § 956 purposes such stock or obligation is treated as "US property"

Inversion Notice – Specifics

- Generally – Regs will provide that, solely for § 956 purposes, any *obligation* or *stock* of a **foreign related person** (FRP) will be treated as "US property" to extent acquired by an **expatriated foreign subsidiary** (EFS) during the § 7874 "applicable period"
- Pledge/Guarantee – Regs will also provide that an EFS that is a pledgor/guarantor of an obligation of a FRP, under principles of § 956(d) and Reg. § 1.956-2(c), will be considered as holding that obligation
  - **FRP** = means, with respect to any expatriated entity (i.e., the inverted domestic corp or partnership), a foreign person related to such entity within the meaning of § 267(b) or § 707(b)(1), or under the same control (within meaning of § 482) as the expatriated entity, *but not* including an EFS (such person, a "non-CFC foreign related person")
  - **EFS** = with one exception, means a CFC with respect to which an expatriated entity is a US shareholder per § 951(b). However, it does *not* include a CFC that is a member of the EAG immediately after the acquisition / all transactions related to the acquisition (completion date) *if* the domestic entity is not a US shareholder with respect to the CFC on/before the completion date. (Exception is generally trying to exclude "legacy" CFCs of FA held at the time of the acquisition – i.e., so they can lend to their group (FRPs))
  - **Applicable period** = begins on the first date properties are acquired as part of inversion; ends 10 years after last date properties acquired as part of the inversion

Funding Dividends / Buybacks



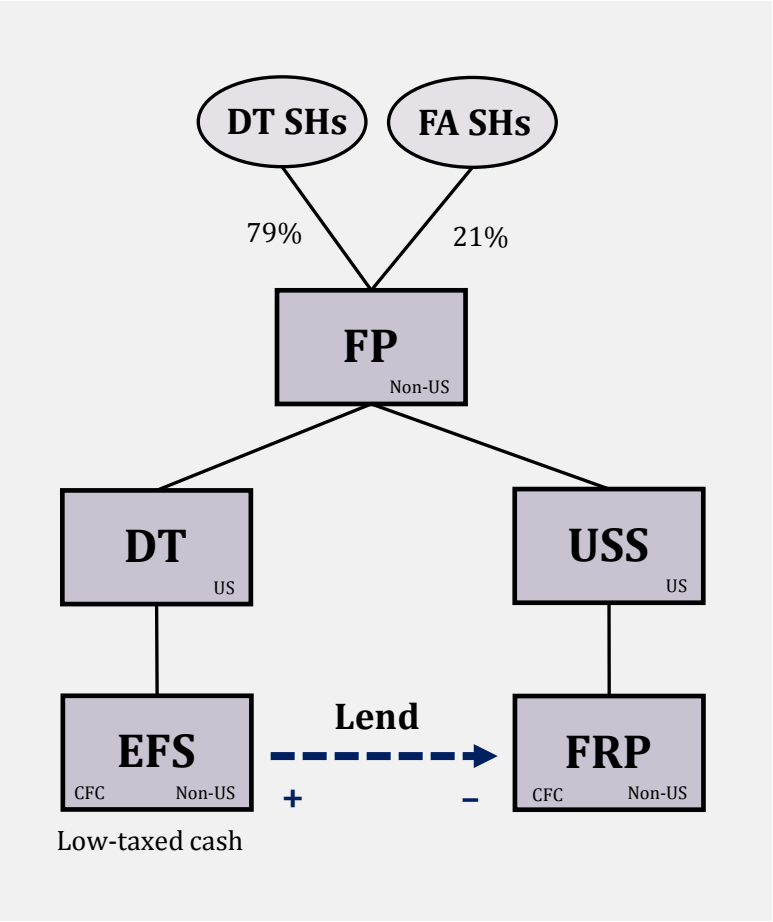
Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- EFS (a historic CFC of DT) lends cash to FRP (a historic foreign subsidiary of FP)
- FRP uses proceeds for various FP-related purposes, including ultimately allowing FP to pay dividends on (or redeem) FP stock

Observations

- FRP is "foreign related person" because it is a non-US person related to DT but is not itself an "expatriated foreign sub". (It is not a EFS because DT is not a USSH in FRP.)
- Notice § 3.01(b) treats the FRP obligation held by EFS as "US property;" DT must evaluate the extent to which it has a § 956-related inclusion
- Absent the Notice, there is no § 956 event

Funding Foreign Acquirer's CFCs



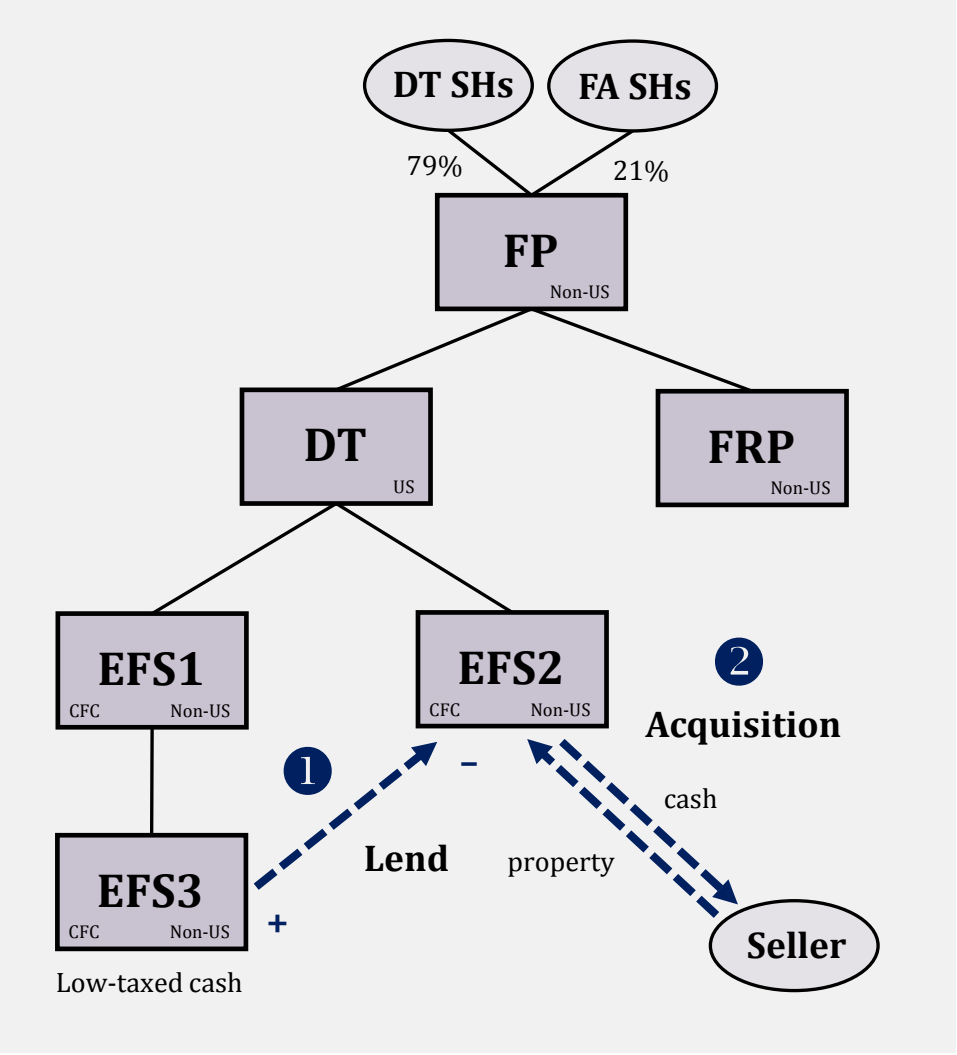
Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- FP also has a US group – headed by USS, which owns FRP (a historic USS-owned CFC)
- EFS (a historic CFC of DT) lends cash to FRP
- FRP uses the cash to fund its operations

Observations

- FRP is "foreign related person" because it is a non-US person related to DT but is not itself an "expatriated foreign sub". (FRP is not a EFS because DT is not a USSH and was not a USSH prior to the inversion)
- Notice § 3.01(b) treats the FRP obligation held by EFS as "US property;" DT must evaluate the extent to which it has a § 956-related inclusion
- **The fact that FRP is a CFC does not change the analysis (i.e., because FRP is not an EFS)**
- Absent the Notice, there is no § 956 event

Funding Domestic Target's CFCs



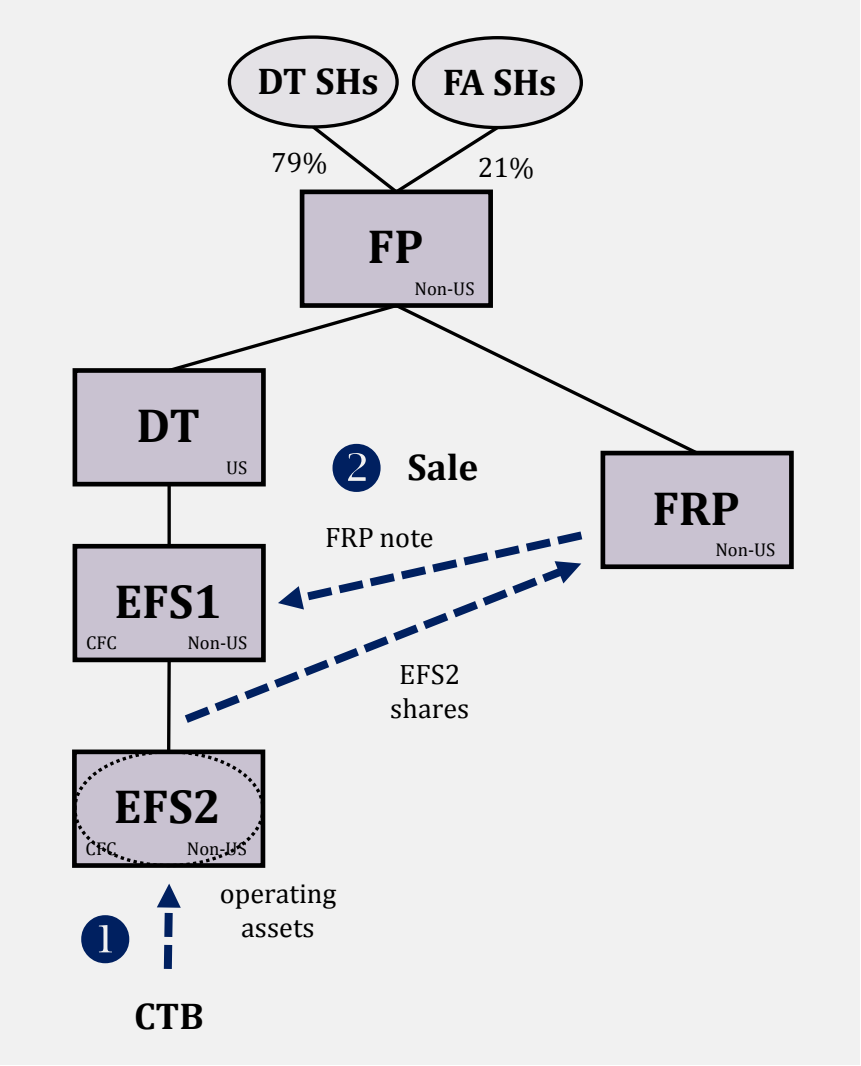
Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- EFS3 (a historic CFC of DT) lends cash to EFS2 (also a historic CFC of DT)
- EFS2 uses the borrowed cash to buy assets for use in its operations

Observations

- Both EFS3 and EFS2 are "expatriated foreign subs" because they are CFCs in which DT was a USSH prior to the inversion
- Because EFS2 is an EFS (and not a FRP), the EFS2 obligation held by EFS3 is not "US property"
- **It would not matter if EFS2 was newly-formed, because it would still be a EFS (i.e., because DT is a USSH thereof)**

Dover Transactions



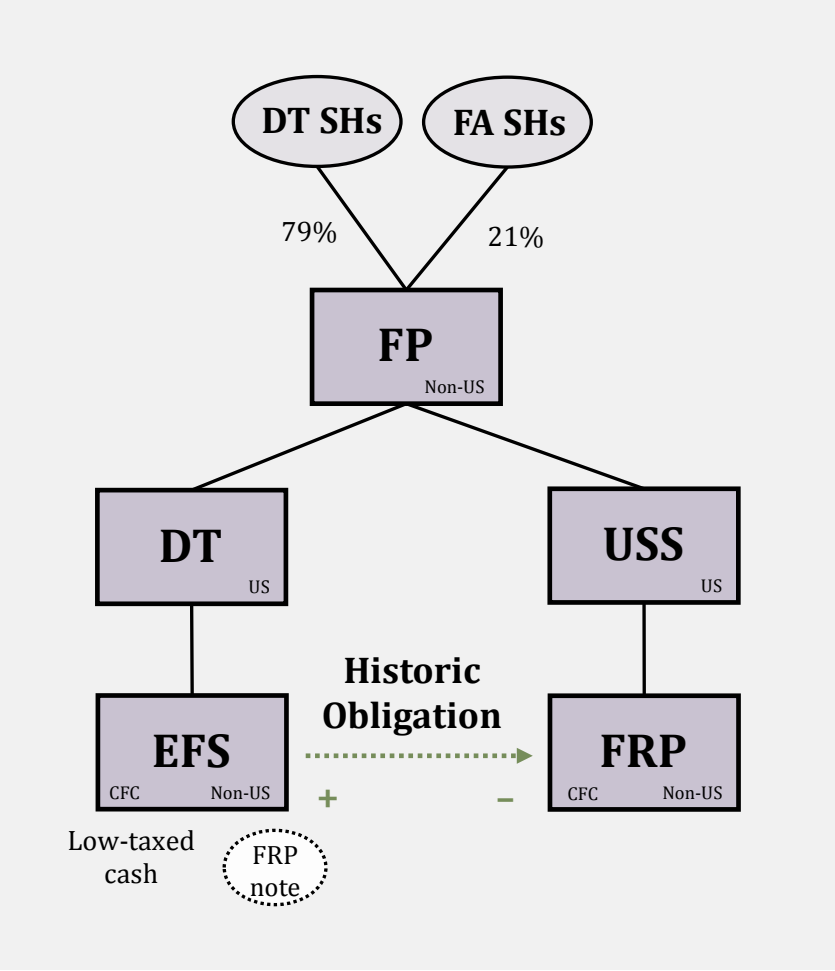
Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- EFS1 sells the operating assets held by EFS2 (its 100%-owned sub) to FRP, in exchange for a note
- FRP operates the historic EFS2 business

Observations

- EFS1 is an "expatriated foreign sub" because it is a CFC in which DT was a USSH prior to the inversion; FRP is "foreign related person" because it is a non-US person related to DT but is not itself an "expatriated foreign sub"
- Notice § 3.01(b) treats the FRP obligation held by EFS1 as "US property;" DT must evaluate the extent to which it has a § 956-related inclusion
- Absent the Notice, there is no § 956 event

Pre-Existing Obligations



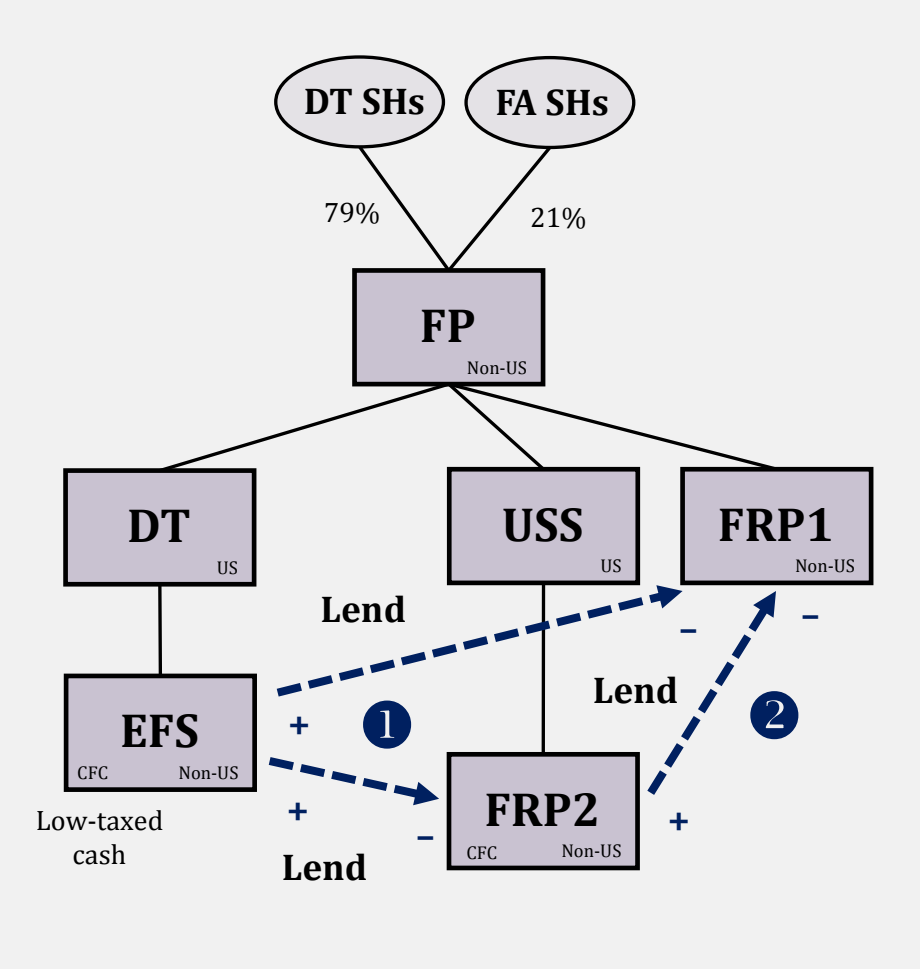
Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- Prior to the inversion, FRP (a historic CFC that is owned by FP) transacted business with EFS (a historic CFC of DT), and at the time of the inversion FRP had outstanding a significant obligation payable to EFS

Observations

- FRP is "foreign related person" because it is a non-US person related to DT but is not itself an "expatriated foreign sub;" thus, the Notice normally would treat the FRP obligation held by EFS as "US property" if acquired post 9/22
- **What does Notice § 4 "acquisition" mean if the historic obligation relates to a pre-existing business relationship (e.g., FRP serves as local distributor for both EFS and FRP products)**
- **If historic obligation relates to a major, one-time transaction, does a post-9/22 Cottage Savings event result in a § 956 event?**

That "Legacy" CFC Aspect of the EFS Definition



Facts

- Public FP acquires DT (i.e., DT inverts) on September 23, 2014
- Prior to the inversion, FP owned FRP1 and, through USS, FRP2 (a CFC).
- Assume various individual loans depicted at left (not conduit)

Observations

- FRP1 and FRP2 are "foreign related persons" because they are non-US persons related to DT but neither is an "expatriated foreign sub" (FRP1 is not a EFS because it is not a CFC and FRP2 is not one – despite being a CFC member of the EAG right after the inversion – because DT was not a USSH in it prior to the inversion)
- Loans in #1 are "US property" (see slides 50/51)
- Loan in #2 is not "US property" because FRP2 is not a EFS – and thus the notice rule does not hit
- **Change the facts: What if USS transferred FRP2 to DT post-inversion in, e.g., B-reorg?**

Inversion Notice – Other Thoughts

- Comments requested on whether any exceptions under § 956(c)(2) or Reg. § 1.956-2 should apply to an obligation or stock of a FRP that is determined to be "US property" under the Notice's promised regs
  - Notice 88-108 exception will not apply to such obligations
- Other issues to consider:
  - Statutory authority
  - Availability of exceptions under § 956(c)(2) such as ordinary course accounts receivable
  - Potential for multiple inclusions under FSA 200216022