Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Transaction Unit

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Shelf	N/A	Business Outbound	–	–
Volume	1	Income Shifting Outbound	**Level 1 UIL**	9411
Part	1.8	Gain Exportation (through contribution or reorg)	**Level 2 UIL**	9411.08
Chapter	1.8.4	Foreign-to-Foreign Transactions – IRC 367(b)	**Level 3 UIL**	N/A
Sub-Chapter	N/A	N/A	–	–

Unit Name	Outbound Transfer of Foreign Stock Followed by CTB Election

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Issue and Transaction Overview

Outbound Transfer of Foreign Stock Followed by CTB Election

A U.S. corporation can transfer foreign stock to another corporation in a wide variety of nonrecognition transactions. For example, a U.S. corporation can transfer foreign stock to another U.S. corporation in a nonrecognition transaction that qualifies as a tax free reorganization under IRC 368(a)(1). However, when such normal nonrecognition transactions result in a transfer of property to a Foreign Corporation (FC), U.S. tax law imposes restrictions on the tax free transfer of certain types of property by overriding normal nonrecognition rules. IRC 367(a)(1) is the Code section that overrides the normal nonrecognition rules. Without an override of the nonrecognition provisions, the gain on appreciated property may permanently escape U.S. tax upon the outbound (O/B) transfer of the property to a FC.

An O/B transfer of foreign stock by a U.S. transferor may initially appear to be an O/B transfer of stock subject to IRC 367(a)(1) treatment; however, when the O/B transfer of foreign stock is stepped together with a subsequent step (such as a check-the-box (CTB) election), a recast of the transaction may result, thereby causing the recast transaction to fall out of the scope of IRC 367(a)(1).

This Practice Unit depicts a commonly used transaction whereby a U.S. corporation transfers 100% ownership of a first-tier controlled foreign corporation (CFC) to another FC and the transferred CFC makes a CTB election to be treated as a disregarded entity (DE) of the foreign transferee corporation after the transfer of stock.

The proper identification of the transaction type is key to determining whether IRC 367(a) may apply. The application of IRC 367(a) may require the filing of a Gain Recognition Agreement (GRA) in order to avoid taxation on an outbound transfer of stock under an IRC 368(a)(1)(B) stock reorganization. Alternatively, the transaction may qualify to be recast and treated as a foreign-to-foreign IRC 368(a)(1)(D) asset reorganization subject to IRC 367(b). The purpose of this Practice Unit is to determine whether the transaction at issue is governed by IRC 367(a) as an outbound transfer of stock or is treated as a foreign-to-foreign transaction subject to the rules under IRC 367(b). This Practice Unit focuses on whether the transaction is subject to the general rule of IRC 367(a)(1) based upon the facts depicted in this Practice Unit.

! **CAUTION:** The U.S. tax consequences of this transaction is dependent on the proper application of the rules under IRC 367(a) or (b).

Issue and Transaction Overview (cont'd)

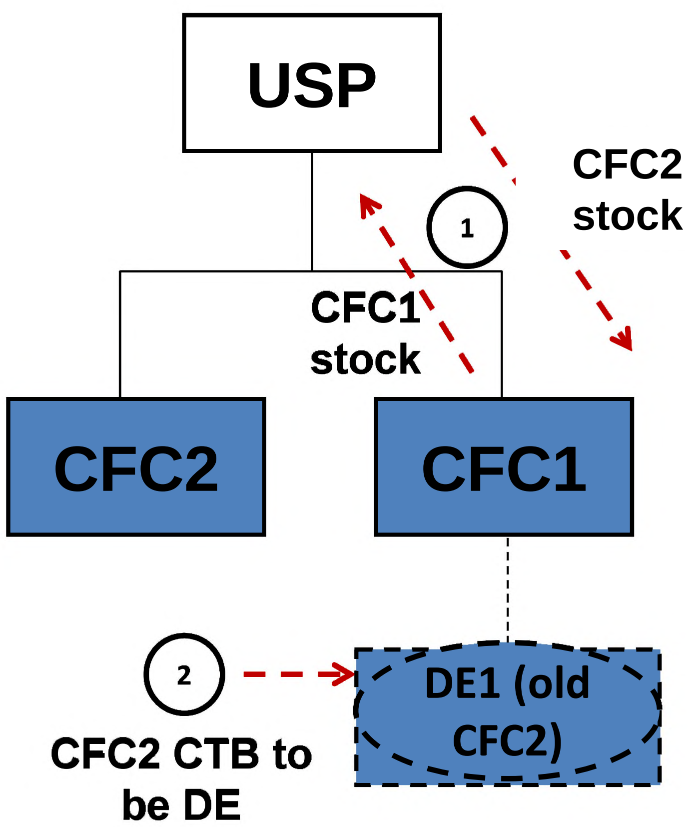
Outbound Transfer of Foreign Stock Followed by CTB Election

! **CAUTION:** Other O/B transfers of property from a U.S. person to a FC that may be subject to IRC 367 will <u>not</u> be covered in this Practice Unit. If the O/B transfer by a U.S. person to a FC involves property other than foreign stock or securities where a CTB election is made, see the following related Practice Units: "Outbound Transfers of Property to Foreign Corporation – IRC 367 Overview," DCN: ISO/9411.08_01(2013); "Outbound Transfer of Foreign Stock," DCN: ISO/9411.08_04(2014); or "Outbound Transfer of Domestic Stock," DCN: ISO/9411.08_06(2014). For O/B transfers of intangible property, see related Practice Unit, "Deemed Annual Royalty Income Under IRC 367(d)," DCN: ISO/9411.02_01(2013).

Transaction and Fact Pattern

Outbound Transfer of Foreign Stock Followed by CTB Election

Diagram of Transaction



Facts

FACT PATTERN – O/B stock transfer followed by CTB Election – Deemed foreign-to-foreign asset reorganization

<u>Facts:</u>

- USP, the U.S. Parent, owns 100% of CFC1 and CFC2.
- CFC2 has a fair market value (FMV) of $10M.
- USP has a basis of $5M in CFC2 stock resulting in a potential built-in gain of $5M.

<u>Transaction:</u>

- STEP 1: USP transfers 100% of CFC2 to CFC1 in exchange for additional (or deemed issued) CFC1 stock.
- STEP 2: Immediately after the exchange of CFC2 stock, CFC2 makes a check-the-box (CTB) election to be treated as a disregarded entity (DE) of CFC1.

<u>Results Of Transaction</u>:

- CFC2 no longer exists as a CFC for U.S. tax purposes and is treated as a DE of CFC1.
- CFC1 continues to be owned 100% by USP.

Effective Tax Rate Overview

Outbound Transfer of Foreign Stock Followed by CTB Election

ETR of Company

The effective tax rate (ETR) of a company will not change as a result of an O/B transfer of foreign stock followed by a CTB election of the transferred CFC (deemed foreign-to-foreign asset reorganization) unless certain criteria are met under the IRC 367(b) regulations. The assets of the transferred corporation will be deemed to be transferred for U.S. tax purposes to the foreign transferee corporation, and the transferred corporation will be treated as a DE of such corporation. The DE will be subject to the same foreign taxes in its foreign jurisdiction as a foreign corporation.

Normally, an exchange of the foreign corporation's stock or assets for stock of the foreign transferee corporation may receive non-taxable treatment in a nonrecognition transaction, such as an IRC 368(a)(1) reorganization or an IRC 351 transfer. However, if a FC's stock is involved at the exchanging S/H level, then IRC 367(b) may apply to the transaction requiring the recognition of deemed dividend income at the exchanging S/H level, thereby resulting in an increase in ETR. The increase in ETR may be offset by any related foreign tax credit (FTC) attributable to the "deemed" dividend.

ETR Impact of Adjustment

Upon certain F-to-F reorganizations or IRC 351 exchanges, USP must include in income a "deemed dividend" equal to the lesser of the gain realized or its share of the CFC's positive "IRC 1248 E&P" resulting in an increase to ETR for financial accounting purposes. To the extent that a deemed dividend is received, USP may also be allowed related FTC, which may minimize the impact of the "deemed dividend" income inclusion to USP's ETR. If no taxation is required on the foreign-to-foreign asset reorganization under IRC 367(b), then the earnings and profits of the transferred corporation will carryover to the foreign transferee corporation.

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Summary of Potential Issues

Outbound Transfer of Foreign Stock Followed by CTB Election	
Issue 1	Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?
Issue 2	Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

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All Issues, Step 1: Initial Factual Development

Outbound Transfer of Foreign Stock Followed by CTB Election

The general purpose of IRC 367(a)(1) is to tax the built-in gain on CFC2 stock that is transferred in an O/B transaction. Specifically, IRC 367(a)(1) imposes taxation on the O/B transfer of CFC2 stock by USP to CFC1 in what would otherwise be a nontaxable exchange. However, the O/B transfer of stock and the following CTB election of CFC2 may qualify as a tax-free asset reorganization (as opposed to a tax-free stock reorganization) under the step transaction doctrine, thus causing the transaction not to be an O/B stock transfer that otherwise may have been subject to IRC 367(a)(1).

Fact Element	Resources	6103 Protected Resources
Review global organization tax organizational charts for ownership of CFC2. ▪ Compare org chart at the beginning and end of the tax year that includes CFC2. ▪ Does CFC2 disappear from the org chart? ▪ Does CFC2 have a change in how it is depicted on the org chart? − Square – Foreign corporate status? − Circle within a square – Disregarded Entity (DE) status? − Other?	▪ Tax Organizational Charts – Beginning of Year and Ending of Year for each year under examination.	

All Issues, Step 1: Initial Factual Development (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election

The general purpose of IRC 367(a)(1) is to tax the built-in gain on CFC2 stock that is transferred in an O/B transaction. Specifically, IRC 367(a)(1) imposes taxation on the O/B transfer of CFC2 stock by USP to CFC1 in what would otherwise be a nontaxable exchange. However, the O/B transfer of stock and the following CTB election of CFC2 may qualify as a tax-free asset reorganization (as opposed to a tax-free stock reorganization) under the step transaction doctrine, thus causing the transaction not to be an O/B stock transfer that otherwise may have been subject to IRC 367(a)(1).

Fact Element	Resources	6103 Protected Resources
Review disclosures or forms on U.S. tax return for any statement related to the transfer of stock. If CFC stock is transferred, there may be additional disclosures or forms filed. ▪ For example, did the CFC file a CTB election?	▪ IRC 351 or 368 Disclosures ▪ Form 5471 of CFC2, Sch. B ▪ Form 5471, Sch O of CFC2, Part II, Section D or E ▪ Form 8832 of CFC2, if filed, lines 1b and 6f ▪ Initial Form 8858 of DE1 (old CFC2) ▪ Form 5471 of CFC1 ▪ Form 5471, Sch O of CFC1, Part II, Section C	

Issue 1, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	**Resources**
<u>Reorganization - Nonrecognition Provisions:</u> There are two types of reorganizations (reorg) defined in IRC 368(a)(1) – stock reorg (B reorg) and asset reorgs (A, C, D, F or G). When there is a valid reorganization as defined in IRC 368(a)(1), certain non-recognition provisions may apply at the S/H level (IRC 354/356) or at the corporate transferor's level (IRC 361). To qualify as a valid "B" stock reorganization, USP must exchange CFC2 stock (target corporation) solely for voting stock of CFC1 (acquiring corporation) under IRC 354. In addition, immediately after the exchange, CFC1 must control CFC2, and CFC2 must continue to be treated as a corporation after the transfer (80% of vote and shares). ▪ Note: An IRC 356 exchange exists at USP's level if USP receives property (boot) in addition to CFC1 stock in exchange for the stock of CFC2. However, boot is not permitted in a B reorganization. If USP sold CFC2 stock to CFC1 for property, such transaction would be treated as a sale, i.e., not as a "B" reorganization.	▪ IRC 354 - *Exchanges of stock and securities in certain reorganizations* ▪ IRC 356 - *Receipt of additional consideration* ▪ IRC 361 – *Nonrecognition of gain or loss to corporations; treatment of distributions* ▪ IRC 368 - *Definitions relating to corporate reorganizations*

Issue 1, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	Resources
Reorganization - Nonrecognition Provisions (cont'd)**:** IRC 361 – In an IRC 368 "asset" reorganization, the transferor exchanges property with the acquiring corporation in exchange for stock of such acquiring corporation under IRC 361 and normally receives nontaxable treatment. An asset reorganization is defined as a reorganization under IRC 368(a)(1)(A), (C), (D), (F) or (G).	▪ IRC 354 - *Exchanges of stock and securities in certain reorganizations* ▪ IRC 356 - *Receipt of additional consideration* ▪ IRC 361 – *Nonrecognition of gain or loss to corporations; treatment of distributions* ▪ IRC 368 - *Definitions relating to corporate reorganizations* ▪ IRC 367 – *Foreign Corporations*

Issue 1, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	Resources
<u>Step Transaction Doctrine: An Overview</u> Individual steps in a transaction may be consolidated into a single integrated transaction to ensure that a transaction is taxed in accordance with its substance rather than its form. There are three tests: (i) the "end result test", under which a transaction is collapsed if a series of formally separate steps are prearranged parts of a single transaction intended from the outset to reach an ultimate result; (ii) the "interdependence test", which focuses on the relationship between the steps and analyzes whether the steps were so interdependent that the legal relations created by one of the transactions seems fruitless without completion of the series; and (iii) the "binding commitment test", under which a series of transactions are collapsed if, when the first step is entered into, there was a binding commitment to undertake the later steps.	▪ IRC 367(a) – O/B property transfers ▪ IRC 351, 354, 356 and/or 361 – Nonrecognition provisions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status

Issue 1, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	Resources
Step Transaction Doctrine: An Overview (cont'd) The courts have implemented the step transaction doctrine in the analysis of individual steps of a transaction in order to recast the transaction, as appropriate, for U.S. tax purposes.	▪ *Associated Wholesale Grocers, Inc. v. U.S.,* 927 F.2d 1517, 1521 (10th Cir. 1991). ▪ *Greene v. U.S.*, 13 F.3d 577, 583 (2d Cir. 1994) ▪ *Am. Bantam Car Co. v. Commissioner,* 11 T.C. 397, 405 (1948), aff'd, 177 F.2d 513 (3d Cir. 1949) ▪ *Barnes Group, Inc. v. Commissioner*, T.C. Memo. 2013-109 ▪ *Andantech LLC v. Commissioner*, T.C. Memo. 2002-97 (2002), aff'd in part, 331 F.3d 972 (D.C. Cir. 2003) ▪ *Long Term Capital Holdings v. U.S.*, 330 F. Supp. 2d 122, 196 n.94 (2004) .

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Issue 1, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	Resources
A transfer of stock may be part of a larger restructuring transaction and may be stepped together with another step, pursuant to the application of the step transaction doctrine. In such case, the transaction may be viewed in a different manner for U.S. tax purposes. Such transactions have different "legal" steps vs. "deemed" steps that occur for U.S. tax purposes. ▪ The steps of a transaction are linked together, which may modify the appropriate tax treatment for U.S. tax purposes. For example, a transfer or sale of stock followed by a liquidation of the target corporation may be stepped together and treated as an asset reorganization. IRC 367(a) may impose taxation on the O/B transfer of property by a U.S. person to a FC in what would otherwise be a nontaxable exchange under IRC 354, 356 or 361 when the reorganization involves one or more foreign corporations. ▪ As a result, the transfer of CFC2 stock by USP to CFC1 may initially appear to be a transfer of foreign stock. However, if the CFC2 stock transfer is followed by a liquidation (or deemed liquidation as a result of a CTB election) of CFC2, then the transactions may be deemed to constitute a foreign-to-foreign (F-to-F) asset reorganization of CFC2's assets being transferred to CFC1. See Rev. Rul. 67-274 and Rev. Rul. 2004-83.	▪ IRC 367(a) – O/B property transfers ▪ IRC 351, 354, 356 and/or 361 – Nonrecognition provisions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status

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Issue 1, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Fact Element	Resources	6103 Protected Resources
A review of any disclosures, GRAs, Form 926 and Form 5471, Schedule O, discloses that USP has transferred CFC2 stock O/B to CFC1 in a transaction that is possibly subject to a reorganization under IRC 368(a)(1). ▪ A review of such documents will provide a basic understanding of the transactions that have occurred. Several transactions may be part of a much larger restructuring transaction. ▪ The review and the filing of documents with the return will provide an indication of the taxpayer's treatment of the transaction for U.S. tax purposes.	▪ IRC 368 Disclosures ▪ Form 5471 of CFC2 ▪ Form 5471, Sch O of CFC2 ▪ Form 8832 of CFC2, if filed ▪ Initial Form 8858 of DE1 (old CFC2) ▪ Form 5471 of CFC1 ▪ Form 5471, Sch O of CFC1	

Issue 1, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Fact Element	Resources	6103 Protected Resources
Organizing the disclosures in a chronological order will assist in the analysis of the transaction. Request supporting documentation on the transaction from the taxpayer, such as: ▪ Organizational Charts (preferably step by step); ▪ Step Plan or any internal documentation, if any, that details the individual steps taken by the taxpayer in the transaction; and ▪ Tax Opinions, if any, authored internally by the taxpayer's employees or outside advisors. When warranted, request that the taxpayer provide a step-by-step presentation of the transaction to the audit team.	▪ Organizational Charts (preferably step by step) ▪ Step Plan, if any ▪ Tax Opinion, if any ▪ Taxpayer Presentation of the Transaction	

Issue 1, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Fact Element	Resources	6103 Protected Resources
If your transaction is similar to the Fact Pattern – that is discussed in this Practice Unit regarding the O/B Transfer of CFC2 stock followed by a CTB Election, an analysis of the facts must be completed to determine whether the step transaction doctrine should be applied to the transaction for the proper tax treatment under IRC 367. Such an analysis would determine whether: ▪ the O/B transfer of CFC stock should be stepped together with the CTB election, so that the transaction is recast as a transaction that does not invoke IRC 367(a) (e.g., Foreign-to Foreign (F-to-F) Asset Reorganization) or ▪ the O/B transfer of CFC stock should be treated as a separate and distinct transaction from the CTB election that would invoke IRC 367(a) (e.g., O/B "B" reorg).	▪ Final Form 5471 of CFC2 ▪ Final Form 5471 Schedule O, Section C of CFC2 ▪ Initial Form 8858 of DE1 ▪ Form 8832	

Issue 1, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Fact Element	Resources	6103 Protected Resources
Some of the items to consider in this analysis include: ▪ How did the taxpayer treat the transaction? ▪ Was the CTB election effective for a date after the O/B stock transfer? ▪ Was the CTB election contemplated at the time of the O/B transfer of CFC stock? **CONSULTATION:** A consultation with Counsel may be required in the analysis of the facts in order to determine if the step transaction doctrine is applicable to the transaction.	▪ Final Form 5471 of CFC2 ▪ Final Form 5471 Schedule O, Section C of CFC2 ▪ Initial Form 8858 of DE1 ▪ Form 8832	

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Issue 1, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
A clear understanding of the type of transaction is key in determining the tax consequences. Exam must determine whether the transaction in question is similar to the Fact Pattern illustrated in this Practice Unit and, thus, qualifies as a tax-free asset reorganization. On its face, it appeared to be two separate transactions – both of which may be impacted by IRC 367 in different ways: ▪ O/B transfer of CFC2 stock to CFC1– possibly a transaction under IRC 367(a), which could be subject to the Treas. Reg. 1.367(a)-3(b) stock exception, then ▪ Foreign-to-Foreign (F-to-F) IRC 332 liquidation of CFC2 into its new CFC owner (CFC1) via a CTB election to be treated as a DE (DE1) – IRC 367(b).	▪ IRC 367(a) – O/B property transfers ▪ IRC 351, 354, 356 and/or 361 – Nonrecognition provisions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 1, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP’s transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
Our Fact Pattern depicts a transaction that may be governed by the step transaction doctrine. See Rev. Rul. 67-274. Although it appears that there is an O/B transfer of CFC2 stock, USP properly treated this transaction as a F-to-F asset reorganization under Rev. Rul. 67-274 by treating the O/B transfer and the CTB election as part of a prearranged plan.	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 1, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP’s transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
As a result, the following steps are deemed to have occurred, and the steps of the transaction indicate that the transaction should be treated as an IRC 368(a)(1)(D) reorganization: ▪ CFC2 is deemed to have transferred its assets to CFC1 in exchange for CFC1 stock (under IRC 361(a)). ▪ CFC 2 is deemed to have distributed CFC1 stock received to USP and liquidates (under IRC 361(c)). ▪ USP is deemed to have exchanged its stock of CFC 2 for the stock of CFC 1 distributed by CFC 2 (under IRC 354). ▪ CFC2 liquidates as part of the asset reorganization.	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 1, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
This transaction may be treated as a F-to-F asset reorg under IRC 368(a)(1)(D). **DECISION POINT:** If the transaction was properly treated as a F-to-F asset reorganization under the step transaction doctrine, proceed to Issue #2 on the application of IRC 367. Alternatively, if the facts show that CFC2 did not CTB to be a DE of CFC1 and continued to be treated as a foreign corporation, then refer to Practice Unit, "Outbound Transfer of Foreign Stock," DCN: ISO/9411.08_04(2014) to continue your analysis under IRC 367(a).	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 1, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 1
Does USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, qualify as a tax-free reorganization (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
DECISION POINT: If the facts of the transaction indicate that the steps of the transaction should not be stepped together as part of a prearranged plan to be treated as a F-to-F asset reorganization, each step of the transaction must be considered separately under IRC 367. As a result, the O/B transfer of CFC1 stock may be subject to taxation under IRC 367(a). See Practice Unit, "Outbound Transfer of Foreign Stock," DCN: ISO/9411.08_04(2014) for further analysis of IRC 367(a). The CTB election resulting in a deemed liquidation would be subject to IRC 367(b). See Practice Unit, "Foreign-to-Foreign Transactions – IRC 367(b) Overview," DCN: ISO/9411.08_03(2013) for further analysis under IRC 367(b).	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 2, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Issue	Resources
Under Issue 1, it was properly determined, based upon the facts of the transaction, that the transaction was a F-to-F asset reorganization under the step transaction doctrine, and, as a result, you must now determine the proper IRC 367 treatment, either under IRC 367(a) or (b). <u>IRC 367(a):</u> Generally, when USP transfers appreciated property (CFC2 stock) O/B to CFC1 in an otherwise nontaxable exchange (e.g., IRC 351, 354, 356, or 361), IRC 367(a)(1) trumps the nonrecognition provision and requires immediate taxation on the gain realized in the exchange. In order for the O/B transfer of CFC2 stock to be subject to IRC 367, three elements must exist: ▪ USP must be a U.S. person (the transferor); ▪ a transfer of CFC2 stock to CFC1, a FC; and ▪ an exchange described in one of the following nonrecognition code sections: IRC 351, 354, 356 or 361. Treas. Reg. 1.367(a)-3(a)(2)(ii) provides that, an IRC 354 exchange of stock pursuant to a direct asset reorganization is not subject to IRC 367(a)(1).	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – *United States Person* ▪ Treas. Reg. 1.367(a)-3(a)(2)(ii) – Exception to IRC 367(a)(1) on certain stock exchanges pursuant to direct asset reorganizations.

Issue 2, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Issue	Resources
IRC 367(b): ▪ In general IRC 367(b) does not require recognition of income, unless prescribed in the regulations. Treas. Reg. 1.367(b)-4 provides such an income recognition rule for certain F-to-F transactions. ▪ This regulation focuses on the acquisition of foreign stock or assets by a FC in certain nonrecognition transactions. If a FC acquires foreign corporate assets or foreign stock in: − An IRC 351 exchange or − An IRC 368(a)(1) reorganization ▪ then the exchanging S/H may be required to include in income a deemed dividend equal to the lesser of the realized gain on the exchange or the CFC's "IRC 1248 E&P amount". The regulations require certain criteria to be met for income recognition at the exchanging S/H level. As a result, if the transaction does not meet the scope and criteria of the regulations, then the transaction will default to the "general" rule of IRC 367(b) and receive non-taxable treatment.	▪ IRC 354 – S/H exchange in a reorganization ▪ IRC 368 – *Definitions relating to Corporate Reorganizations* ▪ IRC 1248 – Ownership criteria for an IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Issue	Resources
<u>IRC 367(b) (cont'd):</u> ▪ Under Treas. Reg. 1.367(b)-4, an exchanging S/H will be required to include in income as a deemed dividend the IRC 1248 E&P amount (limited to realized gain) attributable to the foreign stock exchange if: – The exchange results in the loss of IRC 1248 S/H status (or CFC status), – Preferred or other stock in certain exchanges is received, or – Certain exchanges involving recapitalizations occur. ▪ In our Fact Pattern and under the step doctrine in Issue 1, the following steps are deemed to occur (as previously discussed on slide 21): – CFC2 (the acquired FC) transfers all of its assets (and liabilities) to CFC1 (transferee) in exchange for CFC1 stock, – CFC2 distributes the CFC1 stock to USP, its IRC 1248 S/H, and – USP exchanges its CFC2 stock (cancelled) for CFC1 stock (acquiring FC) under IRC 354 as part of the asset reorganization. – CFC2 liquidates as part of the asset reorganization.	▪ IRC 354 – S/H exchange in a reorganization ▪ IRC 368 – *Definitions relating to Corporate Reorganizations* ▪ IRC 1248 – Ownership criteria for an IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Issue	Resources
IRC 367(b) (cont'd): ▪ In our Fact Pattern, USP was an IRC 1248 S/H of CFC2 immediately before the transaction since USP wholly owned CFC2. ▪ The question that must be answered under IRC 367(b) is whether USP is an IRC 1248 S/H in CFC1, the acquiring corporation, immediately after the exchange. ▪ In other words, did USP lose its 1248 S/H status? ▪ In order for IRC 1248 S/H status to be retained, CFC1, the acquiring corporation, must be a CFC to which USP owns at least 10% of CFC1. On the other hand, if USP does not own at least 10% of CFC1, then USP, as exchanging S/H, may be required, pursuant to Treas. Reg. 1.367(b)-4, to pick up income as a result of the F-to-F asset reorganization. ▪ If IRC 1248 S/H status of USP is maintained, no income recognition is required, and the transaction defaults to the general rule of IRC 367(b).	▪ IRC 354 – S/H exchange in a reorganization ▪ IRC 368 – *Definitions relating to Corporate Reorganizations* ▪ IRC 1248 – Ownership criteria for an IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(b) – Definition of IRC 1248 S/H ▪ Treas. Reg. 1.367(b)-2(c) – Definition of IRC 1248 E&P amount ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status

Issue 2, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Issue	Resources
IRC 367(b) (cont'd): ▪ Even if the F-to-F transaction does not result in an income inclusion under Treas. Reg. 1.367(b)-4, the hovering deficit rule of Treas. Reg. 1.367(b)-7 needs to be considered. ▪ The hovering deficit rule generally provides that if a foreign corporation acquires the assets of another foreign corporation in a transaction described in IRC 381, a deficit in earnings and profits of the distributor, transferor, or acquiring corporation (i.e., the transferee) can be used only to offset earnings and profits accumulated by the surviving corporation after the IRC 381 transaction in the same separate category of the deficit (i.e., the general limitation or passive basket). ▪ In our Fact Pattern, if either CFC2 (the transferor) or CFC1 (the transferee) had a deficit in earnings and profits when CFC2 transferred its assets and liabilities to CFC1, then the deficit in earnings and profits could be used only to offset the earnings and profits accumulated after the date of the transfer.	▪ IRC 367(b) ▪ IRC 381(c)(2)(B) – Carryover of E&P ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Treas. Reg. 1.367(b)-4(b)(1) – Criteria for income recognition – Loss of CFC or IRC 1248 S/H status ▪ Treas. Reg. 1.367(b)-7 – *Carryover of E&P and foreign taxes in certain F-to-F nonrecognition transactions* ▪ Treas. Reg. 1.367(b)-9 – Special rule - carryover of E&P and foreign taxes for "F" reorgs and similar transactions

Issue 2, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Fact Element	Resources	6103 Protected Resources
▪ Determine USP's ownership percentage in CFC1 (transferee) stock after the transaction. – Immediately after the transaction, did USP own 10% or more of the total combined voting power of all classes of stock of CFC1? – Immediately after the transaction, is CFC1 a CFC? ▪ Was more than 50% of the combined voting power of all classes of CFC1 stock entitled to vote owned by US shareholders? ▪ Alternatively, was more than 50% of the total value of CFC1 owned by US shareholders? ▪ Note that constructive ownership rules apply.	▪ Step Plan ▪ Plan of reorganization ▪ Tax Opinions ▪ Stock certificates, stock register ▪ Form 5471 Schedule O – Description of the transfer. ▪ IRC 368 Disclosure ▪ Treas. Reg. 1.367(b)-1(c) Disclosure	

Issue 2, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Fact Element	Resources	6103 Protected Resources
▪ Confirm CFC1 and CFC2's E&P and tax pool computation in order to determine if a hovering deficit issue under Treas. Reg. 1.367(b)-7 exists. This can be accomplished by: – Reviewing each CFC's Form 5471, Schedule J – Requesting E&P and tax pool calculations for each FTC basket (e.g., general limitation and passive baskets) from the taxpayer for both CFCs. – Requesting taxpayer's calculation of the E&P roll-up of CFC2 into CFC1.	▪ Form 5471, Sch J – E&P calculations ▪ E&P and Tax Pool calculations	

Issue 2, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Adjustment	Resources	6103 Protected Resources
In the Fact Pattern in this Practice Unit, a CTB election was made to treat CFC2 as a DE immediately after the O/B transfer of stock to CFC1. As you determined in Issue 1, this transaction was treated as a F-to-F asset reorganization under IRC 368(a)(1)(D). As a result, USP's IRC 354 exchange of CFC2 stock (canceled) for CFC1 stock as part of this F-to-F asset reorganization is not subject to IRC 367(a) per Treas. Reg. 1.367(a)-3(a)(2)(ii). For IRC 367(a) purposes, there was not an O/B transfer of CFC2 stock, and, thus, no gain is recognized. Since IRC 367(a) is not applicable to this transaction, there is no need for a gain recognition agreement (GRA) to be filed to meet the O/B stock exception under Treas. Reg. 1.367(a)-3(b). No further IRC 367(a) analysis is required on the O/B transfer of CFC2 stock as depicted in the Fact Pattern.	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 2, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Adjustment	Resources	6103 Protected Resources
Rather, this transaction is governed by IRC 367(b) and Treas. Reg. 1.367(b)-4. This IRC 368(a)(1)(D) transaction strictly falls under IRC 367(b) because it is a F-to-F asset reorg of CFC2 into CFC1 for U.S. tax purposes that is not treated as an indirect stock transfer under the step transaction doctrine as determined in Issue 1. The determination of whether CFC1 is a CFC with respect to which USP, the exchanging S/H, is an IRC 1248 S/H immediately after the transfer is key in the IRC 367(b) treatment of the transaction.	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

Issue 2, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock Followed by CTB Election
Issue 2
Is USP's transfer of CFC2 stock to CFC1, followed by a CFC2 CTB election, subject to IRC 367(a)(1), potentially resulting in a taxable exchange, or IRC 367(b), potentially resulting in the inclusion of a "deemed dividend" in income?

Explanation of Adjustment	Resources	6103 Protected Resources
In this Fact Pattern, USP was an IRC 1248 S/H of CFC2 immediately before the transaction and is an IRC 1248 S/H of CFC1 immediately after the transaction. IRC 1248 S/H and CFC status were maintained. Thus, no income inclusion is required by USP, the exchanging S/H, under Treas. Reg. 1.367(b)-4(b). The F-to-F asset reorganization of CFC2 into CFC1 defaults to the general rule of IRC 367(b) and is nontaxable. However, Treas. Reg. 1.367(b)-7 must be considered on the carryover of the E&P and tax pools of CFC2 to CFC1 as a result of the transaction. Any deficits in E&P (and related tax pools) must "hover" at CFC1's level and the deficit in E&P can only be used to offset post-transaction undistributed E&P. See related Practice Unit, "Foreign-to-Foreign Transactions – IRC 367(b) Overview," DCN: ISO/9411.08_03(2013) for additional information.	▪ IRC 367(a) – O/B Transfers to FC ▪ IRC 367(b) – F-to-F Transactions ▪ Treas. Reg. 1.367(a)-3(a) – O/B Transfer of Stock ▪ Treas. Reg. 1.367(b)-4 – F-to-F Transactions ▪ Rev. Rul. 67-274 – Recast of stock transfer followed by liquidation as an asset reorg. ▪ Rev. Rul. 2004-83 – Recast of stock sale followed by liquidation as an asset reorg. ▪ Treas. Reg. 301.7701-3(g)(1)(iii) – Deemed liquidation on CTB election – change of corporation to DE status	

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Training and Additional Resources

Chapter 1.8.2 Outbound Transfers of Stock		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
CENTRA sessions	▪ 2013 (TPO) & (IBC) CPE CENTRA - Hot Topics of IRC 367 ▪ 2014 (TPO) CPE CENTRA - Outbound Transfer of Property to Foreign Corporation - IRC 367 Overview	
Reference Materials – Treaties	▪ *BNA Tax Management Int'l Portfolio* 919-3rd – Sec. II – Scope and General Operation of IRC 367(a)(1) – Sec. IV – Para. B - O/B Transfers of Stock – Sec. IV – Para. E - Interaction with Section 367(b) ▪ Dolan - *U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures* Para. 9 – O/B Transfer of Stock – Para. 9.03 & 9.04 – O/B Transfer of Non-CFC and CFC Stock ▪ Dolan - *U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures* Treatises Para 10.02 – General IRC 367(a) Rules	

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
CTB	Check-the-Box
DCN	Document Control Number
DE	Disregarded Entity
ETR	Effective Tax Rate
CFC1	Foreign Acquiring Corporation (Transferee)
CFC2	Foreign Target Corporation (Transferred Corporation)
FC	Foreign Corporation
F-to-F	Foreign-to-Foreign
GRA	Gain Recognition Agreement
IDR	Information Document Request
IRC	Internal Revenue Code
O/B	Outbound
Reorg.	Reorganization described in IRC 368(a)(1)
S/H	Shareholder
U.S.	United States
USP	U.S. Parent

Index of Related Issues

Issue	Associated UIL(s)	References
Outbound Transfer of Intangible Property to Foreign Corporation – IRC 367(d) Overview	9411.02; 9411.08	Practice Unit, “Deemed Annual Royalty Income Under IRC 367(d),” DCN: ISO/9411.02_01(2013)
Outbound Transfer of Property to Foreign Corporation – IRC 367 Overview	9411.08	Practice Unit, “Outbound Transfers of Property to Foreign Corporation – IRC 367 Overview,” DCN: ISO/9411.08_01(2013)
Outbound Transfer of Foreign Stock	9411.08	Practice Unit, “Outbound Transfer of Foreign Stock,” DCN: ISO/9411.08_04(2014)
Outbound Transfer of Domestic Stock	9411.08	Practice Unit, “Outbound Transfer of Domestic Stock,” DCN: ISO/9411.08_06(2014)
Foreign-to-Foreign Transactions – IRC 367(b)	9411.08	Practice Unit, “Foreign-to-Foreign Transactions – IRC 367(b) Overview,” DCN: ISO/9411.08_03(2013)