Internal Revenue Service

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Date:
August 25, 2020

LEGEND:

Parent

Sub 1

DSub

FSub

Corp 1

DRE 1

PRS

State A

Country A

Country B

Date A

Dear :

This letter responds to your authorized representative's letter dated May 8, 2020, requesting rulings under § 1.721(c)-5(e) of the Income Tax Regulations concerning the proposed transaction described below (the "Proposed Transaction"). Supplemental information was provided in letters dated July 15, 2020, and August 10, 2020.

The rulings contained in this letter are predicated upon information and representations submitted by the taxpayer and accompanied by penalties of perjury statements executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the factual information, representations, and other data may be required as part of the audit process.

FACTS

Parent is a domestic corporation incorporated in State A and is the common parent of an affiliated group of corporations that files a consolidated return for Federal income tax purposes (the affiliated group, "the Parent Group"). Parent directly wholly owns Sub 1, a domestic corporation incorporated in State A that is a member of the Parent Group, which directly or indirectly wholly owns DSub, FSub, and the Original Foreign Partners (all of which are described further below). DSub is a domestic corporation incorporated in State A that is a member of the Parent Group.

DSub owns an interest in PRS, a foreign entity formed in Country A and treated as a partnership for Federal income tax purposes. PRS, through its directly and indirectly held subsidiaries, conducts and manages certain foreign business operations on behalf of the Parent Group. Immediately before the Proposed Transaction, FSub, a foreign entity formed in Country A and treated as a corporation for Federal income tax purposes, will own the remaining interest in PRS.

PRS became a partnership for Federal income tax purposes on Date A. On Date A and several subsequent dates before the Proposed Transaction, DSub contributed property (collectively, the "U.S.-Contributed Property") to PRS in exchange for its interest in PRS. The U.S.-Contributed Property mainly consists of (i) assets held directly by DSub and interests in foreign entities treated as disregarded for Federal income tax purposes, and (ii) interests in foreign entities taxable as corporations for Federal income tax purposes, the value of which was de minimis compared to the aggregate value of the U.S.-Contributed Property. Most of the non-stock U.S.-Contributed Property had a value that exceeded its adjusted tax basis at the time of its contribution to PRS.

On Date A, four direct and indirect wholly-owned foreign subsidiaries of FSub, each of which was treated as a corporation for Federal income tax purposes (collectively, the "Original Foreign Partners"), also contributed property to PRS in exchange for interests in PRS. On several dates after Date A but before the Proposed Transaction, one or more of the Original Foreign Partners contributed additional property to PRS.

Before the Proposed Transaction, but after all contributions of property by the Original Foreign Partners to PRS, the Original Foreign Partners will liquidate and transfer each of their interests in PRS to FSub. Thus, at the time of the Proposed Transaction, FSub will be the successor in interest to the entirety of the combined interests previously owned by the Original Foreign Partners in PRS.

Immediately before the Proposed Transaction, the only assets that PRS will directly own are interests in two wholly-owned subsidiaries: (i) DRE 1, a foreign entity formed in Country A that is treated as a disregarded entity for Federal income tax purposes, which directly and indirectly (through several other disregarded entities) holds most of the property contributed to PRS from Date A until the Proposed Transaction; and (ii) Corp 1, a foreign entity formed in Country B that is treated as a corporation for Federal income tax purposes.

The fair market value of many of the assets that PRS directly holds or is deemed to hold has decreased since those assets were contributed to PRS. As a result, immediately before the Proposed Transaction, the net fair market value of DSub's interest in PRS is expected to exceed the aggregate net fair market value of the U.S.-Contributed Property.[1] Further, immediately before the Proposed Transaction, the net adjusted tax basis of DSub's interest in PRS is expected to exceed the aggregate net adjusted tax basis of PRS in the U.S.-Contributed Property. Thus, immediately before the Proposed Transaction, DSub's built-in gain in its PRS interest (equal to the excess of the net fair market value of DSub's interest in PRS over the net adjusted tax basis of DSub's interest in PRS) is expected to exceed the built-in gain of the U.S.-Contributed Property held by PRS (equal to the excess of the aggregate net fair market value of the U.S.-

[1] Any reference in this letter to a "net" amount means an amount determined by taking into account any associated liabilities.

Contributed Property held by PRS over the aggregate net adjusted tax basis of the U.S.-Contributed Property held by PRS).

PROPOSED TRANSACTION

DRE 1 will file an election under Treas. Reg. § 301.7701-3(c)(1)(i) to be classified as an association taxable as a corporation for Federal income tax purposes (the resulting foreign corporation, “New ForCo”).

REPRESENTATIONS

The taxpayer has made the following representations with respect to the Proposed Transaction:

a) The Proposed Transaction will be documented and implemented in a manner that complies with applicable Federal, state, and foreign laws.

b) PRS is and has been properly classified as a partnership since Date A for Federal income tax purposes.

c) Since Date A, Parent has reported PRS as a Section 721(c) partnership within the meaning of Treas. Reg. § 1.721(c)-1(b)(14) on the Parent Group’s Federal income tax returns.

d) Since Date A, PRS has adopted and complied with the remedial allocation method set forth in Treas. Reg. § 1.704-3(d) for purposes of making allocations of items of income, gain, loss, and deduction attributable to all U.S.-Contributed property held by PRS.

e) Since Date A, PRS has complied with the consistent allocation method set forth in Treas. Reg. § 1.721(c)-3(c) with respect to all of its Section 721(c) property within the meaning of Treas. Reg. § 1.721(c)-1(b)(15).

f) DSub has complied with, and will continue to comply with, the procedural and reporting requirements set forth in Treas. Reg. § 1.721(c)-6(b) with respect to all Section 721(c) property contributed by DSub to PRS.

g) Since it became a partner in PRS through the initial contribution of the U.S.-Contributed Property, DSub has consented, and will continue to consent, to extending the statute of limitations on assessment of tax, as required by Treas. Reg. § 1.721(c)-6(b)(5), with respect to all Section 721(c) property contributed by DSub.

h) Since Date A, the allocations of items of income, gain, loss, and deduction of PRS had, and will have, economic effect under the alternate test for economic effect set forth in Treas. Reg. § 1.704-1(b)(2)(ii)(d) and such economic effect was, and will be, substantial under Treas. Reg. § 1.704-1(b)(2)(iii).

i) For Federal income tax purposes, the Proposed Transaction will qualify as an exchange described in Section 351 to which Section 367 applies.

j) The aggregate fair market value of the property to which Section 367 applies as a result of the Proposed Transaction will at least be equal to the fair market value of DSub's interest in PRS immediately before the Proposed Transaction, and the aggregate amount of built-in gain attributable to such property will at least be equal to the amount by which the fair market value of DSub's interest in PRS exceeds the adjusted tax basis of DSub's interest in PRS immediately before the Proposed Transaction.

k) There is no plan or intent that, after the Proposed Transaction, New ForCo, or any successor to New ForCo, will dispose of or transfer any of the property held by DRE 1 immediately before the Proposed Transaction to any person that is not a related person within the meaning of Sections 267(b), (c), (f) or Section 707(b)(1).

l) There is no plan or intent that, after the Proposed Transaction, PRS, or any successor to PRS, will dispose of or transfer any interest in New ForCo or any successor to New ForCo to any person that is not a related person within the meaning of Sections 267(b), (c), (f) or Section 707(b)(1).

LAW AND ANALYSIS

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(c) provides that the Secretary may provide by regulations that Section 721(a) shall not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, will be includible in the gross income of a person other than a United States person.

Treas. Reg. § 1.721(c)-2(b) provides that, in general, except as provided in certain provisions including Treas. Reg. § 1.721(c)-3, nonrecognition under Section 721(a) will

not apply to gain realized by the contributing partner upon a contribution of Section 721(c) property to a Section 721(c) partnership.

Treas. Reg. § 1.721(c)-1(b)(14)(i) provides that, in general, a partnership (domestic or foreign) is a Section 721(c) partnership if there is a contribution of Section 721(c) property to the partnership and, after the contribution and all transactions related to the contribution, (i) a related foreign person with respect to the U.S. transferor is a direct or indirect partner in the partnership; and (ii) the U.S. transferor and related persons own 80 percent or more of the interests in partnership capital, profits, deductions, or losses.

Treas. Reg. § 1.721(c)-1(b)(18)(i) provides that a U.S. transferor is a United States person within the meaning of Section 7701(a)(30), other than a domestic partnership. Treas. Reg. § 1.721(c)-1(b)(12) provides that a related person is, with respect to a U.S. transferor, a person that is related (within the meaning of Section 267(b) or 707(b)(1)) to the U.S. transferor. Treas. Reg. § 1.721(c)-1(b)(11) provides that a related foreign person is, with respect to a U.S. transferor, a related person (other than a partnership) that is not a United States person.

Section 267(b)(3) provides that two persons are described within Section 267(b) if they are corporations which are members of the same controlled group, as defined in Section 267(f). Section 267(f) provides in part that “controlled group” generally has the meaning given to that term by Section 1563(a) except that (i) “more than 50 percent” shall be substituted for “at least 80 percent” in each place it appears in Section 1563(a).

Section 1563(a)(1) provides that a controlled group of corporations means any group of one or more chains of corporations connected through stock ownership with a common parent corporation if (i) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations; and (ii) the common parent corporation owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Treas. Reg. § 1.721(c)-1(b)(15)(i) provides that, in general, Section 721(c) property is property, other than excluded property, with built-in gain that is contributed to a partnership by a U.S. transferor.

Treas. Reg. § 1.721(c)-1(b)(6) provides that excluded property is (i) a cash equivalent; (ii) a security within the meaning of Section 475(c)(2), without regard to Section 475(c)(4); (iii) tangible property with a book value exceeding adjusted tax basis by no more than $20,000 or with an adjusted tax basis in excess of book value; and (iv) an

interest in a partnership in which 90 percent or more of the property (as measured by value) held by the partnership (directly or indirectly through interests in one or more partnerships that are not excluded property) consists of property described in paragraphs (b)(6)(i) through (iii) of Treas. Reg. § 1.721(c)-1(b)(6).

Treas. Reg. § 1.721(c)-1(b)(2) provides that built-in gain is, with respect to property contributed to a partnership, the excess of the book value of the property over the partnership's adjusted tax basis in the property upon the contribution, determined without regard to the application of Treas. Reg. § 1.721(c)-2(b).

Treas. Reg. § 1.721(c)-3(b) provides that a contribution of Section 721(c) property to a Section 721(c) partnership that would be subject to Treas. Reg. § 1.721(c)-2(b) will not be subject to Treas. Reg. § 1.721(c)-2(b) if the conditions of the gain deferral method identified in Treas. Reg. § 1.721(c)-3(b) are satisfied with respect to that property. Treas. Reg. § 1.721(c)-3(b)(1)(i) provides that a Section 721(c) partnership adopts the remedial allocation method described in Treas. Reg. § 1.704-3(d) with respect to the Section 721(c) property and applies the consistent allocation method provided in Treas. Reg. § 1.721(c)-3(c). Treas. Reg. § 1.721(c)-3(b)(2) provides that upon an acceleration event, the U.S. transferor recognizes an amount of gain equal to the remaining built-in gain with respect to the Section 721(c) property or an amount of gain required to be recognized under Treas. Reg. § 1.721(c)-5(d) or (e), as applicable. Treas. Reg. § 1.721(c)-3(b)(3) provides that the procedural and reporting requirements provided in Treas. Reg. § 1.721(c)-6(b) are satisfied. Treas. Reg. § 1.721(c)-3(b)(4) provides that the U.S. transferor consents to extend the period of limitations on assessment of tax as required by Treas. Reg. § 1.721(c)-6(b)(5).

Treas. Reg. § 1.721(c)-1(b)(13)(i) provides that remaining built-in gain is, with respect to Section 721(c) property subject to the gain deferral method, the built-in gain reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for purposes of Treas. Reg. § 1.721(c)-1(b)(13)(i), without taking into account increases or decreases to the property's book value pursuant to Treas. Reg. § 1.704-1(b)(2)(iv)(f) or (s).

Treas. Reg. § 1.721(c)-4(b) provides that, except as provided in certain provisions, including Treas. Reg. § 1.721(c)-5, an acceleration event with respect to Section 721(c) property is any event that either would reduce the amount of remaining built-in gain that a U.S. transferor would recognize under the gain deferral method if the event had not occurred or could defer the recognition of the remaining built-in gain. Treas. Reg. § 1.721(c)-4(b) applies on a property-by-property basis.

Treas. Reg. § 1.721(c)-5 identifies exceptions to acceleration events, which, like the rules regarding acceleration events provided in Treas. Reg. § 1.721(c)-4(b), apply on a property-by-property basis.

Treas. Reg. § 1.721(c)-5(e) provides that if a Section 721(c) partnership transfers Section 721(c) property to a foreign corporation in a transaction described in Section 367, the property will no longer be subject to the gain deferral method. Treas. Reg. § 1.721(c)-5(e) provides further that to the extent any U.S. transferor is treated as transferring the Section 721(c) property to the foreign corporation for purposes of Section 367, the tax consequences will be determined under Section 367. Treas. Reg. § 1.721(c)-5(e) provides, however, that for the remaining portion of the property (if any), the U.S. transferor must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the Section 721(c) partnership had sold that portion of the Section 721(c) property immediately before the transfer for fair market value. Finally, Treas. Reg. § 1.721(c)-5(e) provides that the stock in the transferee foreign corporation received will not be subject to the gain deferral method.

Section 367(a) provides that if, in connection with any exchange described in certain provisions, including Section 351, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation.

Section 351(a) provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in Section 368(c)) of the corporation.

Section 368(c) provides that the term “control” means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Section 367(d)(1) provides that, except as provided in regulations prescribed by the Secretary, if a United States person transfers any intangible property to a foreign corporation in an exchange described in Section 351 or 361, (i) Section 367(a) shall not apply to the transfer of such property, and (ii) the provisions of Section 367(d) shall apply to such transfer.

Section 367(d)(2)(A) provides that, in general, if Section 367(d)(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 Section 367(d)(2)(A)(ii) shall be commensurate with the income attributable to the intangible.

Treas. Reg. § 301.7701-3(c)(1)(i) provides that, in general, an eligible entity may elect to be classified other than as provided under Treas. Reg. § 301.7701-3(b), or to change its classification, by filing Form 8832, *Entity Classification Election*. Treas. Reg. § 301.7701-3(g)(1)(iv) provides that if an eligible entity that is disregarded as an entity separate from its owner elects under Treas. Reg. § 301.7701-3(c)(1)(i) to be classified as an association, the following is deemed to occur: The owner of the eligible entity contributes all of the assets and liabilities of the entity to the association in exchange for stock of the association. Treas. Reg. § 301.7701-3(g)(3)(i) provides that for this purpose, an election is treated as occurring at the start of the day for which the election is effective and that any transactions that are deemed to occur as a result of a change in classification are treated as occurring immediately before the close of the day before the election is effective.

Pursuant to Treas. Reg. § 1.721(c)-1(b)(18)(i), DSub is a U.S. transferor because it is a United States person within the meaning of Section 7701(a)(30). Pursuant to Treas. Reg. § 1.721(c)-1(b)(12), Section 267(b)(3), Section 267(f), and Section 1563(a)(1), FSub and the Original Foreign Partners are related persons with respect to DSub because DSub, FSub, and the Original Foreign Partners are all indirect wholly-owned subsidiaries of Parent through Sub 1, and Parent directly wholly owns Sub 1. Pursuant to Treas. Reg. § 1.721(c)-1(b)(11), FSub and the Original Foreign Partners are related foreign persons with respect to DSub because they are related persons that are not United States persons.

The taxpayer has represented that PRS is and has been properly classified as a partnership since Date A for Federal income tax purposes. Pursuant to Treas. Reg. § 1.721(c)-1(b)(15)(i), any U.S.-Contributed Property, other than excluded property within the meaning of Treas. Reg. § 1.721(c)-1(b)(6), with built-in gain within the meaning of Treas. Reg. § 1.721(c)-1(b)(2), is Section 721(c) property because it was contributed to PRS, a partnership, by DSub, a U.S. transferor.

Pursuant to Treas. Reg. § 1.721(c)-1(b)(14)(i), PRS is a Section 721(c) partnership because there was a contribution of Section 721(c) property to PRS, as described in the preceding paragraph, and after the contribution and all transactions related to the contribution, (i) related foreign persons with respect to DSub (the Original Foreign Partners and later FSub) were partners in the partnership; and (ii) DSub and related persons with respect to DSub (the Original Foreign Partners and later FSub) owned all of the interests in PRS.

The taxpayer has represented that since Date A, Parent has reported PRS as a Section 721(c) partnership within the meaning of Treas. Reg. § 1.721(c)-1(b)(14) on the Parent Group’s Federal income tax returns. Taxpayer has made further representations that certain requirements of the gain deferral method have been, and will continue to be, met.

In the Proposed Transaction, DRE 1, an entity that is disregarded as separate from its owner for Federal income tax purposes, will elect under Treas. Reg. § 301.7701-3(c)(1)(i) to be classified as an association. Pursuant to Treas. Reg. § 301.7701-3(g)(1)(iv), PRS, the owner of DRE 1 and a Section 721(c) partnership, will be deemed to contribute all of the assets and liabilities of DRE 1, including the Section 721(c) property, to New ForCo, a foreign corporation, in exchange for stock of New ForCo in a transaction that the taxpayer has represented is described in Sections 351 and 367. The deemed transactions described in the previous sentence are treated as occurring immediately before the close of the day before the election is effective.

The taxpayer has represented that the aggregate fair market value of the property to which Section 367 applies as a result of the Proposed Transaction will at least be equal to the fair market value of DSub's interest in PRS immediately before the Proposed Transaction, and the aggregate amount of built-in gain attributable to such property will at least be equal to the amount by which the fair market value of DSub's interest in PRS exceeds the adjusted tax basis of DSub's interest in PRS immediately before the Proposed Transaction. Thus, pursuant to Treas. Reg. § 1.721(c)-5(e) and Treas. Reg. § 1.721(c)-3(b)(2), there is no remaining portion of Section 721(c) property that is not subject to Section 367 and DSub, therefore, will not recognize any income or gain under Section 721(c) as a result of the Proposed Transaction. Instead, pursuant to Treas. Reg. § 1.721(c)-5(e), the tax consequences to DSub from the deemed transfer by PRS of Section 721(c) property to New ForCo will be determined under Section 367. In addition, pursuant to Treas. Reg. § 1.721(c)-5(e), the Section 721(c) property owned by PRS immediately before the Proposed Transaction will no longer be subject to the gain deferral method described in Treas. Reg. § 1.721(c)-3 after the Proposed Transaction.

CONCLUSION

Based solely on the information submitted and on the representations set forth above, we hold as follows:

1) DSub will not recognize any income or gain under Section 721(c) as a result of the Proposed Transaction.

2) The tax consequences to DSub from the deemed transfer by PRS of Section 721(c) property to New ForCo will be determined under Section 367.

3) The Section 721(c) property owned by PRS immediately before the Proposed Transaction will no longer be subject to the gain deferral method described in Treas. Reg. § 1.721(c)-3 after the Proposed Transaction.

No opinion is expressed as to the tax treatment of the Proposed Transaction under other provisions of the Code and regulations, and no opinion is expressed about the tax

treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by this ruling. In particular, no opinion is expressed on the following:

1) Whether the Proposed Transaction meets the requirements of Section 351 or the regulations promulgated thereunder.

2) Whether, in each taxable year since Date A, the allocations of items of income, gain, loss, and deduction of PRS meet the requirements for the alternate test for economic effect set forth in Treas. Reg. § 1.704-1(b)(2)(ii)(d) and the substantiality test set forth in Treas. Reg. § 1.704-1(b)(2)(iii).

3) The potential application of Section 91 to the Proposed Transaction.

4) The amount of or manner of calculating the income or gain to be recognized in applying Section 367 to the Proposed Transaction.

5) Any potential application of Section 482 to, or in connection with, the Proposed Transaction.

6) The value, adjusted tax bases, statements of relative value, and other comparisons of amounts described in this ruling.

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

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Kenneth A. Jeruchim
Senior Technical Reviewer, Branch 4
(International)