

International M&A Update

FBA Tax Conference

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Panelists

- Joseph Calianno, Grant Thornton
- Sean Mullaney, PricewaterhouseCoopers
- Caroline Ngo, McDermott Will & Emery
- Robert Williams, Internal Revenue Service
- Brenda Zent, Department of Treasury

- John Bates, Ivins, Phillips & Barker
(moderator)

Agenda

- Regulatory update
- § 367 background
- GRA and § 6038B reporting regulations
- § 367(a)(5) regulations
- Notice 2012-39

§ 367 Background

- Overlay on Subchapter C nonrecognition provisions
- Primarily prevents US persons from using Subchapter C nonrecognition provisions to:
 - Transfer appreciated assets outside US taxing jurisdiction
 - Avoid taxation of E&P of foreign subsidiaries at ordinary rates (backstop to § 1248)

§ 367 Overview

- § 367(a) – outbound transfers of tangible assets, certain limited intangible property, and stock or securities (§§ 351, 354, 356, and 361)
- § 367(b)
 - Foreign-to-foreign transactions (§§ 351, 354, 356, and 361)
 - Inbound transactions (§§ 332, 354, 356, and 361)
- § 367(d) – outbound transfers of intangibles (§§ 351 and 361)
- § 367(e) – outbound and foreign-to-foreign § 332 liquidations
- Cross-border § 355 distributions – §§ 367(b), (e)

§ 367(a)

- § 367(a)(1)
 - General rule – foreign corporation denied corporate status in determining extent to which gain recognized
 - Results in US person recognizing gain on each item of appreciated property transferred
 - Transaction continues to otherwise qualify for tax-free treatment
- Character and source of gain determined as if property disposed of in taxable transaction
- Appropriate adjustments to basis, E&P, and other items

§ 367(a) – Foreign Active Trade or Business Exception

- Exception to gain recognition rule of § 367(a)(1)
 - Assets used or held for use in foreign trade or business
 - § 6038B reporting requirement
- Exceptions
 - Subsequent dispositions of transferred property (Reg. § 1.367(a)-2T)
 - Outbound § 368 asset reorganization (§ 367(a)(5))
 - “Tainted” assets (Reg. § 1.367(a)-4T, 5T)
 - Depreciation recapture (Reg. § 1.367(a)-4T)
 - Branch loss recapture (Reg. § 1.367(a)-6T)

Outbound Transfer of Foreign Corporation Stock or Securities

- Reg. § 1.367(a)-3(b) – except as provided in § 367(a)(5), gain not recognized if
 - US transferor is less than 5% shareholder of transferee foreign corporation, or
 - US transferor is 5% shareholder of transferee foreign corporation and enters into GRA
- Must also consider the provisions of § 367(b) (Reg. § 1.367(b)-4)

Outbound Transfer of Domestic Corporation Stock or Securities

- Gain recognized unless substantive and reporting requirements satisfied
 - US transferors receive no more than 50% (by vote or value) of stock of transferee foreign corporation in the transaction
 - US persons who are either officers or directors of US target, or 5% shareholders of US target own, immediately after transfer, no more than 50% (by vote or value) of stock of transferee foreign corporation
 - Transferee foreign corporation active trade or business requirement
 - 36-month foreign active trade or business
 - Substantiality requirement – FMV of transferee foreign corporation greater than or equal to FMV of transferred domestic corporation
 - No intention to dispose of or discontinue trade or business
- GRA requirement – US person must file GRA if 5% transferee shareholder

Outbound § 368 Asset Reorganization

- § 367(a)(5) – generally requires US target to recognize gain on outbound § 361(a) or (b) transfer of property by disallowing exceptions that might otherwise apply
- Statute contemplates regulatory exception
 - US target corporation controlled (§ 368(c)) by five or fewer domestic corporate shareholders
 - Subject to basis adjustment and other conditions provided in regulations
- Proposed regulations issued in 2008 can be relied upon until effective date of any final regulations

Reg. § 1.367(a)-8 – GRAs

- US transferor agrees to recognize gain on initial transfer if transferee foreign corporation disposes of (or is deemed to dispose of) transferred property during five taxable years following close of taxable year of initial transfer
- Certain events cause gain recognition (“triggering events”)
- Generally report gain on amended return for year of initial transfer (election to report gain for year of triggering event), plus interest charge
- Appropriate basis adjustments to reflect gain recognized

§ 367(d) – Outbound Transfers of Intangible Assets

- § 367(d) – US transferor generally treated as having sold intangible property in exchange for deemed annual payments contingent on productivity, use, or disposition of intangible property
 - Parallels commensurate with income standard of §482
 - Duration – lesser of useful life of intangible property or 20 years
 - Special rules for dispositions of intangible property by transferee foreign corporation or dispositions of stock of foreign transferee corporation by US transferor
- § 367(d) property not subject to § 367(a)
- Intangible property defined by cross-reference to § 936(h)(3)(B)
 - Regulatory exclusion of foreign goodwill and going concern value

§ 367(b) Overview

- Reg. § 1.367(b)-3 – governs inbound liquidations and asset reorganizations
 - All E&P regime – certain exchanging shareholders take “all E&P amount” into income as dividend
 - Not limited by built-in gain in foreign target stock (compare “section 1248 amount”)
- Reg. § 1.367(b)-4 – governs foreign-to-foreign § 351 transactions and reorganizations
 - Backstop to § 1248

Proposed Outbound Reporting Regulations

Current Reporting Regulations on Exceptions to Section 367(a)(1): GRA Requirement

- As discussed, the statute and regulations provide exceptions to the general rule under section 367(a)(1).
- In some cases, these exceptions require the US transferor to file a “gain recognition agreement” and other related documents under Treas. Reg. sec. 1.367(a)-8 (“section 367(a) GRA regulations) in order to avoid the recognition of gain under section 367(a)(1).
- If there is a failure to timely file a GRA in connection with the initial transfer, the US transferor must recognize the full amount of gain with respect to the transfer unless the US transferor demonstrates that the failure was due to “reasonable cause.”
- Similarly, if there is a failure to comply in any material respect with any requirement of the section 367(a) GRA regulations or with the terms of an existing GRA, the US transferor must recognize the full amount of gain realized on the initial transfer unless the US transferor demonstrates that the failure was due to “reasonable cause.”

Current Reporting Regulations on Exceptions to Section 367(a)(1): Other Statements and Reporting Requirements

- In addition to the section 367(a) GRA regulations, other regulations under section 367(a) require certain other statements to be filed. See e.g., Treas. Reg. sec. 1.367-3(c)(6). The penalty for not complying with these rules is not specified.
- In addition, a US transferor who transfers certain property to a foreign corporation in certain nonrecognition transfers is subject to the reporting requirements of section 6038B and the regulations thereunder. The penalty for not complying with these rules is capped at \$100,000, unless the failure was due to intentional disregard.

Current Reporting Regulations on Exceptions to Section 367(a)(1): IRS Response Within 120 Days

- A U.S. transferor can obtain relief from a failure to file a GRA or failure to comply in any material respect with the section 367(a) GRA regulations by requesting relief and establishing that the failure was due to reasonable cause and not willful neglect.
- The IRS must notify the taxpayer in writing if the IRS determines that the U.S. transferor's failure was not due to reasonable cause or if additional time is needed to make a determination.
- This notification is to be made within the 120-day period that begins on the date that the IRS notifies the U.S. transferor in writing that its request for relief has been received and assigned for review.
- If the U.S. transferor is not so notified before the close of the 120-day period, the US transferor is deemed to have established that the failure was due to reasonable cause and not willful neglect.

Current Reporting Regulations on Exceptions to Section 367(e)(2) for Outbound Liquidations

- As discussed, the regulations provide exceptions to the general rule under section 367(e)(2) for outbound liquidations.
- The exceptions generally require the filing of certain statements or schedules by the liquidating corporation and the distributee corporation. The penalty for not complying with the reporting rules is not specified.
- In addition, a domestic liquidating corporation that distributes property to a foreign corporation in a transaction subject to section 367(e)(2) is subject to section 6038B and the regulations thereunder.

The Proposed Outbound Reporting Regulations

- The proposed regulations:
 - Change the reasonable cause standard to “willful failure” for failure to file a GRA or comply with GRA requirements,
 - Retain the reasonable cause standard for section 6038B penalty,
 - Remove the 120-day response requirement, and
 - Provide similar rules for statements required under 1.367(a)-3 and section 367(e)(2) and specify the penalty for not filing these statements.

Proposed Outbound Reporting Regulations

- Willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which includes gross negligence, reckless disregard, or willful negligent.
- “Willful” will be based on all the facts and circumstances.

Proposed Outbound Reporting Regulations

- Examples demonstrate the meaning of a “willful failure”:
 - Failure to timely file was an “isolated oversight” → not willful failure
 - Failure to timely file + history of failing to timely file required tax and information returns, in particular, GRAs + failure to implement safeguards to ensure that it would timely file GRAs → willful failure
 - Timely filed GRA stated required fair market value information was “available upon request” → willful failure
 - GRA filed as a result of hindsight → willful failure

Selected Issues Under Section 367(a)(5)*

*These slides were prepared on February 26, 2013 and as of that date no final section 367(a)(5) regulations had been issued.

General Overview – Section 367(a)(5)

- General Rule – requires US Target to recognize gain on outbound Section 361(a) or (b) transfer of property by disallowing exceptions to Section 367(a)(1) that might otherwise apply
 - Foreign active trade or business exception
 - Stock or securities exceptions

General Overview – Section 367(a)(5)

- Statute contemplates regulatory exception
 - US Target corporation controlled (Section 368(c)) by five or fewer domestic corporate shareholders
 - Affiliated group members treated as 1 shareholder
 - Subject to basis adjustment and other conditions provided in regulations

General Overview – Section 367(a)(5)

- Limited guidance provided by IRS regarding the application of section 367(a)(5) prior to the proposed regulations. *See e.g.*, Reg. 1.367(a)-3(e)(1), Notice 2008-10, and PLRs 9731039 and 9533005.
- Proposed regulations issued August 2008
 - Can be relied upon until effective date of any final regulations
 - See also Reg. Sec. 1.367(a)-3(e)

General Overview – Prop. Reg.

1.367(a)-7

- The proposed regulations confirm the general rule of section 367(a)(5), but provide an elective exception to the general rule pursuant to which the exceptions provided by section 367(a) and the regulations thereunder may be available.

General Overview – Prop. Reg. 1.367(a)-7

- The conditions and requirements of the elective exception ensure that the exceptions to the general rule of section 367(a)(1) are available only to the extent:
 - The net built-in gain in certain property (section 367(a) property) transferred by the U.S. transferor in the section 361 exchange remains subject to corporate-level taxation in the hands of the controlling domestic corporate shareholders of the U.S. transferor through their ownership of stock received in the transaction.
- The proposed regulations generally apply to all property transferred by the U.S. transferor, other than property to which section 367(d) applies.
 - Proposed regulations under section 367(a) require section 367(d) property to be treated as property to which section 367(a) applies (section 367(a) property) in transactions that may be eligible for the exception to the coordination rule of Reg. 1.367(a)-3(d)(2)(vi)(A) provided by Prop. Reg. 1.367(a)-3(d)(2)(vi)(B)(1).
 - Section 367(a)(5) applies to transfers that are both section 351 and 361 transfers.

General Overview – Prop. Reg. 1.367(a)-7

- The conditions and requirements of the elective exception include:
 - **Control Requirement**
 - At the time of the section 361 exchange, the U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer, but at least one, domestic corporations (the control group).
 - Only direct ownership counts.
 - If U.S. transferor is controlled by more than 5 domestic corporations but some combination of 5 or fewer has section 368(c) control, U.S. transferor must designate the 5 or fewer domestic corporations.
 - REITs, RICs, and S-corps cannot be part of control group.
 - Members of the same affiliated group (within the meaning of section 1504) are treated as one corporation.

General Overview – Prop. Reg. 1.367(a)-7

– U.S. Transferor Gain Recognition Requirement

- Gain recognition due to non-control group members.
 - The U.S. transferor must recognize gain equal to the aggregate amount of inside gain allocable to non-control group members.
- Gain recognition where control group member is unable to preserve gain.
 - The U.S. transferor must recognize gain to the extent any control group member cannot preserve its share of inside gain in the **stock received** that is allocable to the section 367(a) property transferred in the section 361 exchange.
 - » Gain is required to be recognized when the controlled group member's share of inside gain exceeds the FMV of the stock received by the controlled group member that is allocable to section 367(a) property.
 - » Boot or liability assumption in the transaction can give rise to gain recognition by the U.S. transferor depending on particular facts.

General Overview – Prop. Reg. 1.367(a)-7

– Inside Gain

- Generally speaking, the inside gain is the aggregate gross fair market value of the section 367(a) property transferred by the U.S. transferor in a section 361 exchange over the aggregate adjusted bases in such property plus a proportionate amount of any liabilities of the U.S. transferor assumed in the section 361 exchange or satisfied in the reorganization pursuant to section 361(c)(3), but only to the extent the payment of such liability would give rise to a deduction.
 - Special adjustments to basis if gain recognized by U.S. transferor on transfer.
 - Certain special rules and definitions apply.

General Overview – Prop. Reg.

1.367(a)-7

– Basis Adjustments

- Each control group member's basis in the stock received in the transaction as determined under section 358 and the regulations under that section (section 358 basis) that is allocable to the section 367(a) property transferred by the U.S. transferor in the section 361 exchange is reduced to the extent necessary to preserve the control group member's share of inside gain.
 - Only the basis of stock received by the control group member that is attributable to section 367(a) property transferred in the section 361 exchange is reduced (for example, the basis of stock attributable to section 367(d) property is not reduced).
 - Rule is designed to preserve net built-in-gain via stock received in transaction by control group members.

General Overview – Prop. Reg. 1.367(a)-7

– Agreement to Amend or File a U.S. Income Tax Return

- The U.S. transferor must include a statement with its U.S. income tax return for the year of the section 361 exchange certifying that if the foreign acquiring corporation disposes of a significant amount of the section 367(a) property transferred in the section 361 exchange in one or more related transactions entered into with a principal purpose of avoiding the U.S. tax that would have been imposed on a sale of such property by the U.S. transferor at the time of the section 361 exchange, then the U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor) shall file a U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year of the section 361 exchange reporting the gain realized but not recognized on the section 361 exchange.
 - A disposition of a significant amount of the section 367(a) property occurs if the foreign acquiring corporation disposes of an amount of the section 367(a) property transferred in the section 361 exchange that is greater than forty percent of the fair market value of the section 367(a) property at the time of the section 361 exchange.

General Overview – Prop. Reg. 1.367(a)-7

- **Election and Reporting Requirements**
 - To elect to apply the exception, the U.S. transferor and the control group members must enter into a written agreement to make such election on or before the due date for the U.S. transferor's timely-filed return for the taxable year in which the section 361 exchange occurs.
 - Each party to the written agreement must also include a statement with its timely-filed return for the year of the section 361 exchange reporting the election and other specified information.

General Overview – Prop. Reg. 1.367(a)-7

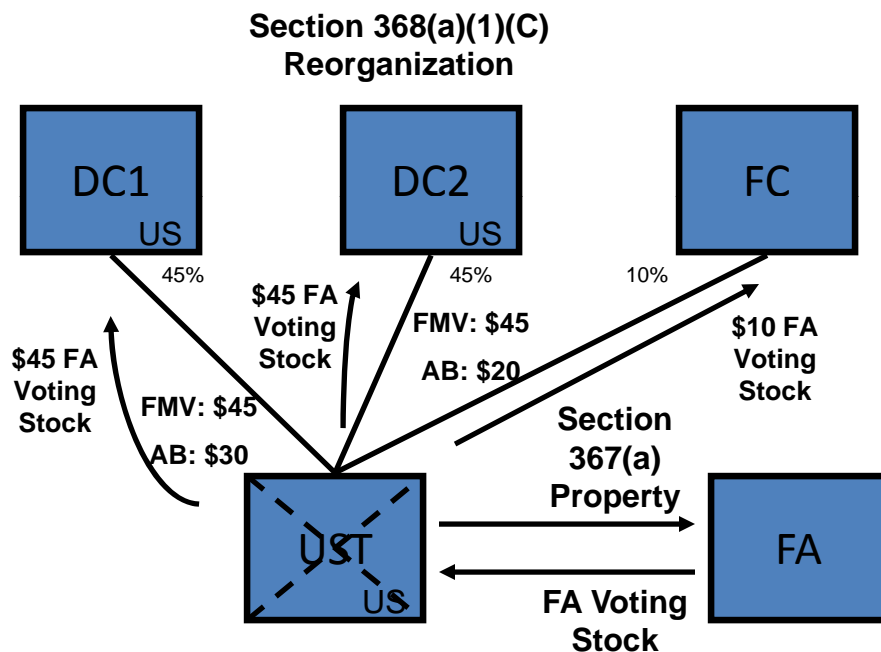
- **Special Rules**
 - Multiple blocks of stock.
 - If a control group member holds multiple blocks of stock received (or deemed received) in the transaction, the section 358 basis of each block of stock must be reduced pro rata based on the relative section 358 basis of each block of stock.
 - Special rules for divisive and successive distributions to which section 355 applies.
 - The proposed regulations apply to property transfers by U.S. transferors, including RICs, REITs, and subchapter S corporations.

General Overview – Prop. Reg. 1.367(a)-7

- **Special Rules**

- Gain recognized by the U.S. transferor treated as recognized with respect to the section 367(a) property transferred in the section 361 exchange in proportion to the amount of gain realized by the U.S. transferor on the transfer of each item of section 367(a) property.
- Gain recognized by the U.S. transferor due to non-control group members and where control group members are unable to preserve the gain shall be applied after taking into account any gain recognized by the U.S. transferor on the transfer of the section 367(a) property in the section 361 exchange pursuant to all other provisions under section 367(a) and the regulations under that section.
- Reasonable cause exception for failure to comply with administrative rules.
- An anti-stuffing rule.
 - A principal purpose test designed to address certain acquisitions of built-in-loss property to impact inside gain.
- Other special rules and definitions.

Example under Proposed Regulations – Section 367(a)(5)



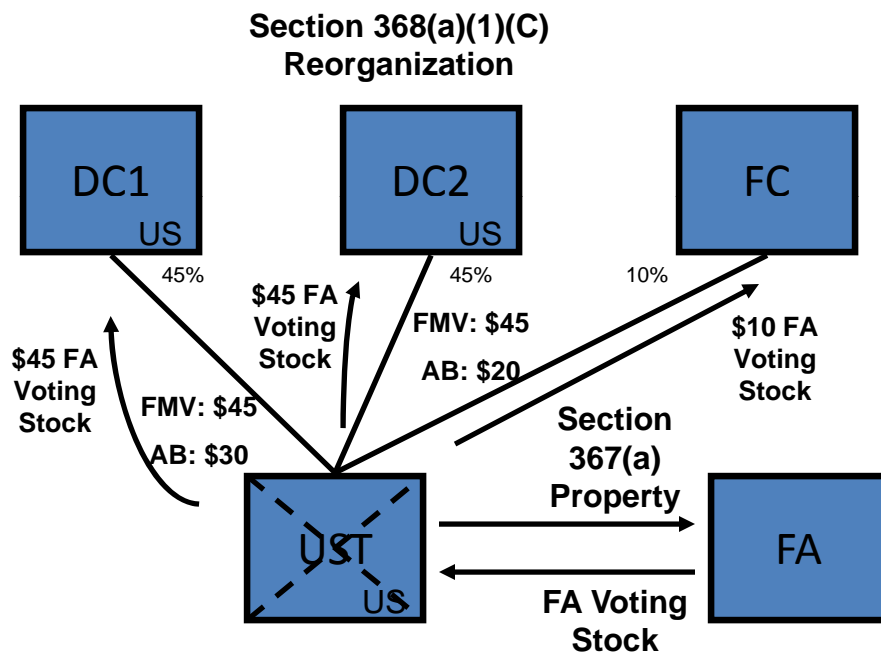
- UST transfers its section 367(a) property (which generally qualify for the section 367(a)(3) exception and have a zero basis) to FA in section 361 transaction in exchange for \$100 FA voting stock.
- UST distributes the FA stock to DC1, DC2, and FC.
- UST's total inside gain (\$100) is allocated as follows:

DC1 – 45

DC2 – 45

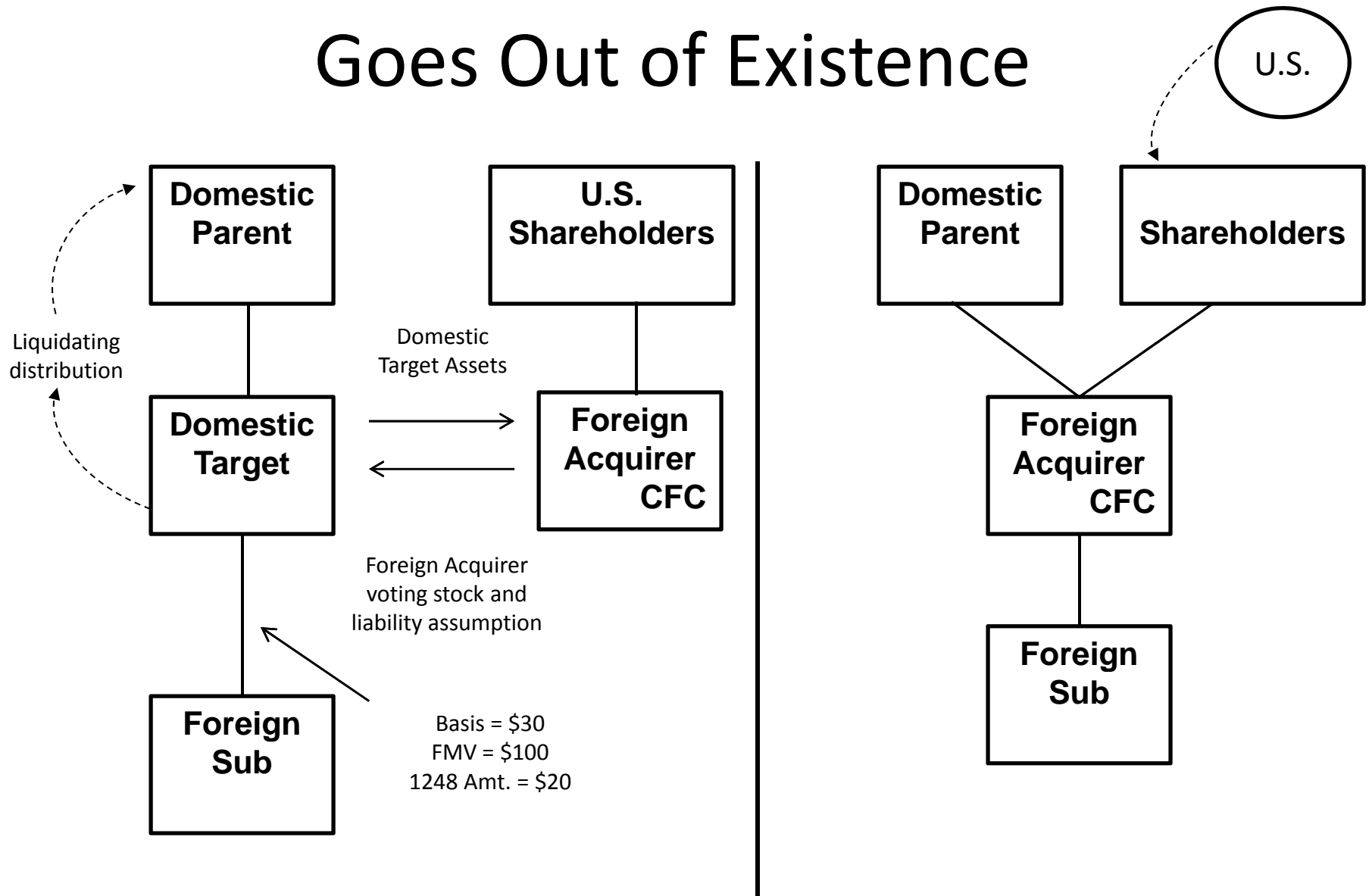
FC – 10

Example under Proposed Regulations – Section 367(a)(5)



- UST must recognize \$10 of gain on the transfer of the section 367(a) property attributable to FC's ownership.
- DC1 and DC2 recognize no gain on their exchanges under section 354(a)(1) and reduce their respective section 358 basis in the stock of FC to \$0 in order to preserve their respective share of the inside gain.
- See Prop. Reg. 1.367(a)-7(g) for additional examples.

Section 1248 Shareholder Goes Out of Existence



Section 1248 Shareholder Goes Out of Existence

- Assume Domestic Target (and ultimately Domestic Parent) receives 20% of the voting stock of Foreign Acquirer in the transaction and both Foreign Acquirer and Foreign Sub are CFCs immediately after the transaction.
- Assume that, under current law, Domestic Parent files a GRA w/r/t Domestic Target's transfer of Foreign Sub to Foreign Acquirer (assume requirements of section 367(a)(5) and Treas. Reg. 1.367(a)-3(e) are satisfied). Domestic Target must include in income its section 1248 amount of \$20 (Domestic Target not treated as a section 1248 shareholder of Foreign Acquirer because Domestic Target goes out of existence). See Treas. Reg. 1.367(b)-4(b), Ex. 4.
- Compare this result with result under Prop. Reg. 1.367(b)-4(b), Ex. 4. Assume section 367(a)(5) and Prop. Reg. 1.367(a)-7 are satisfied (and Domestic Parent enters into GRA). No section 1248 income inclusion for Domestic Target as a result of the exchange and, if certain conditions are satisfied, no income inclusion on Domestic Target's distribution of Foreign Acquirer stock to Domestic Parent. See section 1248(f)(1) and Prop. Regs. 1.1248(f)-1 and -2.

Notice 2012-39

Notice 2012-39

Section 367(d) – The Statute

d) Special rules relating to transfers of intangibles.--

(1) In general.--Except as provided in regulations prescribed by the Secretary, if a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or 361--

(A) subsection (a) shall not apply to the transfer of such property, and

(B) the provisions of this subsection shall apply to such transfer.

(2) Transfer of intangibles treated as transfer pursuant to sale of contingent payments.--

(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.

Notice 2012-39

Boot in 367(d) Transfers - Section 351 Transfers

- 1990 IRS NSAR 8126, CCA 200610019, and PLR 200845044 treat boot received in an outbound section 351 exchange as a prepayment of the section 367(d) deemed inclusion.
 - Importantly, the IRS determined that section 367(d) trumped section 351(b) -- the boot is a prepayment of the section 367(d) inclusions, but it does not trigger gain under section 351(b).

Notice 2012-39

In July 2012, the IRS and Treasury issued Notice 2012-39, providing that in an outbound reorganization, boot received by the U.S. transferor will be treated as a prepayment of the section 367(d) royalty, and thus currently includible in income, to the extent the boot is attributable to section 936(h)(3)(B) intangible property.

- Boot includes “Non-Qualifying Liabilities” and “U.S. Transferor Distributions” as described on a subsequent slide.
- The rules also trigger immediate gain recognition (see section 4.03) to the extent there is not a “qualified successor” to the U.S. Transferor.
- The rules described in the Notice apply to transfers occurring on or after July 13, 2012.

Notice 2012-39

Policy Justification for the Notice:

“The IRS and the Treasury Department are aware that certain taxpayers are engaging in transactions intended to repatriate earnings from foreign corporations without the appropriate recognition of income.

....

the transactions have resulted in a repatriation in excess of \$100x (\$100x at the time of the reorganization and then through repayment of the receivable in the amount of USP’s income inclusions over time) while only recognizing income in the amount of the inclusions over time.

....

The IRS and the Treasury Department believe that these transactions raise significant policy concerns, and accordingly, intend to revise the regulations under section 367(d) in the manner described in this notice.”

Notice 2012-39, Section 3

Notice 2012-39

- Definitions:
 - “Non-Qualifying Liabilities”:
 - Includes all liabilities of the U.S. transferor, other than liabilities:
 - Incurred in the ordinary course of the U.S. transferor’s ATOB (as defined in section 367(a)(3)),
 - That did not arise in connection with the reorganization; and
 - That is owed to an unrelated person (section 267(b)/707(b) relationship test).
 - Amount increased (but not in excess of total liabilities) by an amount equal to the sum of the distributions, including U.S. Transferor Distributions, made by the U.S. transferor (or any predecessor) with respect to its stock, including distributions in redemption, during the two-year period immediately preceding the reorganization.
 - “U.S. Transferor Distributions”:
 - Any distributions by the U.S. transferor of money or other property (within the meaning of section 356) to shareholders pursuant to the plan of reorganization, but only to the extent such money or other property is not provided by the transferee corporation in exchange for property of the U.S. transferor acquired in the section 361 exchange.

Notice 2012-39

- Definitions (cont.):
 - “Ownership Interest Percentage”:
 - The ratio of the value of the stock in the U.S. transferor owned by a shareholder to the value of all outstanding stock of the U.S. transferor.
 - Except where otherwise provided – determined immediately before the reorganization.
 - Numerator is reduced (but not below zero) by U.S. Transferor Distributions received by the shareholder. Denominator is reduced by the total amount of U.S. Transferor Distributions.
 - “Section 367(d) Property”:
 - Any property described in Section 936(h)(3)(B).
 - “Section 367(a) Property”:
 - Any property that is not Section 367(d) Property.

Notice 2012-39

- Definitions (cont.):
 - “Qualified Stock”:
 - Stock in the transferee foreign corporation, including stock received in the transferee foreign corporation in exchange for, or with respect to, stock of the U.S. transferor (e.g., under section 354, 355 or 356).
 - “Qualified Successor”:
 - A shareholder of the U.S. Transferor that is a domestic corporation (other than a RIC, REIT, or S Corp) provided such shareholder receives Qualified Stock in the reorganization or immediately after the reorganization owns Qualified Stock other than Qualified Stock received in the reorganization.
 - “Section 367(d) Percentage”:
 - Ratio of the aggregate value of Section 367(d) Property to the aggregate value of all property transferred in a section 361 exchange.

Notice 2012-39

Treatment of Qualified Successors:

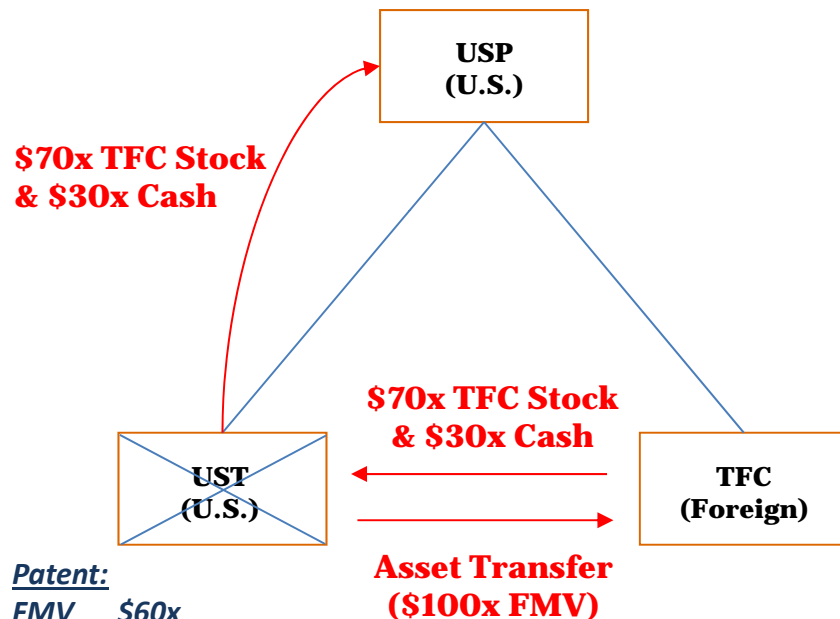
- Each Qualified Successor must take into account the income attributable to a proportionate share of the contingent annual payments that the U.S. transferor would have been treated as receiving had the U.S. transferor remained in existence, and had the U.S. transferor not recognized any income under Notice 2012-39.
- The income attributable to a Qualified Successor's proportionate share of the contingent annual payments is excluded from gross income to the extent of the income included by the U.S. transferor under Notice 2012-39 that is attributable to the Qualified Successor (credit amount).

Notice 2012-39

Facts

Section 367(d)

- UST transfers the patent and 367(a) Asset to TFC in exchange for \$70x of TFC stock and \$30x cash.
- Following the transfer, UST distributes the \$70x of TFC stock and \$30x cash and liquidates.

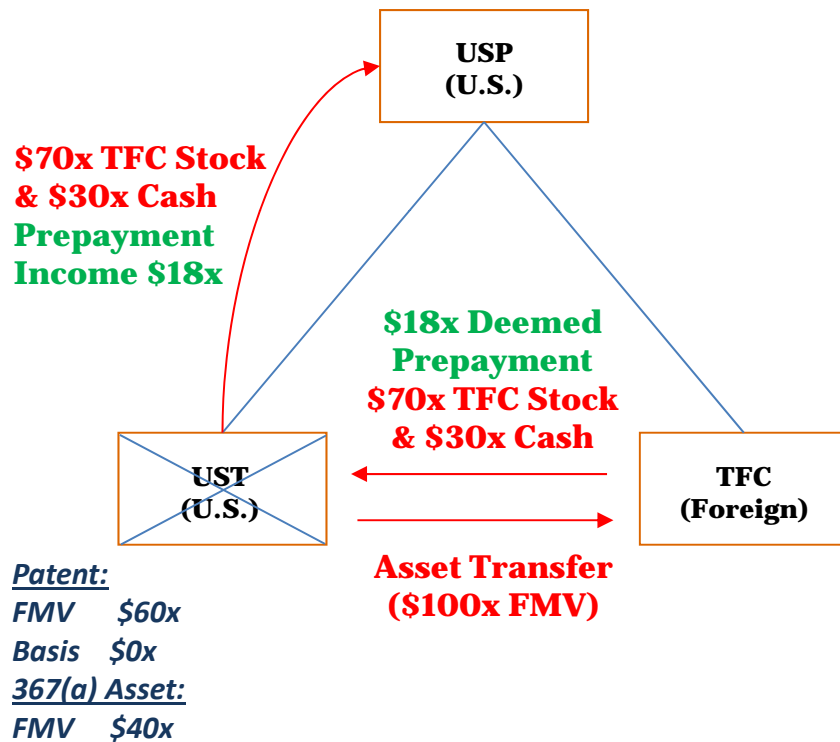


Notice 2012-39

Analysis

Treatment of UST

- UST's transfer of the patent to TFC is an outbound section 367(d) transfer subject to section 367(d) and the regulations as modified by Notice 2012-39.
- The Section 367(d) Percentage (60%) is computed as the \$60x aggregate value of the Section 367(d) Property (the patent) transferred in the exchange, divided by the \$100x aggregate value of all property transferred.
- UST will take into account, as a prepayment, \$18x, the product of the Section 367(d) percentage (60%) multiplied by the amount of cash (\$30x) received by USP, a Qualified Successor.

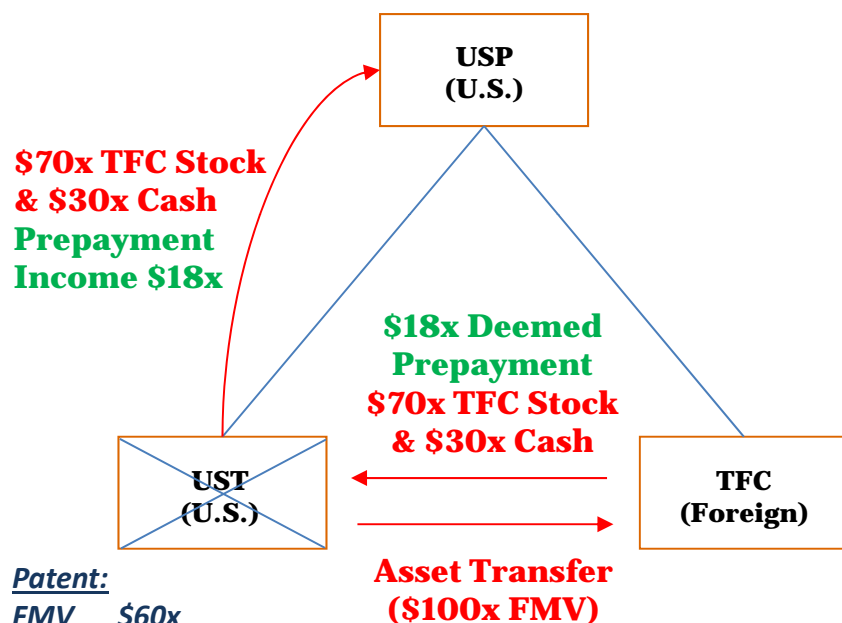


Notice 2012-39

Analysis (Cont.)

Treatment of USP

- USP is a Qualified Successor because:
 - It is a shareholder of UST that receives Qualified Stock under section 356.
 - It is a shareholder of UST that owns Qualified Stock (existing stock in TFC).
- USP, as a Qualified Successor to UST, will take into account the income attributable to the contingent annual payments that UST would have received under §1.367(d)-1T(c) over the remaining useful life of the intangible property, determined as if UST had remained in existence and not taken into account the \$18 of income.
- The first \$18 of contingent annual payments are excluded from USP's gross income, and any additional contingent annual payments are included in USP's gross income. USP may establish an account receivable with respect to any contingent annual payments included in gross income by USP under this notice.



Patent:
 FMV \$60x
 Basis \$0x
367(a) Asset:
 FMV \$40x

Notice 2012-39

Unresolved Issues:

- Are the transferee foreign corporation's earnings and profits decreased for the amount of the advanced payment included in the U.S. transferor's income?
- Does the advanced payment create basis in the transferred intangible?
- Can the Qualified Successor claim a loss if the Section 367(d) Property declines in value such that the advanced payment included in the U.S. transferor's return exceeded the actual income generated by the Section 367(d) Property offshore?

Notice 2012-39

Unresolved Issues (Cont.):

- Under section 4.04 the Notice, subsequent dispositions of the stock of the transferee foreign corporation stock trigger immediate gain in all cases where the stock is transferred to a foreign person.
 - This rule applies even if the transfer is a section 351 transfer of the stock to a wholly owned foreign corporation.
- Would the IRS attempt to subject the debt assumed by the transferee foreign corporation in a Section 351 transfer to the principles of the Notice? And how would this interact with Section 357(c)? Will future regulations do so?