



AMERICAN **BAR** ASSOCIATION

Tax Section

# **VIRTUAL 2020** MAY TAX MEETING

## **Current Events Panel: Oh! The Places Your Attributes Will Go**

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American Bar Association  
May 2020 Virtual Meeting  
Foreign Activities of U.S. Taxpayers Committee  
July 2, 2020

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# Agenda

- Final Regulations under Section 245A
- Creation of PTEP and Exempt Earnings/Basis Adjustments
- Cross Border Section 304
- All Boot D Reorganizations

# Section 245A(e) Basics

# Section 245A Structure

- **General Rules**
  - Section 245A(a): A U.S. corporation is permitted a deduction equal to the **foreign source portion** of any **dividend** received from a **specified 10-percent owned foreign corporation** if the U.S. corporation is a US shareholder with respect to such foreign corporation (the “Section 245A DRD”)
  - Section 245A(d): Disallows foreign tax credits (“FTCs”)for and deductions of any taxes paid or accrued with respect to any dividend for which participation exemption is allowed
  - Section 245A(e): Section 245A(a) participation exemption does not apply to any dividend from a controlled foreign corporation (a “CFC”) if the dividend is a **hybrid dividend**

# Section 245A(e)

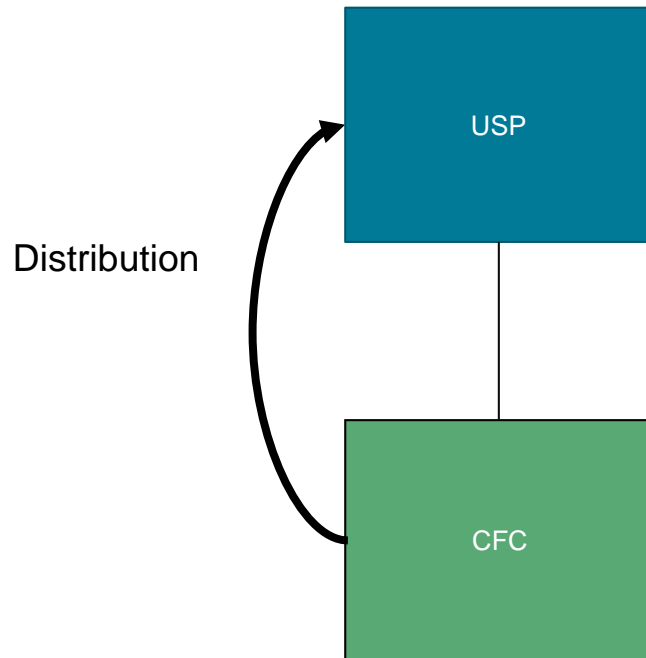
## Hybrid Dividend Received by U.S. Shareholders

- A dividend is a “**hybrid dividend**” if it satisfies two conditions:
  - The dividend would be eligible for the Section 245A DRD (but for Section 245A(e)) and
  - The CFC payor (or a related person) is or was allowed a deduction or other tax benefit with respect to the dividend under a “relevant foreign tax law”.
- If a U.S. shareholder receives a hybrid dividend, then the U.S. shareholder is not eligible to receive the Section 245A DRD with respect to such hybrid dividend and loses any associated FTCs.

# Section 245A(e) Hybrid Dividend Received by U.S. Shareholders

- **Additional Rules**
  - If a lower-tier CFC pays a hybrid dividend, the recipient CFC must include such hybrid dividend in subpart F income.
  - FTCs are disallowed under Section 245A(d) (disallowance of foreign tax credits and deductions).

# Section 245A(e) – Example



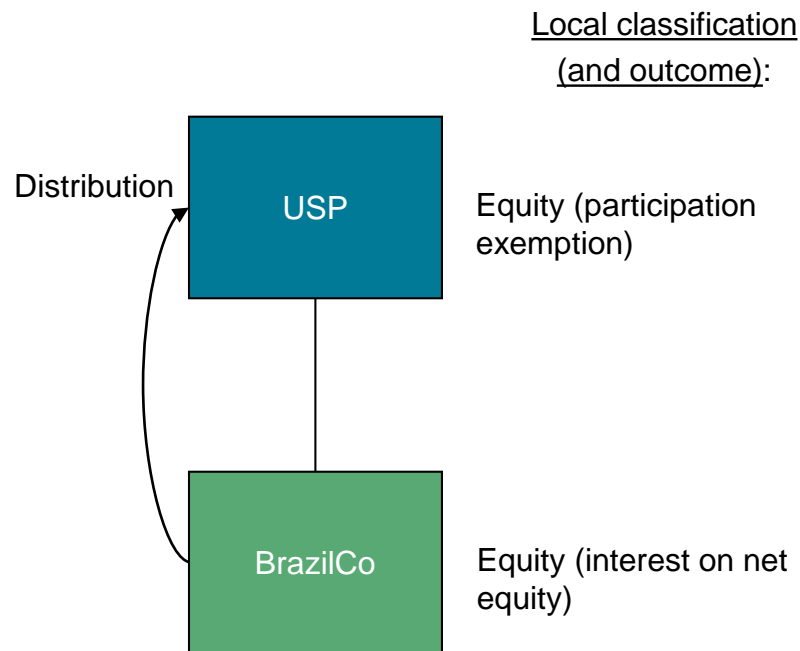
## Facts

- USP directly owns 100% of CFC. CFC gets a deduction in its jurisdiction for dividends paid to USP.
- FC makes a dividend distribution to USP.

## Consequences

- Section 245A(e) applies because CFC is allowed a tax benefit (i.e., the deduction) in its jurisdiction for the dividend paid.
- USP must include in income the full dividend, including the deducted amount that is deemed distributed or actually distributed.
- USP is also unable to take FTCs for any WHT or other taxes imposed by CFC's jurisdiction on the dividend distribution.

# Section 245A(e) Hybrid Dividend (Practical Example)



- USP directly owns 100% of BrazilCo, a CFC.
- Brazilian tax law allows an “interest on net equity” (“INE”) in an amount equal to (i) the Brazilian company’s equity multiplied by (ii) the Brazilian central bank’s long-term interest rate, and limited to the greater of (a) 50% of the Brazilian company’s net accounting income and (b) 50% of the Brazilian company’s retained earnings and profits reserves.
- BrazilCo’s total net equity is \$1,000,000 and Brazilian central bank’s long-term interest rate is 5%.
- Brazil:
  - BrazilCo may create up to \$50,000 INE, deduct against \$50,000 of income, and save \$17,000 in Brazilian CIT.
  - Brazilian 15% INE withholding tax applies to the \$50,000 INE, resulting in \$7,500 of withholding tax.
- US:
  - Section 245A(e) applies and the distribution is a hybrid dividend because (i) USP would be allowed a Section 245A(a) deduction but for Section 245A(e), and (ii) BrazilCo is allowed a tax benefit (i.e., INE) in Brazil.
  - USP must include in income the full dividend, resulting in tax of \$10,500.
  - USP is unable to take Section 901 credits for or deduct the \$7,500 Brazilian withholding tax.
- Total tax of \$18,000 worse than a \$17,000 with no INE.



# Final Regulations

# Final Regulations

## Definitions – Reg. § 1.245A(e)-1

- Hybrid dividend
  - US shareholder would be allowed a deduction under Section 245A(a) to the extent of the sum of the US shareholder's hybrid deduction accounts with respect to each share of stock of the CFC, determined at close of CFC's taxable year.
- Earnings from lower-tier foreign corporations
  - If have Section 1248 gain from the sale of a lower-tier CFC, this amount is treated as distributed directly to the US shareholder.

# Final Regulations Framework – Reg. § 1.245A(e)-1

- Example
  - When a domestic corporation sells stock of a CFC results in a Section 1248 dividend, such dividend is considered to be a dividend directly to the domestic corporation and is a Section 245A(e) hybrid dividend to the extent of the CFC's hybrid deduction account.
- Ordering rule
  - Amounts received by a US shareholder from a CFC are subject to the rules of Section 245A(e) and this section based on the order in which they are received.

# Final Regulations

## Hybrid Dividends of Tiered Corporations

- General rule
  - If a receiving CFC receives a tiered hybrid dividend from another CFC and domestic corporation is a US shareholder for both CFCs:
    - Tiered hybrid dividend is treated as sub F income of the receiving CFC for taxable year of the CFC in which dividend is received
    - US Shareholder includes in gross income its pro rata share of subpart F income and loses any FTC.

# Final Regulations Hybrid Deduction Accounts

- Required for each share of CFC stock
  - Purpose of the accounts
    - Eliminate double non-taxation effect of certain hybrid arrangements
  - The account will reflect the hybrid deductions allocated to each share
  - Hybrid deductions include a deduction or other tax benefit
    - Allowed to the CFC under a relevant foreign law (even if the benefit is not used or reduces tax)
    - Deduction or tax benefit is from an amount paid, accrued or distributed for an instrument issued by CFC that is treated as stock for US tax purposes.
  - There is an exception for integration or imputation system.
  - Notional interest deductions (such as the Belgium notional interest deduction) are treated as hybrid deductions.

# Final Regulations Hybrid Deduction Accounts

- Coordination with Foreign Law
  - Foreign thin cap rules do not apply
  - Foreign hybrid mismatch rules do not apply
- Hybrid Deduction Allocation
  - A hybrid deduction is allocated to a share of CFC stock to extent relates to an amount paid, accrued or distributed by the CFC with respect to the share
  - A hybrid deduction for equity is allocated to a share of stock of a CFC based on the product of the amount of the deduction for all equity of the CFC and a fraction (the FMV of the share over the FMV of all stock of the CFC).

# Final Regulations Hybrid Deduction Accounts

- Operating rules
  - Adjustments to the hybrid deduction account are made at end of CFC's taxable year on a per share basis
  - The hybrid deduction account is increased by the amount of hybrid deductions of the CFC allocated to the share for the taxable year
  - The hybrid deduction account is adjusted for the amount of hybrid deductions.
  - Hybrid deduction accounts must be maintained in the CFC's functional currency. Dividend is determined with spot currency rate at the time of the dividend.

# Proposed Regulations



# Proposed Regulations Hybrid Deduction Accounts

- Additional end of year adjustments to hybrid deduction accounts for each share:
  - Reduction for subpart F inclusions (this is not a dollar-for-dollar reduction)
  - Reduction for GILTI inclusions (this is not a dollar-for-dollar reduction)
  - Reduction for inclusions under Sections 951(a)(1)(B) and 956, to the extent the inclusion occurs by reason of the application of the application of Section 245A(e) (this is a dollar-for-dollar reduction).

# Proposed Regulations

## Hybrid Deduction Accounts – Subpart F and GILTI

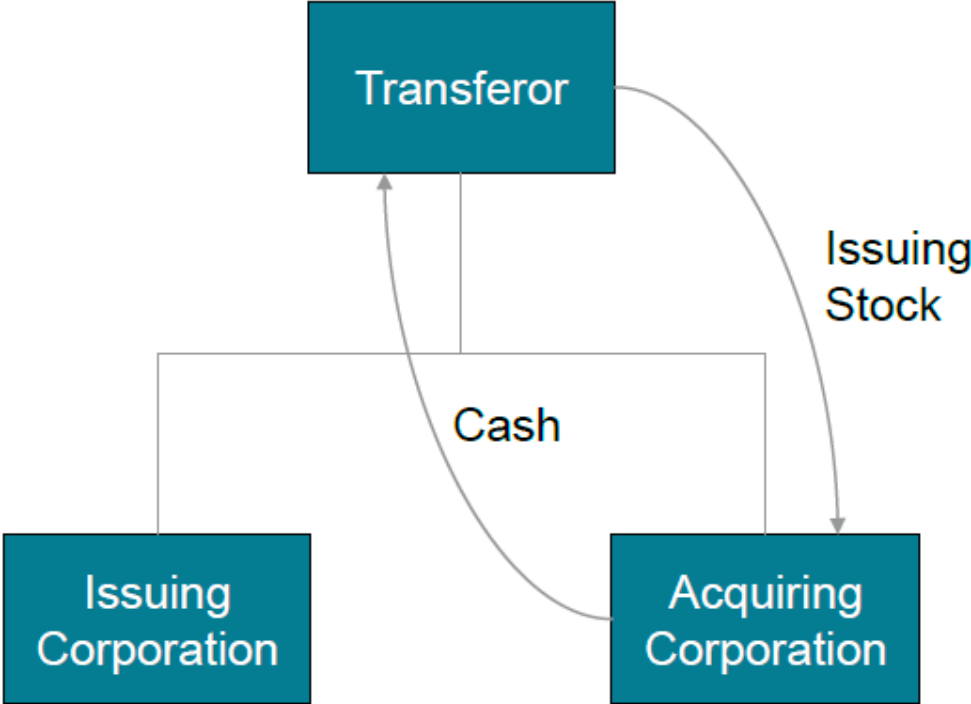
- Steps to compute adjusted subpart F inclusion on a per share basis
  - Determine domestic corporation's pro rata share of CFC's subpart F income and attribute to each share
  - Determine associated foreign income taxes (without taking into account FTC limitations)
  - Adjust to approximate the tax effect of the associated foreign income by two-steps
    - Add associated foreign taxes to the subpart F inclusion
    - Subtract an amount equal to the amount of income offset by the associated foreign income taxes (associated FTC/corporate tax rate).

# Cross Border Section 304

# Section 304(a)(1) – Brother-Sister Transaction

- If one or more persons are in control of two corporations, and in return for property, the acquiring corporation acquires stock of the issuing corporation from the person (or persons) so in control, the property is treated as a distribution in redemption of the acquiring corporation.
- To the extent that Section 301 applies, the following two transactions result:
  - The issuing corporation (“I”) stock is treated as having been transferred to the acquiring corporation (“A”) in exchange for A stock in a transaction qualifying under Section 351(a); and
  - A is treated as having redeemed the A stock issued in the transaction.

# Section 304 – Brother-Sister Transaction



# Section 304 – Control

- Section 304(c) provides that “control” means ownership of stock possessing:
  - At least 50% of the total combined voting power of all classes of stock entitled to vote; or
  - At least 50% of the total value of all classes of stock.
- Section 318(a) constructive ownership rules apply for purposes of determining control, except that the 50% conditions set forth in Sections 318(a)(2)(C) and 318(a)(3)(C) are reduced to 5% conditions.
- Certain upstream stock sales will not satisfy the control requirement. See Rev. Rul. 74-605.

# Section 304 – Key Operating Rules

- **Relevant Corporation For Determining Dividend Equivalence**
  - Application of the Section 302(b) rules is made by reference to the stock of the issuing corporation (Section 304(b)(1)).
- **Amount Constituting A Dividend**
  - In determining the amount constituting a dividend, the distribution is treated as having been made—
    - By the acquiring corporation, to the extent of its E&P; then
    - By the issuing corporation, to the extent of its E&P (Section 304(b)(2)).
    - Special rules for foreign acquiring corporations (Section 304(b)(5)).
- **Coordination Between Section 351 and Section 304**
  - Section 304 and not Sections 351, 357 and 358 apply to any property received in a distribution described in Section 304.
  - Certain “acquisition indebtedness” assumed by the acquiring corporation will not cause Section 304 to apply.

# Section 304 – Basis Consequences

- To the extent that Section 301 applies to the deemed redemption under Section 304(a)(1):
  - The acquiring corporation will take a carryover basis under Section 362, subject to Section 362(e); and
  - If the seller holds other shares of the acquiring corporation basis of the shares deemed redeemed will hop to other shares held by the seller. Reg. § 1.302-2(c); Rev. Rul. 77-427.
    - Query – What if the seller does not own any other shares of the acquiring corporation?



# Section 1059 Overview

- Section 1059(a)
  - Requires reduction in stock basis for *nontaxed* portion of extraordinary dividend.
  - To extent nontaxed portion exceeds basis, recognize gain from the sale or exchange of stock.
  - But not applicable if meet two year holding period.
- Section 1059(e)(1)(A)
  - Even if meet two year holding period, redemption subject to above rules if:
    - (1) part of a partial liquidation,
    - (2) not pro rata as to all shareholders, or
    - (3) *Section 304 transaction*.
- Section 1059(e)(1)(B)
  - An exchange described in Section 356 (boot in a reorganization) which is treated as a dividend shall be treated as a redemption of stock for purposes of applying Section 1059(e)(1)(A).

# Section 304 Transactions with CFCs

- Application of Section 304 in transactions involving CFCs is uncertain
  - Requires the application of subchapter C – regulations that predate the 1997 change in the statute
  - Requires the application of Sections 959 and 961
- Proposed regulations issued in 2006 provided some guidance
  - Regulations never finalized, and Treasury intends to withdraw and re-propose regulations. See Notice 2019-01, Section 2

*“The Treasury Department and the IRS intend to withdraw the 2006 proposed regulations and to issue new proposed regulations under Sections 959 and 961.”*
- Key questions include:
  - How does PTEP move in a Section 304 transaction?
  - How does Section 961 basis move in a Section 304 transaction?
  - When do these movements take place?
  - How does Section 245A apply in a Section 304 transaction?

# PTEP and Basis Adjustments

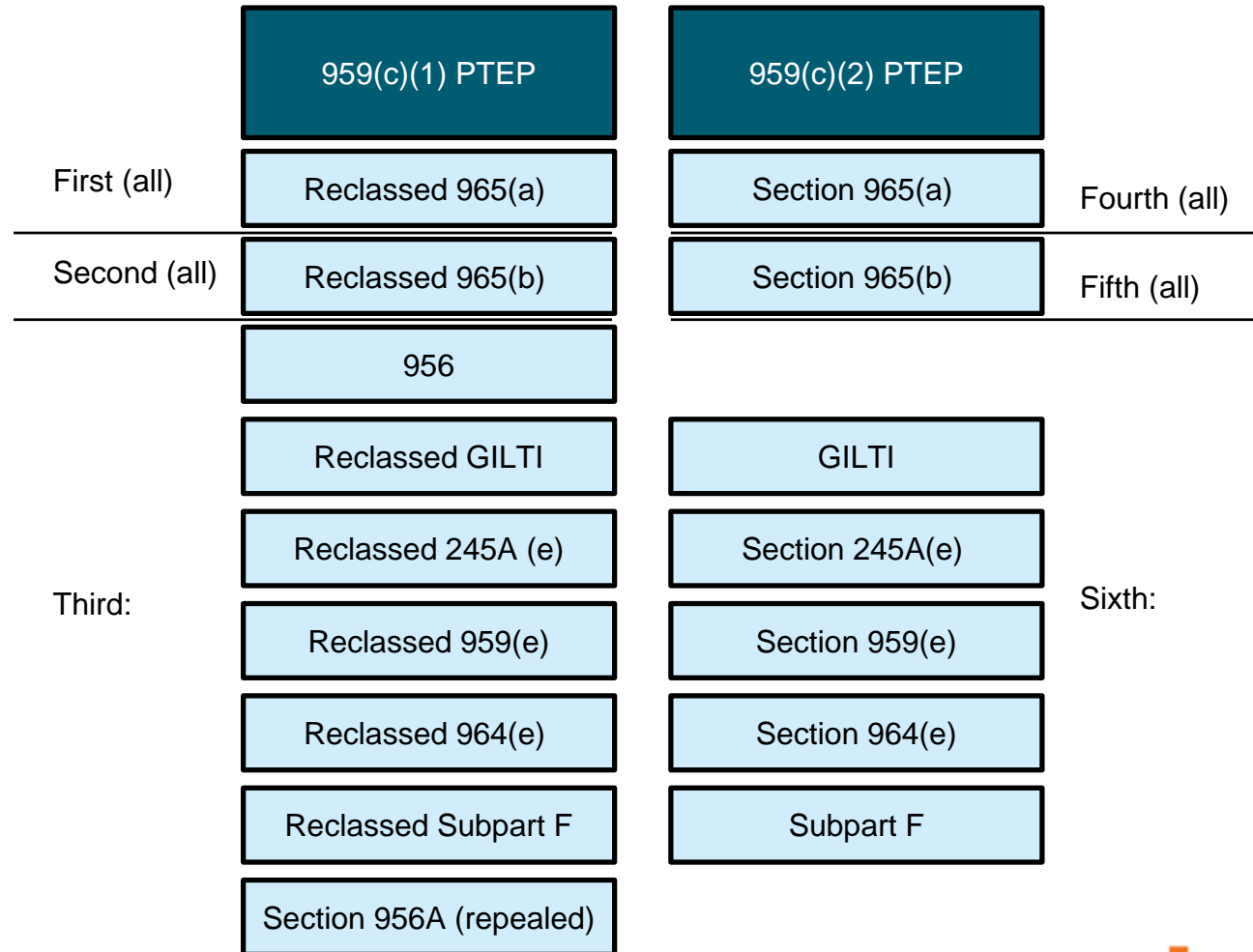
# Cross Border Tax-Free Transactions – Earnings and Profits What Happens to Them?

- Since 1990s, multiple regulatory projects
  - Primarily promulgated under Section 367(b)
  - Generally contained in Reg. §§ 1.367(b)-3, -4, -5, -7, -10, -13
- Goal as stated in every preamble: *Preserve or, when appropriate, trigger, the Section 1248 amount*
  - Consistent with policy of Section 367(b): “essential to protect against tax avoidance in transfers to foreign corporations and upon the repatriation of previously untaxed foreign earnings....” H.R. Rep. No. 658, 94th Cong., 1st Sess. 241 (1975).
- Cover most Sub C transactions along with certain other deemed sub C transactions e.g., Section 304
- Reg. § 1.367(b)-7(b) on PTEP: “Reserved”
- Future Section 1248 amount may be available for Section 245A deduction

# Sections 959 and 961

- Provides rules, together with Section 961 (discussed below), to prevent double taxation of U.S. shareholder's previously taxed earnings and profits attributable to a shareholder's subpart F income inclusion under Section 951(a).
- Section 959 provides an exclusion from gross income of previously taxed earnings and profits (PTEP)
- Section 959(a)(1) excludes from a USSH's income any distributions out of the earnings and profits ("E&P") of a CFC that are attributable to amounts that are or have been include by such shareholder under Section 951(a).
  - Section 959(a)(2) provides a similar rules for a USSH's inclusion under Section 956, discussed below.
  - Section 959(b) excludes from subpart F income a lower-tier CFC's PTEP as it moves up a Section 958(a) ownership chain.
- Section 959(c) divides a CFC's E&P into the following categories:
  - Section 959(c)(1): E&P that were required in prior years to be included as investments in "U.S. property" under Sections 951(a)(1)(B) and 956;
  - Section 959(c)(2): E&P that were required in prior years to be included as subpart F income under Section 951(a)(1)(A), including Section 965 and GILTI, and
  - Section 959(c)(3): Other E&P (potential Section 245A-eligible income).

# Notice 2019-1 Categories of PTEP



# Notice 2019-1

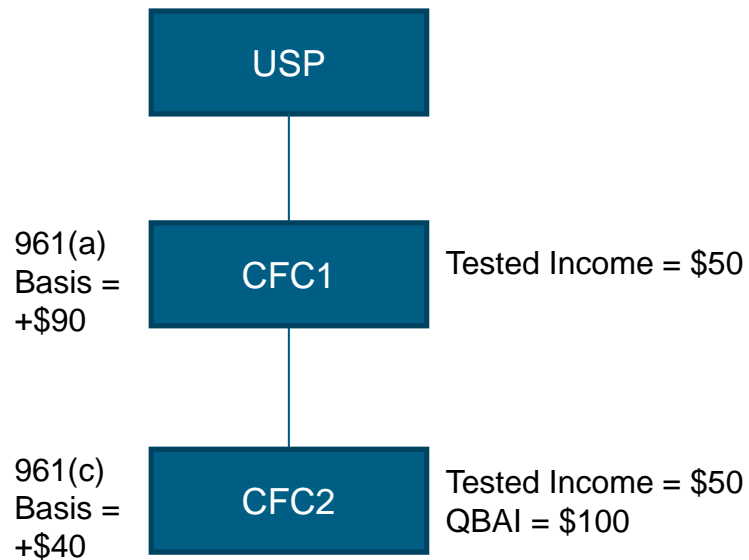
- Created the moniker PTEP (f/k/a PTI or Previously Taxed Income)
  - Formal acronym for the bucket of earnings and profits (E&P) of a CFC previously subject to US tax
  - Refers to earnings and profits of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a US shareholder (as defined under Section 951(b)) under specific Code section. See Sections 959(a) and (e).
- Created 16 categories of PTEP
- Intent to withdraw and replace 2006 proposed regulations
- No distribution of PTEP unless CFC has current or accumulated E&P that would otherwise support a dividend under Section 316, even if CFC has PTEP accounts
- Section 965-specific ordering rule (Section 965 PTEP distributed first)
  - Ordering Rules: Notice 2019-1, § 3.02
    - Special Priority Rule (applied first to (c)(1) PTEP and then to (c)(2) PTEP:
      - Section 965(a) PTEP
      - Section 965(b) PTEP
    - General Rule:
      - (c)(1) PTEP, LIFO by annual account and pro rata among PTEP groups
      - (c)(2) PTEP, LIFO by annual account and pro rata among PTEP groups
      - (c)(3) E&P

# Section 961

- Section 961 generally authorizes Treasury and the IRS to issue rules regarding basis adjustments in the stock of CFCs in order to prevent the double taxation of a USSH's subpart F income.
  - Under Section 961(a) and the regulations thereunder, a USSH increases its basis in the stock of a CFC (or in property by reason of which it is considered to own the stock of a CFC) by the amount of the USSH's Section 951(a) inclusion with respect to such CFC stock.
  - Under Section 961(b) and the regulations thereunder, a USSH decreases its basis in the stock of a CFC (or in property by reason of which it is considered to own the stock of a CFC) by the amount of PTEP distributions received by the USSH with respect to such CFC stock.
  - Section 961(c) and the regulations thereunder provide rules for basis adjustments similar to those under Section 961(a) and (b) for the stock of lower-tier CFCs held by upper-tier CFCs – the upper-tier CFC adjusts its basis in the lower-tier CFC stock and the USSH adjusts its basis in the upper-tier CFC stock.
  - Tax Reform added Section 961(d), which requires a domestic corporation that is a USSH and that Section 245A-eligible dividend to reduce its basis in the stock of the specified 10-percent owned foreign corporation by the amount of such dividend, except to the extent such basis was already reduced under Section 1059.
    - The Section 961(d) basis reduction applies solely for purposes of determining loss on the disposition of the stock of the specified 10-percent owned foreign corporation.



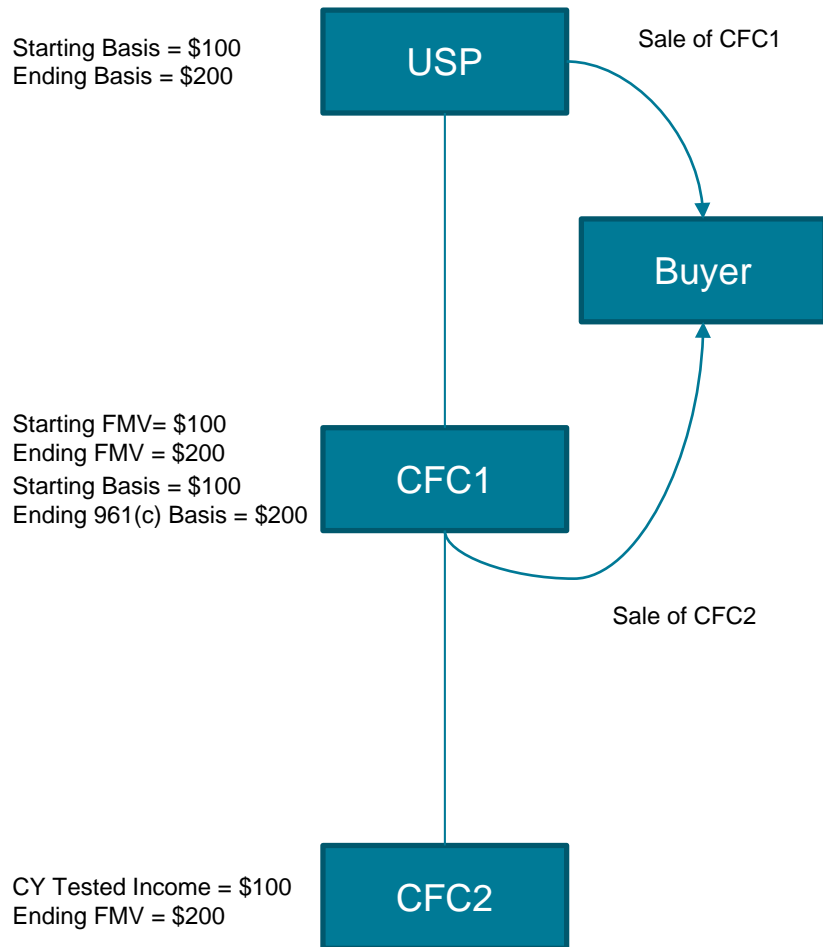
# PTEP and Section 961 Adjustments – The Basics



## PTEP Allocation and 961 Basis Adjustments

- USP has a \$90 GILTI Inclusion
  - \$100 Tested Income - \$10 DTIR
- \$50 of PTEP is allocated to CFC1
- \$40 of PTEP is allocated to CFC2
- CFC2 has \$10 of untaxed E&P, potentially eligible for a Section 245A deduction if/when distributed up the chain to USP.
- Under Section 961(a), USP increases its basis in the stock of CFC1 by \$90
- Under Section 961(c), CFC1 increases its basis in the stock of CFC2 by \$40 for purposes of Section 951.

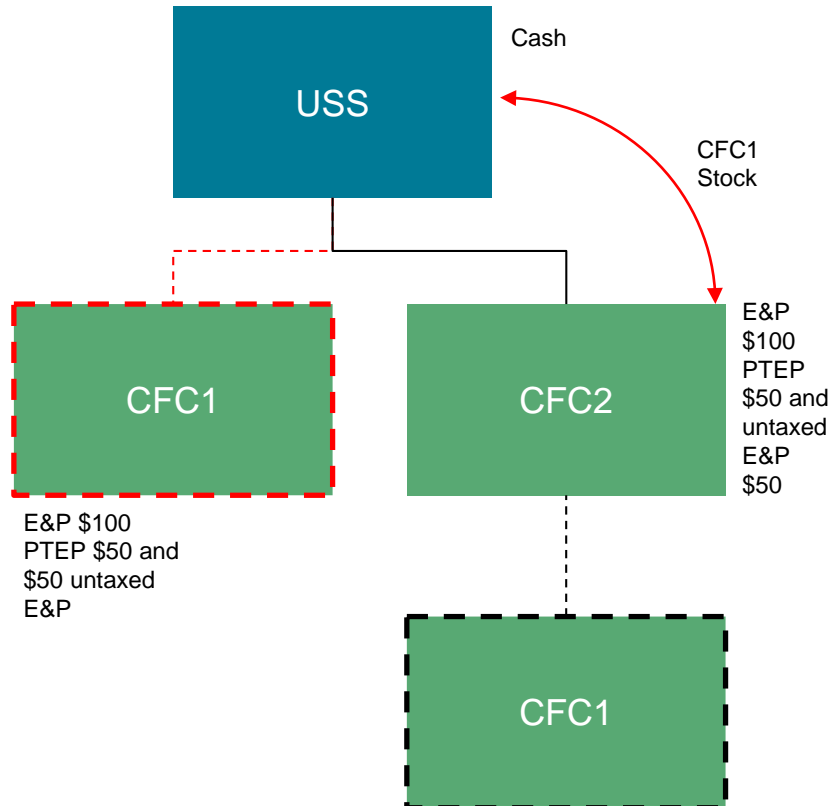
# PTEP and Section 961 Adjustments – Scope of Section 961(c)



## PTEP Allocation and 961 Basis Adjustments

- USP's initial basis in CFC1 = \$100
- CFC2 has \$100 of earnings, all of which are included in income under Section 951A.
- The value of CFC1 and CFC2 increases in respect of those retained earnings.
- USP increases its basis in CFC1 to \$200
- CFC1 increases its basis *under 961(c)* in CFC2
- RESULTS
  - If USP sells CFC1 = no gain or loss
  - If CFC1 sells CFC2
    - No subpart F income
    - What about tested income?
      - If yes, double taxation of earnings and potential for capital loss in stock of CFC1
- Scope of Section 961(c) basis adjustment
  - Reserved in Final GILTI Regs
  - But see Section 951A(f)

# Sale of CFC by USS (same US shareholder)



## Transaction – USS sells CFC1 to CFC2 for \$150

### Section 304(a)(1) overview

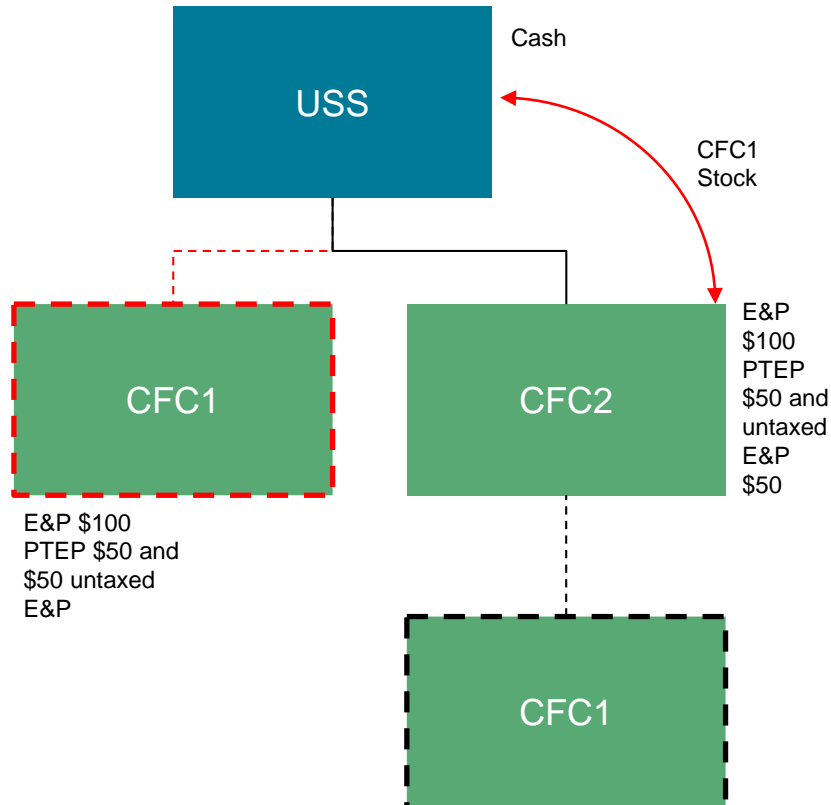
USS is deemed to contribute CFC1 to CFC2 in a Section 351 transaction in exchange for CFC2 shares; then CFC2 is deemed to redeem the deemed issued shares

- Deemed redemption is treated as a Section 301 distribution under Section 302(d)
- Dividend is sourced first to E&P of acquiring corporation (CFC2), then to E&P of issuing corporation (CFC1)

### Section 959 – PTEP Issues

- Is any portion of the deemed dividend from PTEP of CFC2 or CFC1?
  - The proposed regulations generally provide that distributions are first sourced from PTEP in a Section 304 transaction.
  - Should the deemed distribution be sourced from CFC1's PTEP before it is sourced from CFC2's untaxed E&P?
  - Will future regulations limit the ability of the deemed distribution to be sourced from PTEP?

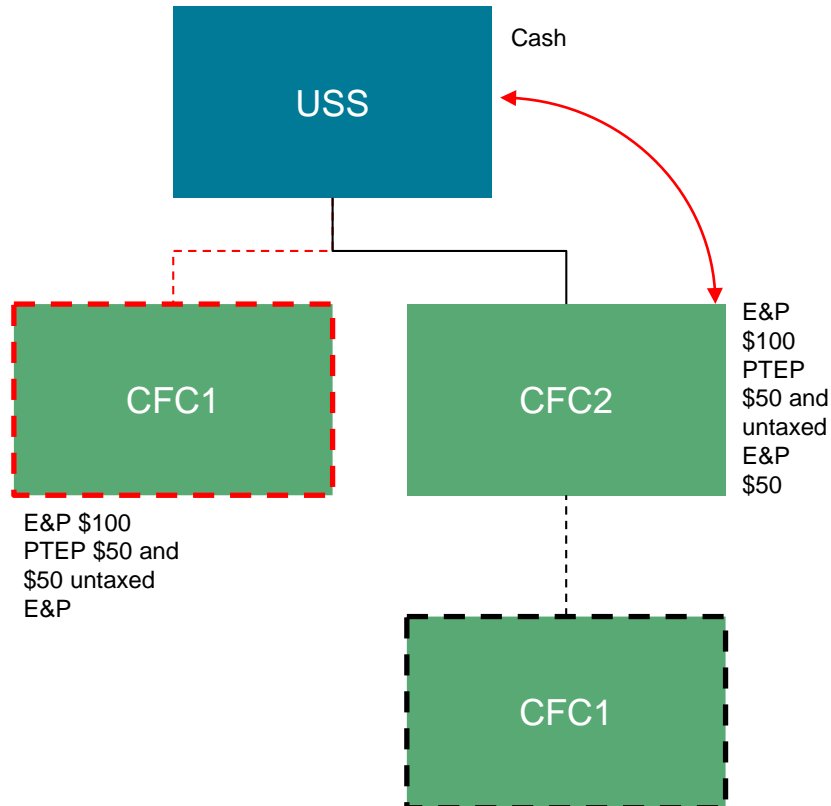
# Sale of CFC by USS (same US shareholder) (Cont.)



## Untaxed E&P Issues

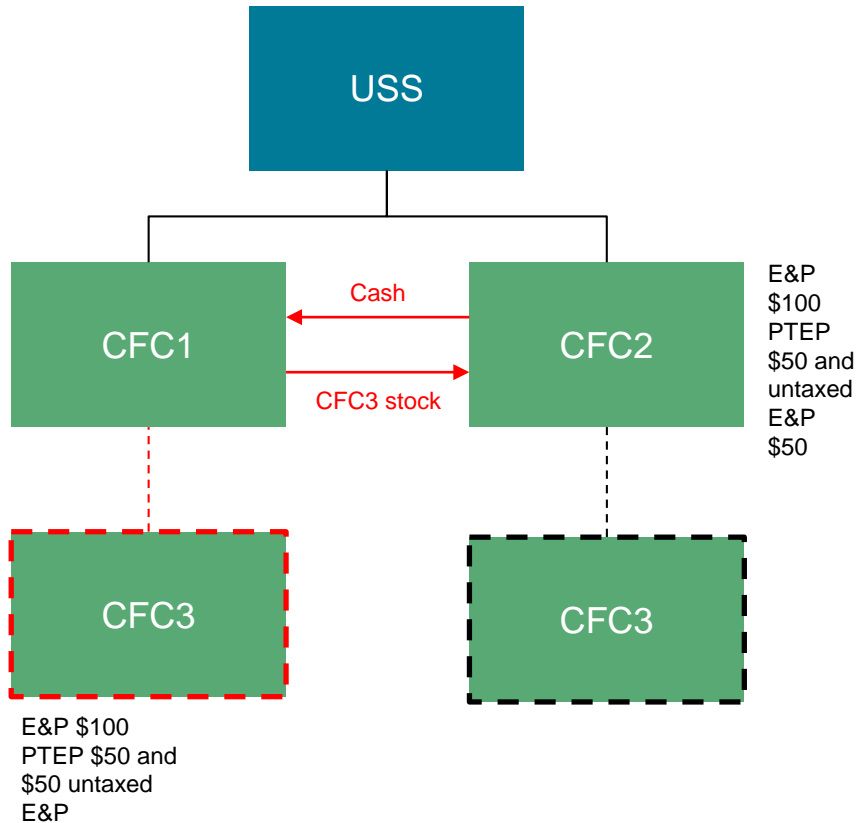
- Section 245A – Does USS receive a Section 245A deduction
  - Is USS's holding period with respect to CFC1 or CFC2 relevant for purposes of determining whether Section 245A applies?
  - Dividend is treated as paid directly from CFC2 to USS
- Section 1248 Inclusion – infinite?
  - If Section 1059(a)(2) result in sale or exchange treatment, Section 1248 appears to recharacterize the gain as dividend income eligible for the Section 245A deduction, increasing the amount of reduction under Section 1059 and thus the amount of the sale or exchange.
- Temp. Section 1.245A-5T
  - Extraordinary disposition account at CFC1 or CFC2 could result in limitation on Section 245A deduction.
  - If CFC2 has an extraordinary disposition account and CFC1 does not, should the dividend be sourced from CFC1 first?

# Sale of CFC by USS (same US shareholder) (Cont.)



- Reg. § 1.302-2(c): In any case in which an amount received in redemption of stock is treated as a distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed.
- Query: Difference between selling all of the stock of issuing corporation (i.e., CFC1 –v- retaining some stock)
- In dividend-equivalent redemptions under Section 302(d), any unrecovered basis in the redeemed stock of a shareholder may be shifted to other stock only if such an adjustment is a “proper adjustment” within the meaning of Reg. § 1.302-2(c).
- If USS retains stock of CFC1, PTEP of CFC 2 is reallocated to the CFC2 stock retained (Prop. Reg. § 1.959-3(h)(3)(ii) (2006)) in a manner consistent with, and in proportion to, the proper adjustments under Reg. § 1.302-2(c)
- Will future regulations provide details as to when Section 961(a) or (c) basis is created or moved?
- To the extent that CFC1 continues to have a PTEP account post-transaction, does CFC2 have Section 961(c) basis in the CFC1 stock (only available for limited purposes) or normal basis?
- Will Section 961 basis from current-year SubF/GILTI be available, or will there be a timing mismatch resulting in gain under Section 961(b)?

# Sale of CFC by CFC (same US shareholder)



## Transaction –CFC1 sells CFC3 to CFC2 for \$150

Section 304(a)(1) overview

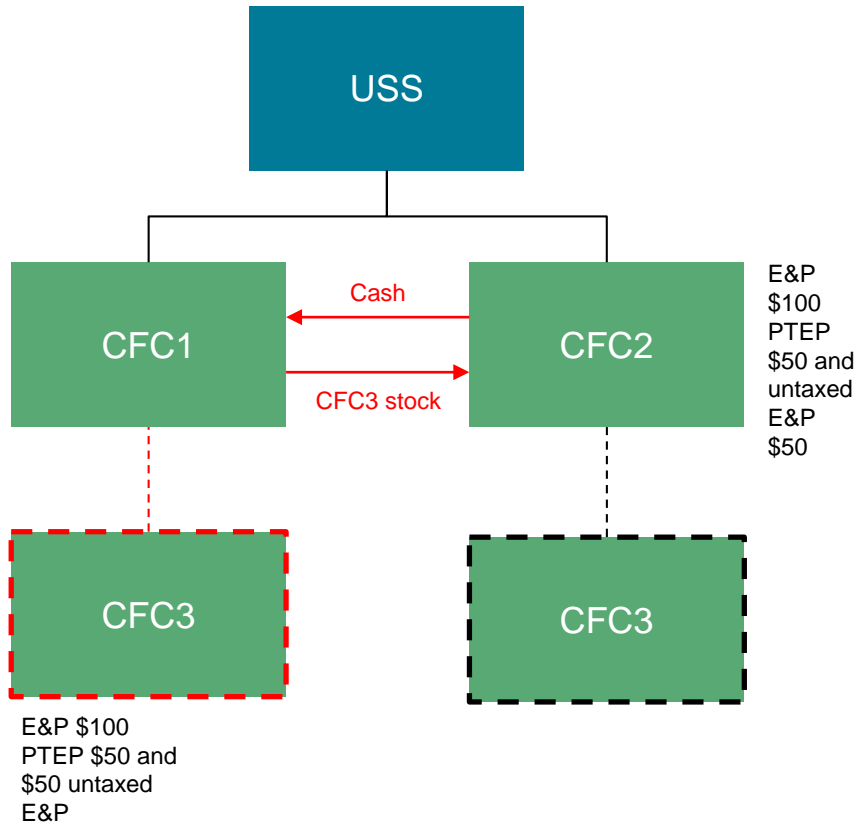
CFC1 is deemed to contribute CFC3 to CFC2 in a Section 351 transaction in exchange for CFC2 shares; then CFC2 is deemed to redeem the deemed issued shares

- Deemed redemption is treated as a Section 301 distribution under Section 302(d)
- Dividend is sourced first to E&P of acquiring corporation (CFC2), then to E&P of issuing corporation (CFC3)

## Section 959 – PTEP Issues

- Is any portion of the deemed dividend from PTEP of CFC2 or CFC3?
  - The proposed regulations generally provide that distributions are first sourced from PTEP in a Section 304 transaction.
  - Should the deemed distribution be sourced from CFC3's PTEP before it is sourced from CFC2's untaxed E&P?
  - Will future regulations limit the ability of the deemed distribution to be sourced from PTEP?

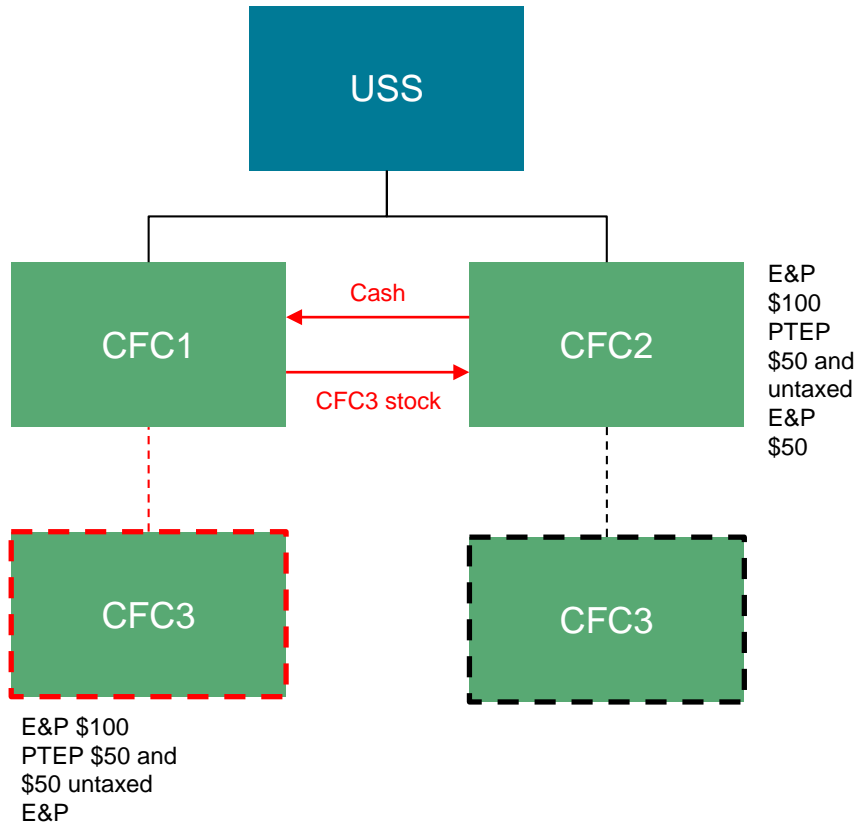
# Sale of CFC by CFC (same US shareholder) (Cont.)



## Untaxed E&P Issues

- Note – Treasury has consistency stated that the Section 245A deduction is not available to a CFC receiving a dividend.
- Unless an exception applies (e.g., Section 954(c)(6)), CFC1 should be treated as having subpart F income as a result of the deemed dividend.
- Section 1248 Inclusion – infinite?
  - If Section 1059(a)(2) result in sale or exchange treatment, Section 1248 appears to recharacterize the gain as dividend income eligible for the Section 245A deduction, increasing the amount of reduction under Section 1059 and thus the amount of the sale or exchange.
- Temp. Section 1.245A-5T
  - Extraordinary disposition account at CFC1 or CFC2 could result in limitation on Section 245A deduction.
  - If CFC2 has an extraordinary disposition account and CFC1 does not, should the dividend be sourced from CFC1 first?

# Sale of CFC by CFC (same US shareholder) (Cont.)



## Basis Issues

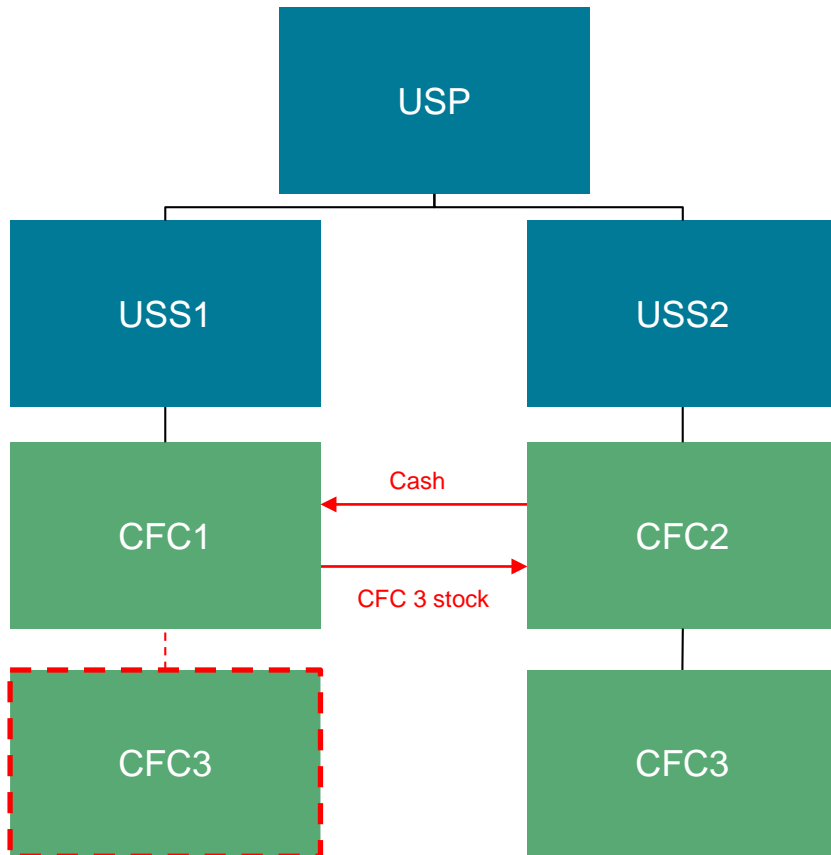
- Reg. § 1.302-2(c): In any case in which an amount received in redemption of stock is treated as a distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed.

## Section 961 – Basis Issues

- Will future regulations provide details as to when Section 961(a) or (c) basis is created or moved?
- To the extent that CFC3 continues to have a PTEP account post-transaction, does CFC2 have Section 961(c) basis in the CFC3 stock (only available for limited purposes) or normal basis?
- Will Section 961 basis from current-year SubF/GILTI be available, or will there be a timing mismatch resulting in gain under Section 961(b)?



# Change in US Shareholder



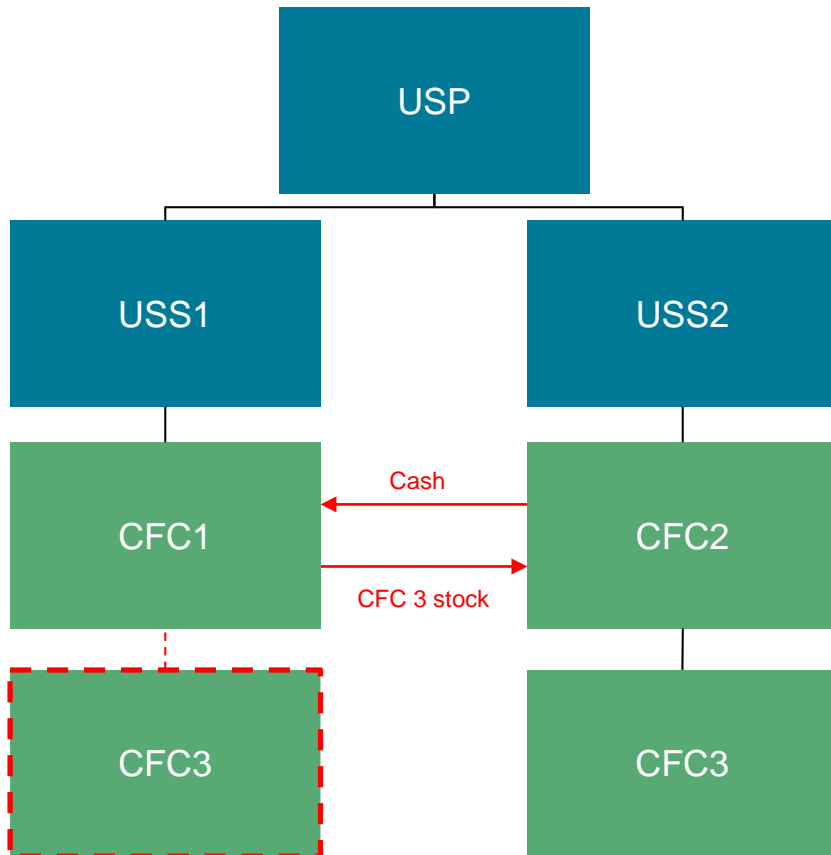
## Transaction –CFC1 sells CFC3 to CFC2

Section 304(a)(1) overview

CFC1 is deemed to contribute CFC3 to CFC2 in a Section 351 transaction in exchange for CFC2 shares; then CFC2 is deemed to redeem the deemed issued shares

- Deemed redemption is treated as a Section 301 distribution under Section 302(d)
- Dividend is sourced first to E&P of acquiring corporation (CFC2), then to E&P of issuing corporation (CFC3)

# Change in US Shareholder (Cont.)



## Considerations

- Same questions as above, but different answers?
- Additional questions:
  - How will future regulations provide for the sharing of PTEP, basis, extraordinary disposition accounts, or other attributes when there is a change in U.S. shareholder?
  - Can a year-end election be made for CFC1 under Temp. Reg. § 1.245A-5T(e)(3)?
  - Treasury requested comments on the treatment of consolidated groups under Temp. Reg. § 1.245A-5T.

# All Boot D Reorganizations

# Non-Divisive “D” Requirements

## Statutory – Section 368(a)(1)(D)

- In a non-divisive “D” reorganization, a corporation must transfer substantially all of its assets to another corporation. See Section 354(b)(1)(A).
- Immediately after the transfer, the transferor corporation, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, must be in “Section 304 control” of the corporation to which the assets are transferred.
  - Control as used in the context of non-divisive “D” reorganizations is different from control as used in the context of other reorganizations. See Section 368(a)(2)(H)(I).
  - Section 304 control means the ownership of stock possessing at least 50-percent of the total combined voting power of all classes of stock entitled to vote, or at least 50-percent of the total value of the shares of all classes of stock. See Section 304(c).

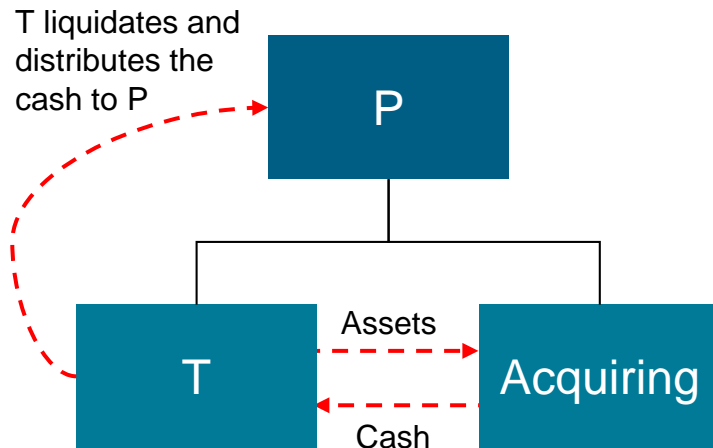
# Non-Divisive “D” Requirements

- Attribution rules contained in Section 318 apply for purposes of determining Section 304 control.
  - In pursuance of the plan of reorganization, the transferor corporation in a non-divisive “D” reorganization must distribute all of the stock and securities of the transferee corporation it received in the transfer, as well as any retained assets, to its shareholders and security holders (i.e., it generally must liquidate as part of the plan). See Section 354(b)(1)(B).

## Non-statutory

- Continuity of Shareholder Interest
- Continuity of Business Enterprise

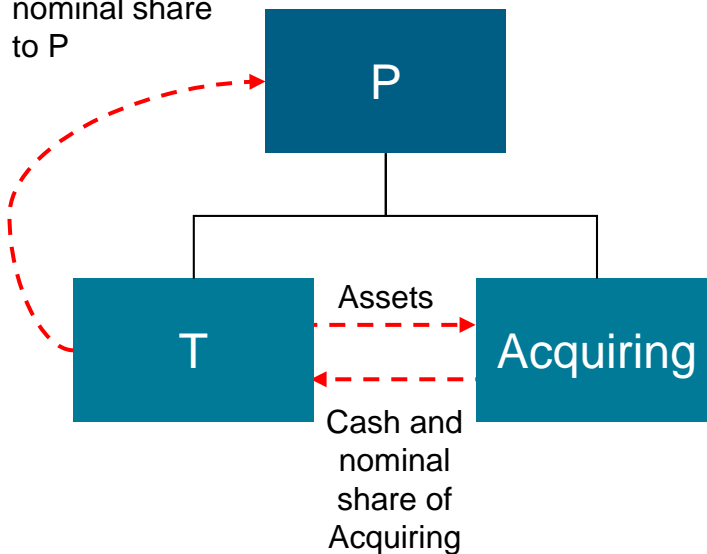
# All-Boot D Reorganizations – Rev. Rul. 70-240



- Even though no stock or securities of Acquiring are distributed in a transaction which qualifies under Sections 354 or 356, the transaction qualifies as a “D” Reorganization.
- T is deemed to receive Acquiring stock from Acquiring (in addition to the cash it actually received) and distributing the stock and cash to P in exchange for the T stock held by T.
- Pursuant to Section 356(a)(1), P will recognize gain to the extent of the cash received.
  - P’s gain will be a dividend to the extent of the earnings of profits of T and Acquiring. Section 356(a)(2).

# All-Boot D Reorganizations – Reg. § 1.368-2(I)

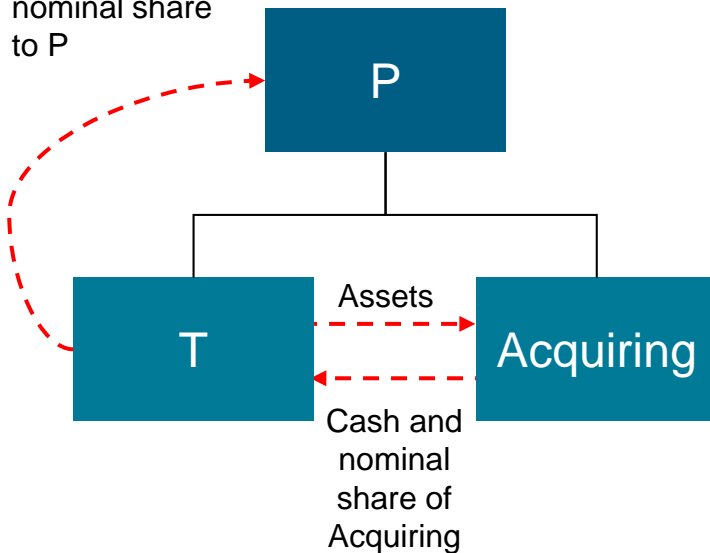
T liquidates and distributes the cash and nominal share to P



- The regulations provide that the Distribution Requirement will be satisfied even though no stock and/or securities are actually issued in the transaction if the same person or persons own, directly or indirectly, all of the stock of the transferor and transferee corporations in identical proportions.
- The transferee will be deemed to issue a nominal share of stock to the transferor in addition to the actual consideration exchanged for the transferor's assets.
- The nominal share is then deemed distributed by the transferor to its shareholders and, when appropriate, further transferred through chains of ownership to the extent necessary to reflect the actual ownership of the transferor and transferee corporation.
- The nominal shares are respected for all U.S. federal income tax purposes, including basis purposes.

# All-Boot D Reorganizations – Reg. § 1.368-2(I)

T liquidates and distributes the cash and nominal share to P



- Nominal Share Issuance

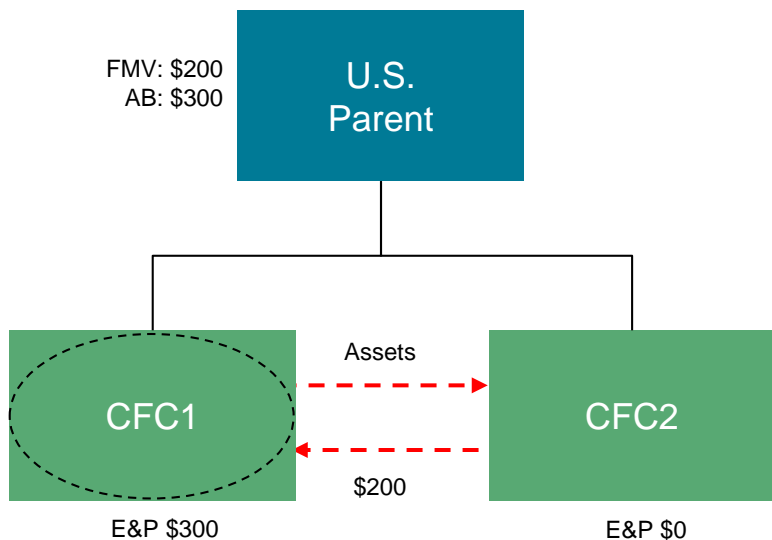
- If no consideration is received (or the consideration < FMV of Assets)
  - Transferee is treated as issuing stock with FMV equal to the excess of the FMV of assets over FMV of consideration
- If FMV of Consideration = FMV of Assets
  - Transferee is deemed to issue a nominal share of stock.



# All-Boot D Reorganizations – Basis Consequences

- If the basis of Target exceeds its fair market value, the basis regulations provide that the Acquiring shareholder may designate the share of Acquiring stock to which the basis (if any) of the surrendered shares attach.
- The ability to designate the share of stock of the issuing corporation to which the basis, if any, of the stock or securities surrendered will attach applies only to a shareholder that owns actual shares in the issuing corporation.
- Permits potential loss planning opportunities if the basis of Target exceeds its fair market value.

# All Boot D Reorganizations with CFCs Built-In Loss Target



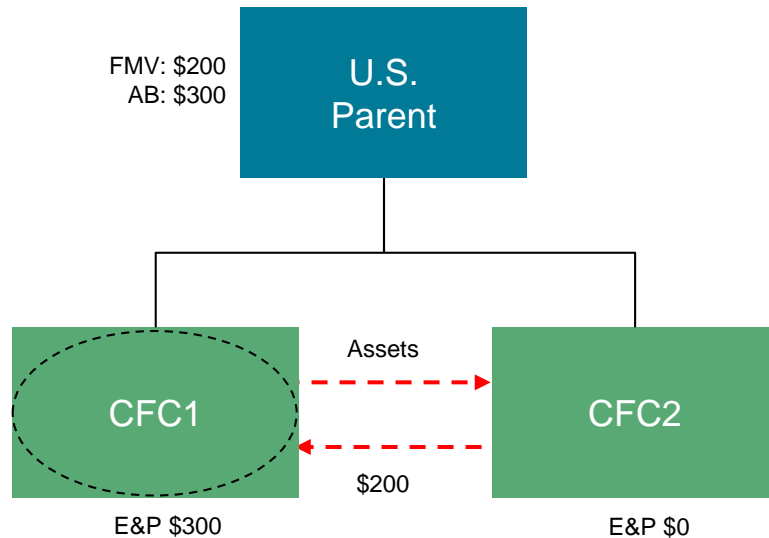
## Overview

- U.S. Parent (USP) owns CFC1 which has a FMV less than stock basis (assumes uniform basis in shares).
- CFC1 transfers all of its assets to CFC2, in exchange for \$200 of cash, and liquidates (e.g., via a CTB election) in a transaction that qualifies as an all boot D reorganization. See, e.g., Reg. § 1.368-2(l); Rev. Rul. 70-240; Rev. Rul. 2004-83.

## Analysis

- Because USP owns directly all of the stock of both CFC1 and CFC2, CFC2 is treated as issuing a nominal share of CFC2 stock to CFC1, which CFC1 is treated as distributing to USP.

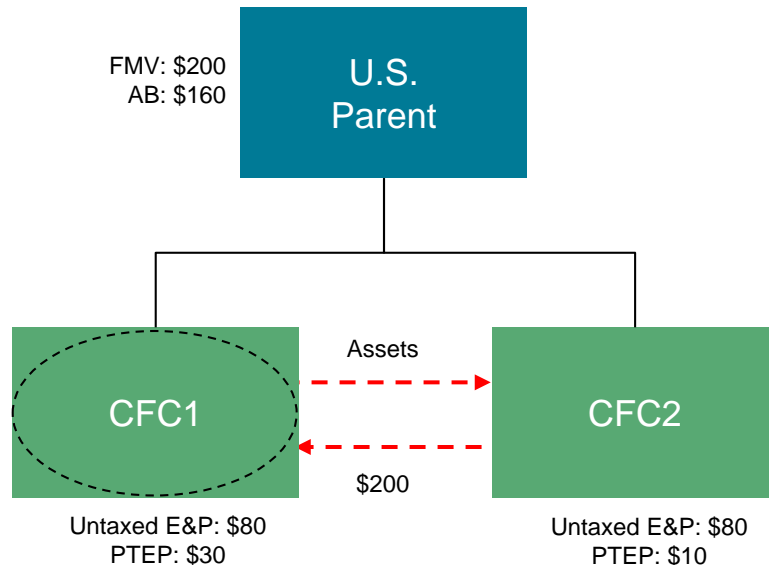
# All Boot D Reorganizations with CFCs Built-In Loss Target



## Analysis (cont.)

- Gain Limitation
  - USP recognizes gain to the extent of the lesser of the amount of boot received (\$200) or the gain in the CFC1 shares (\$0). Section 356(a)(1).
  - Section 304 does not have a gain limitation.
- USP's basis in the CFC2 stock would include its basis in the CFC1 stock. Section 358.
  - USP's basis in CFC1 is reduced from \$300 to \$100. USP has the ability to designate which share of CFC2 stock is increased to preserve the \$100 remaining basis.
- USP is able to repatriate \$200 from CFC2 with no incremental tax cost other than basis reduction

# All Boot D Reorganizations with CFCs Built-In Gain Target



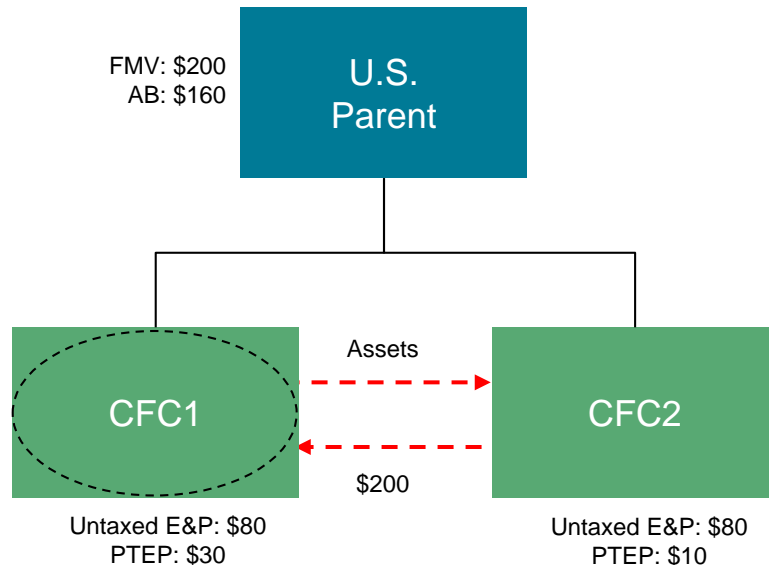
## Overview

- U.S. Parent (USP) wholly-owns CFC2 and CFC1, which has a FMV of \$200 and basis of \$160 (assumes uniform basis in shares).
- CFC1 transfers all of its assets to CFC2 in exchange for \$200 of cash, and CFC1 liquidates (e.g., via a CTB election) in a transaction that qualifies as an all boot D reorganization. See, e.g., Reg. § 1.368-2(l); Rev. Rul. 70-240; Rev. Rul. 2004-83.

## Anticipated Results

- Because USP owns directly all of the stock of both CFC1 and CFC2, CFC2 is treated as issuing a nominal share of CFC2 stock to CFC1, which CFC1 is treated as distributing to USP.
- USP is expected to recognize gain to the extent of the lesser of the amount of boot received (\$200) or the gain in the CFC1 shares (\$40). Section 356(a)(1).
- Under Section 356(a)(2), USP's \$40 gain is characterized as a boot dividend.
- Section 1248 is not expected to apply. Reg. §§ 1.367(b)-4(b)(1), 1.367(b)-2(b).

# All Boot D Reorganizations with CFCs Built-In Gain Target



## Anticipated Results (cont.)

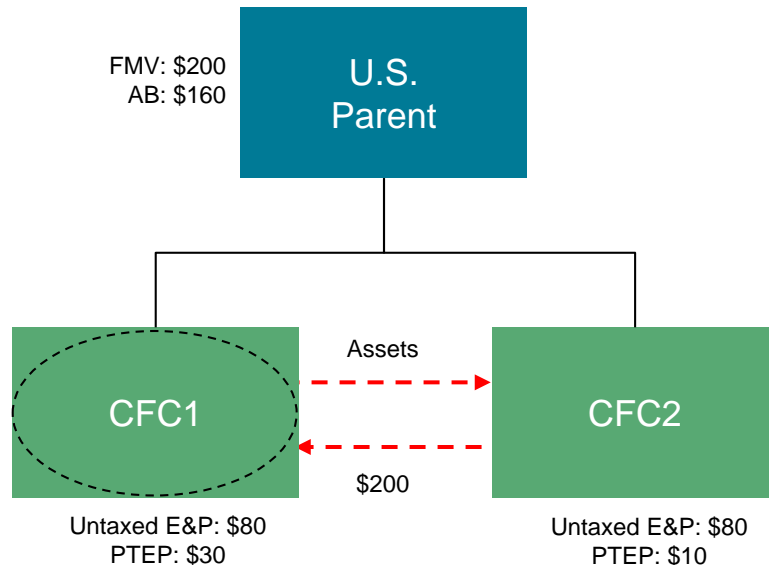
- **Source of the dividend**

- CFC 1's and CFC 2's combined E&P. Rev. Rul. 70-240 and *Davant v. Comm'r*, 366 F.2d 874 (5th Cir. 1966).
  - Is CFC1's or CFC2's E&P is used first?
  - No explicit rule like Section 304
- CFC 1's E&P. *Atlas Tool Co. v. Comm'r*, 614 F.2d 860 (3d Cir. 1980).

- **Section 959 – PTEP Issues**

- Is any portion of the deemed dividend from PTEP of CFC2 or CFC1?
  - The Service has ruled in that boot dividends under Section 356(a)(2) are treated as dividends for purposes of Section 959. See, e.g., PLR 9327010 (Mar. 25, 1993); 9118004 (Jan. 30, 1991).
- Should the deemed distribution be sourced from CFC1 and CFC2's PTEP before it is sourced from untaxed E&P?

# All Boot D Reorganizations with CFCs Built-In Gain Target

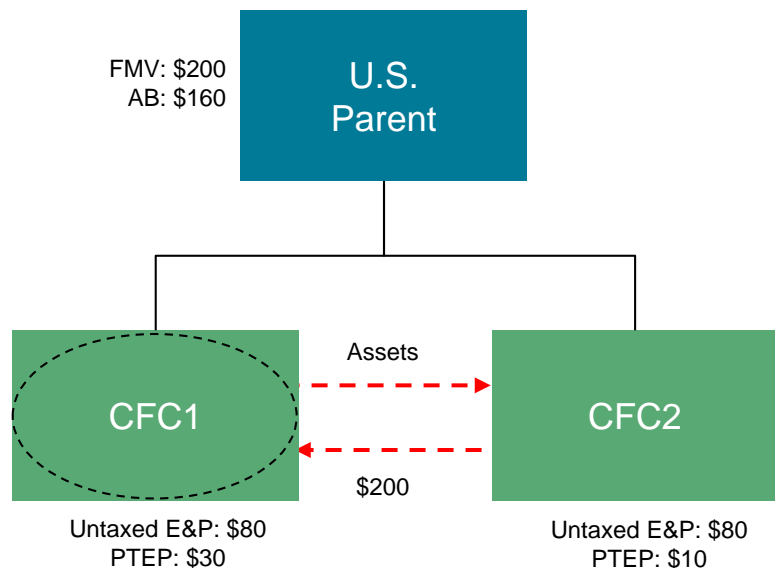


## Anticipated Results (cont.)

- **Section 959 – PTEP Issues (cont.)**

- Will future regulations limit the ability of the deemed distribution to be sourced from PTEP?
- If USP is able to source the boot dividend from PTEP of CFC1, it may be getting a double benefit as a result of the basis increase in the stock of CFC1 it received under Section 961(a).
- Because the Section 356(a)(2) boot dividend is limited to the amount of gain in the CFC1 stock held by USP, which has been increased by \$30 of subpart F income that are now PTEP, it could be argued that USP is getting an additional \$30 benefit.

# All Boot D Reorganizations with CFCs Built-In Gain Target

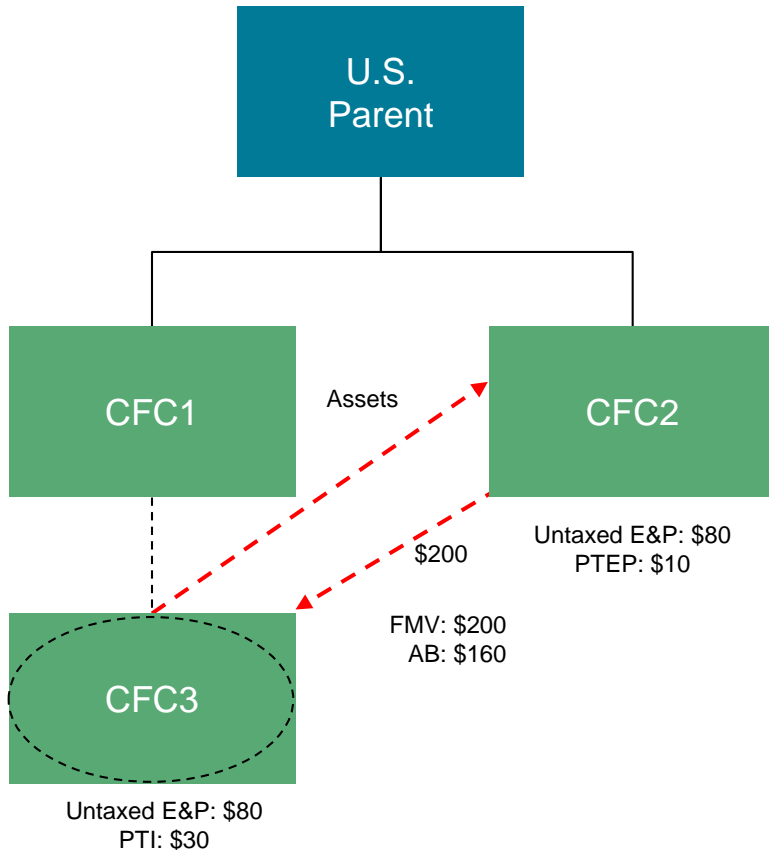


## Anticipated Results (cont.)

### • **Untaxed E&P Issues**

- Pre-TCJA
  - If the boot dividend is not treated as coming out of PTEP, then USP would recognize \$40 of gross income.
- Post-TCJA
  - If the boot dividend is not treated as coming out of PTEP, the boot dividend could qualify under Section 245A for a 100% DRD.
  - CFC2 would inherit CFC1's untaxed E&P of \$80, but also the \$30 of PTEP. Distributions out of CFC2 to USP would also be expected to qualify for a 100% DRD under Section 245A.

# All Boot D Reorganizations with CFCs Built-In Gain Target – Indirect Ownership



## Overview

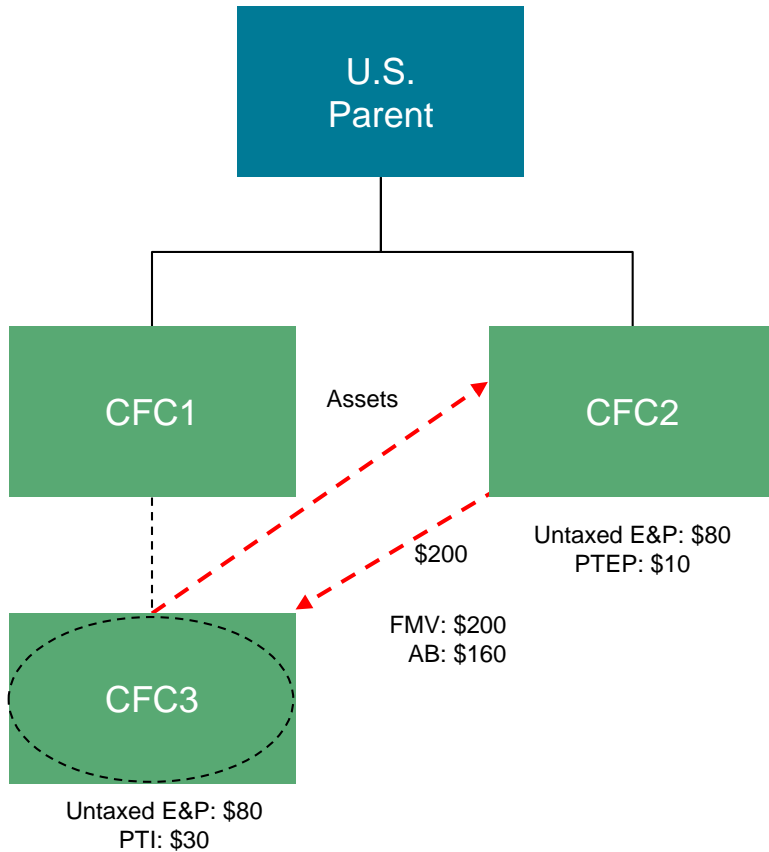
- Same facts as the above example, except that target is now CFC3, a wholly-owned subsidiary of CFC1. CFC1 has made an upward adjustment of \$30 in its CFC3 basis under Section 961(c).
- CFC3 transfers all of its assets to CFC2 in exchange for \$200 of cash, and CFC3 liquidates (e.g., via a CTB election) in a transaction that qualifies as an all boot D reorganization.

## Anticipated Results

- Because USP owns all of the stock of CFC2 directly and CFC3 indirectly, CFC2 is treated as issuing a nominal share of CFC2 stock to CFC3, which CFC3 is treated as distributing to CFC1 and then USP
- Section 1248 is not expected to apply. Reg. §§ 1.367(b)-4(b)(1), 1.367(b)-2(b).



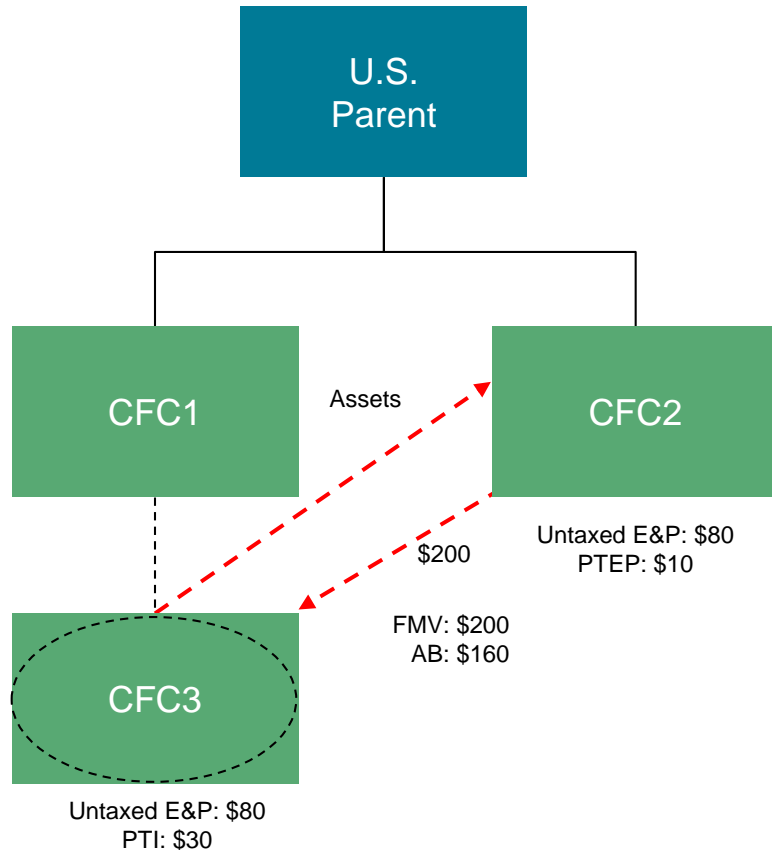
# All Boot D Reorganizations with CFCs Built-In Gain Target – Indirect Ownership



## Anticipated Results (cont.)

- CFC1 is expected to recognize gain to the extent of the lesser of the amount of boot received (\$200) or the gain in the CFC3 shares (\$40). Section 356(a)(1).
- Under Section 356(a)(2), USP's \$40 gain is characterized as a boot dividend.
- **Source of the dividend** - Same issues as prior example
  - CFC 3's and CFC 2's combined E&P. Rev. Rul. 70-240 and *Davant v. Comm'r*, 366 F.2d 874 (5th Cir. 1966).
  - Is CFC3's or CFC2's E&P is used first?
  - No explicit rule like Section 304
  - CFC 3's E&P. *Atlas Tool Co. v. Comm'r*, 614 F.2d 860 (3d Cir. 1980).

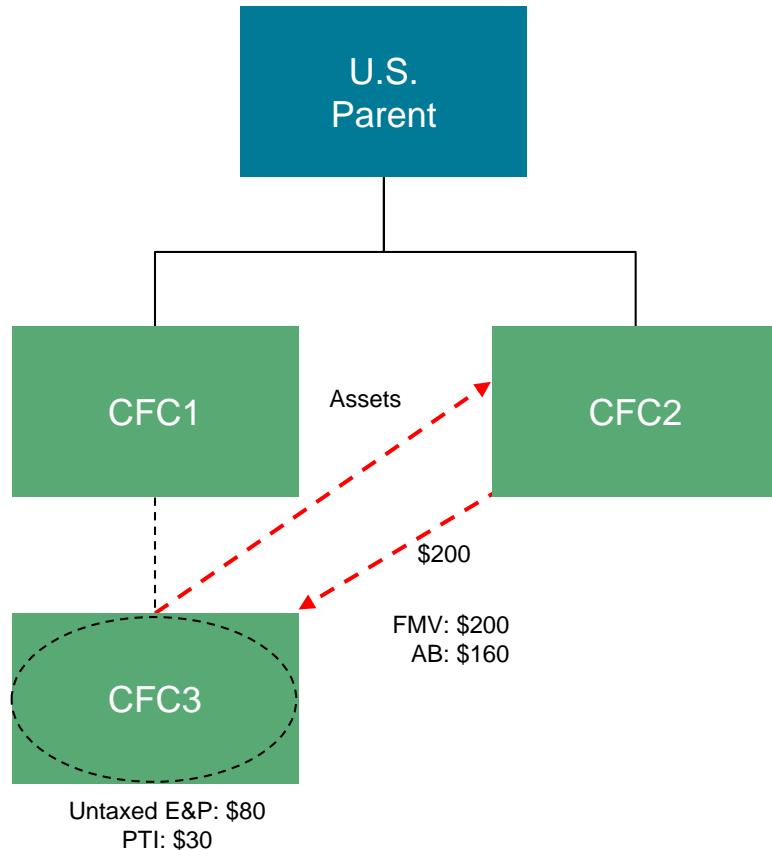
# All Boot D Reorganizations with CFCs Built-In Gain Target – Indirect Ownership



## Anticipated Results (cont.)

- **Section 959 – PTEP Issues** - Same issues as prior example
  - Is any portion of the deemed dividend from PTEP of CFC3 or CFC2?
  - Should the deemed distribution be sourced from CFC2 and CFC3's PTEP before it is sourced from untaxed E&P?
- **Untaxed E&P Issues**
  - If the boot dividend is not treated as coming out of PTEP, then CFC1 should be treated as having subpart F income as a result of the boot dividend, unless an exception applies (e.g., Section 954(c)(6)). See Notice 2007-9 (indicating that a dividend for purposes of Section 954(c)(6) includes stock gain recharacterized as a dividend under Section 356(a)(2)).

# All Boot D Reorganizations with CFCs Built-In Gain Target – Indirect Ownership



## Anticipated Results (cont.)

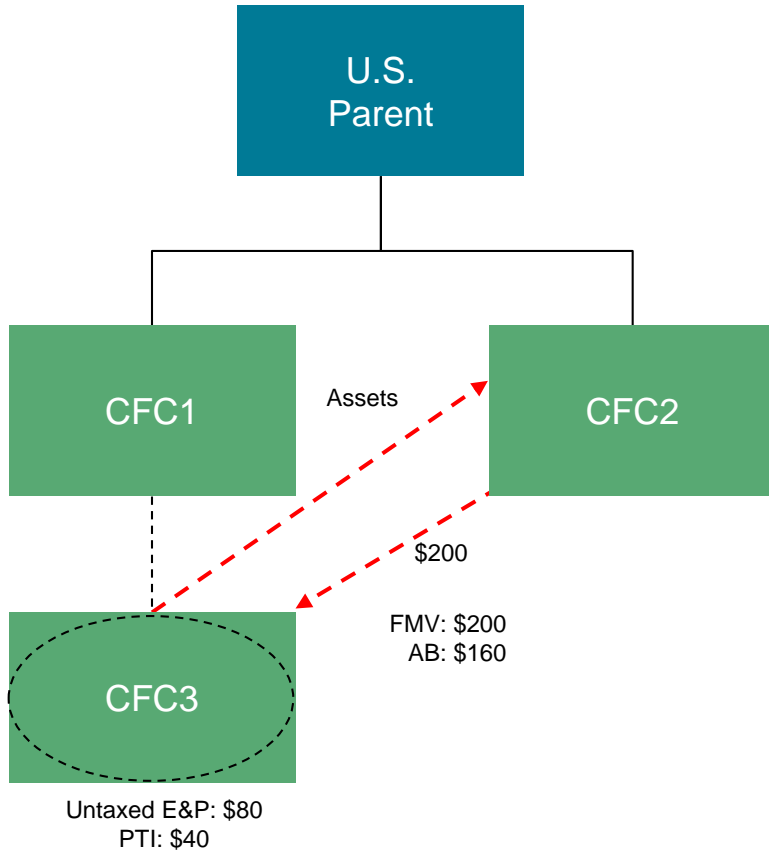
- **Section 961 – Basis Issues**

- Will future regulations provide details as to when Section 961(a) or (c) basis is created or moved?
- Will Section 961 basis from current-year SubF/GILTI be available, or will there be a timing mismatch resulting in gain under Section 961(b)?

- **Section 951A Issues**

- Section 951A(f)(1)(A) provides that GILTI inclusions shall be treated in the same manner as an amount included under Section 951(a)(1)(A) (i.e., subpart F income) for purposes of, inter alia, Sections 959 and 961.
- Section 961(c) provides that lower-tier CFC basis is increased by reason of subpart F and GILTI inclusions, “but only for the purposes of determining the amount included under Section 951.”

# All Boot D Reorganizations with CFCs Built-In Gain Target – Indirect Ownership

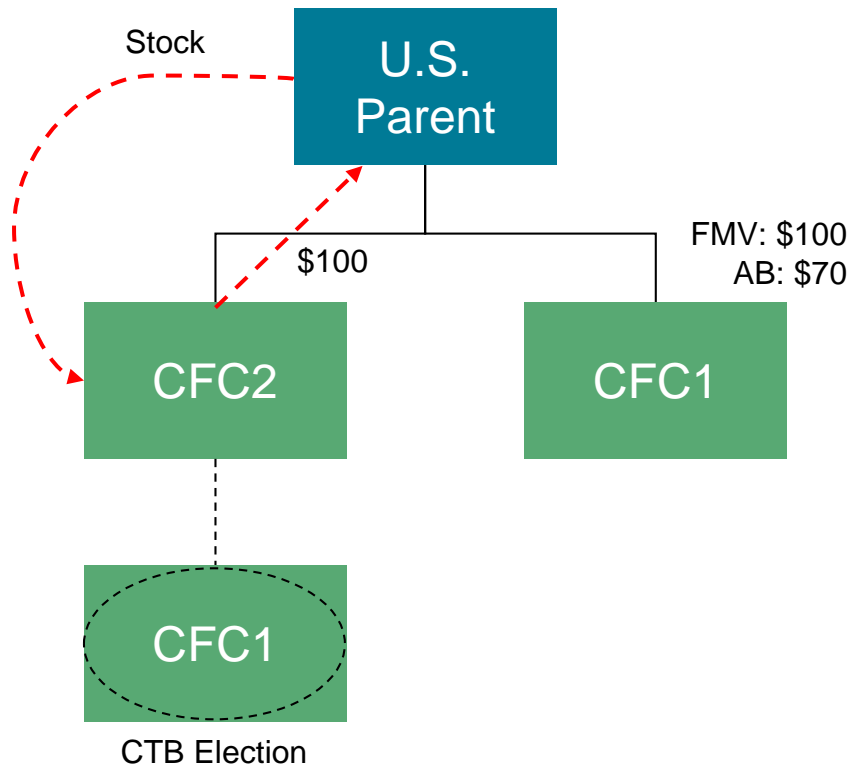


## Anticipated Results (cont.)

### • Section 951A Issues (cont.)

- Section 951A(f)(1)(A) applies to amounts included in gross income under Section 951A(a)
- Because subpart F income is excluded from GILTI, but the Section 961(c) stock basis is not taken into account in determining subpart F income, would CFC1 have to include the basis increase of \$40 as GILTI?

# All Boot D Reorganizations with CFCs Converting a Section 304 Stock Sale into an All Boot D Reorganization



## Overview

- U.S. Parent (USP) wholly-owns CFC2 and CFC1
- USP transfers the stock of CFC1 to CFC2 in exchange for \$100
- CFC1 files a CTB election to be treated as a disregarded entity of CFC2

## Anticipated Results

- Transaction is expected to qualify as a D reorganization. See, e.g., Reg. § 1.368-2(l); Rev. Rul. 70-240; Rev. Rul. 2004-83
- USP is expected to receive a \$30 boot dividend under Section 356(a)(2)

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