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Westchester County, NY/Connecticut Region

2009-2010 Luncheon Series

Update on Inversion Transactions & Expatriated Entities

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Background on Outbound Inversions

- Why invert?
 - Avoid Subpart F income
 - Facilitate cash mobilization
 - Earnings stripping
 - Avoid Code § 1248

Background on Outbound Inversions

- McDermott (Bhada) - 1983
 - Shares of US corp were exchanged for shares of an existing Panamanian subsidiary of US corp
 - Was taxable at shareholder level (some losses recognized)
 - Avoided Subpart F & 1248
 - I.R.S. argued 304 transaction but lost
 - Led Congress to enact Code § 1248(i) to prevent avoidance of Code § 1248

Background on Outbound Inversions

- Heley of Troy - 1994
 - Shares of US corp were exchanged for shares of a new Bermuda corp in a B reorg
 - Under the then applicable 367(a) regulations, no gain to US transferors
 - Shares of US corp were then transferred to a Barbados corp for treaty benefits
 - New foreign acquisitions to be made by Bermuda corp to avoid Subpart F & 1248
 - Led to Notice 94-46 (and later amended reg.s) which would trigger gain at shareholder level under 367(a)

Background on Outbound Inversions

- Continued Wave of Inversions
 - Ingersoll-Rand
 - Tyco
 - Stanley Works
 - Cooper Industries
 - Others
- Shareholder-level taxation was an ineffective deterrent
 - Depressed stock market in 2002
 - Many tax exempt shareholders
- Earnings stripping benefits improved

Code § 7874

- Enacted as part of AJCA of 2004
- Effective for post-March 3, 2004 inversions
- Applies to taxable & non-taxable transactions
- Appears to have turned the tide against inversions
- Only applies if a “surrogate foreign corporation” exists

Code § 7874

Guidance to Date

- TD 9238 (December 27, 2005)
 - -1T, disregard of affiliate owned stock
- TD 9265 (June 5, 2006)
 - -2T, surrogate foreign corporation
- TD 9399 (May 18, 2008)
 - Final -1 regulations
- TD 9453 (June 9, 2009)
 - -2T, substantial re-write of temporary regulations
- Notice 2009-78

Surrogate Foreign Corporation

- Acquisition Condition
- Ownership Condition
- Insubstantial Condition

Surrogate Foreign Corporation Acquisition Condition

A foreign corporation must acquire, directly or indirectly, substantially all of the properties held, directly or indirectly, by a domestic corporation

Code § 7874(a)(2)(B)(i)

Surrogate Foreign Corporation Ownership Condition

After the acquisition at least 60% of the stock of the foreign corporation must be held by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation

Code § 7874(a)(2)(B)(ii)

Surrogate Foreign Corporation Insubstantial Condition

After the acquisition the expanded affiliated group (“EAG”) that includes the foreign corporation must not have substantial business activities in its country of incorporation, when compared to the total business activities of the EAG.

Code § 7874(a)(2)(B)(iii)

Surrogate Foreign Corporation Partnerships

Code § 7874 applies to outbounds of domestic partnerships as well, if the foreign corporation acquires substantially all of the properties constituting a trade or business of a domestic partnership

Surrogate Foreign Corporation Two Ownership Thresholds

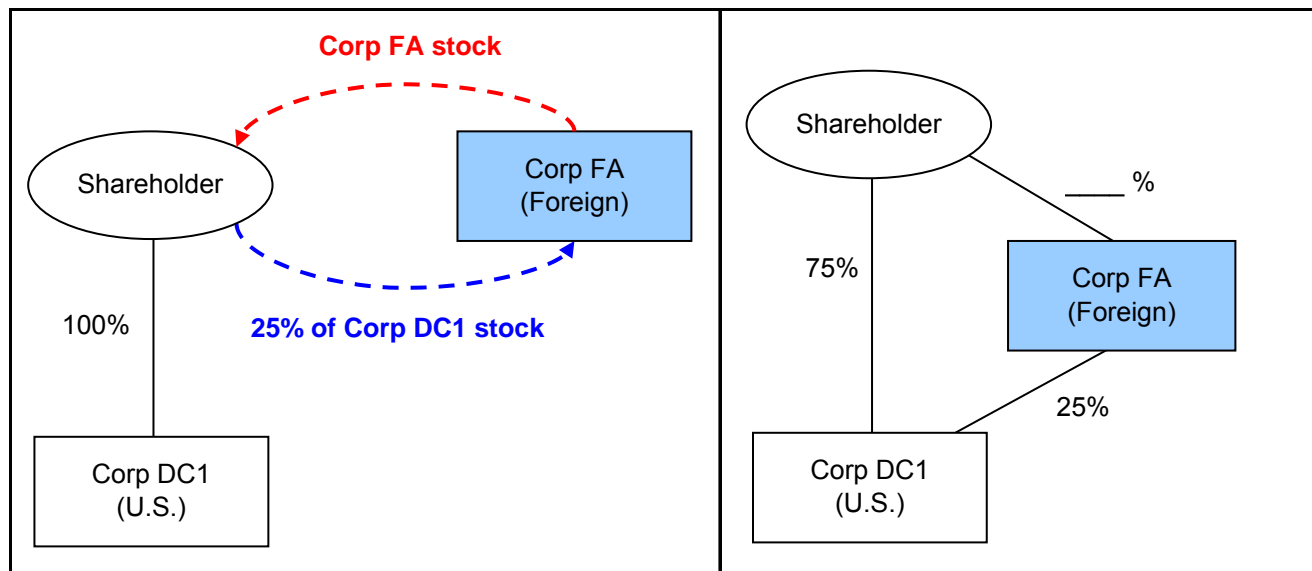
- 60% ownership creates a floor for taxable income recognition
- 80% ownership causes the surrogate foreign corporation (SFC) to be treated as a domestic corporation

Surrogate Foreign Corporation

Acquisition Condition

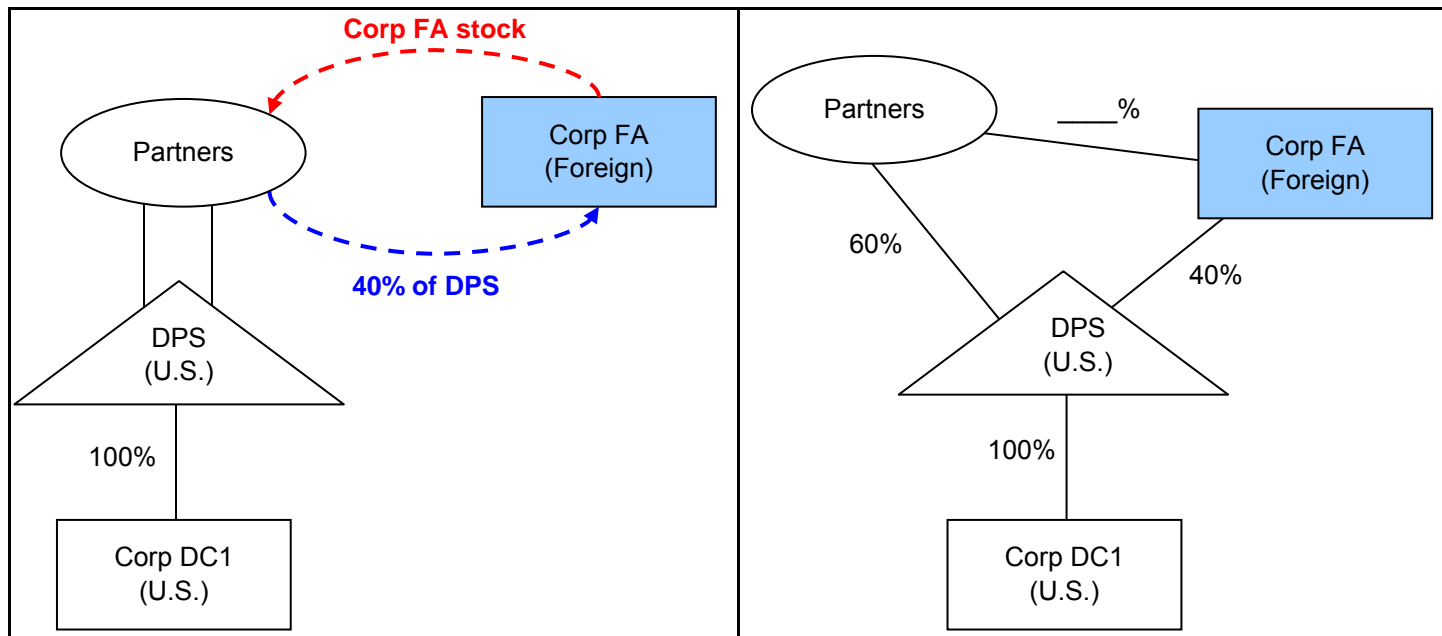
Surrogate Foreign Corporation Acquisition Condition

Indirect Acquisition – Stock of Dom. Corp:
-2T(n), Example 1



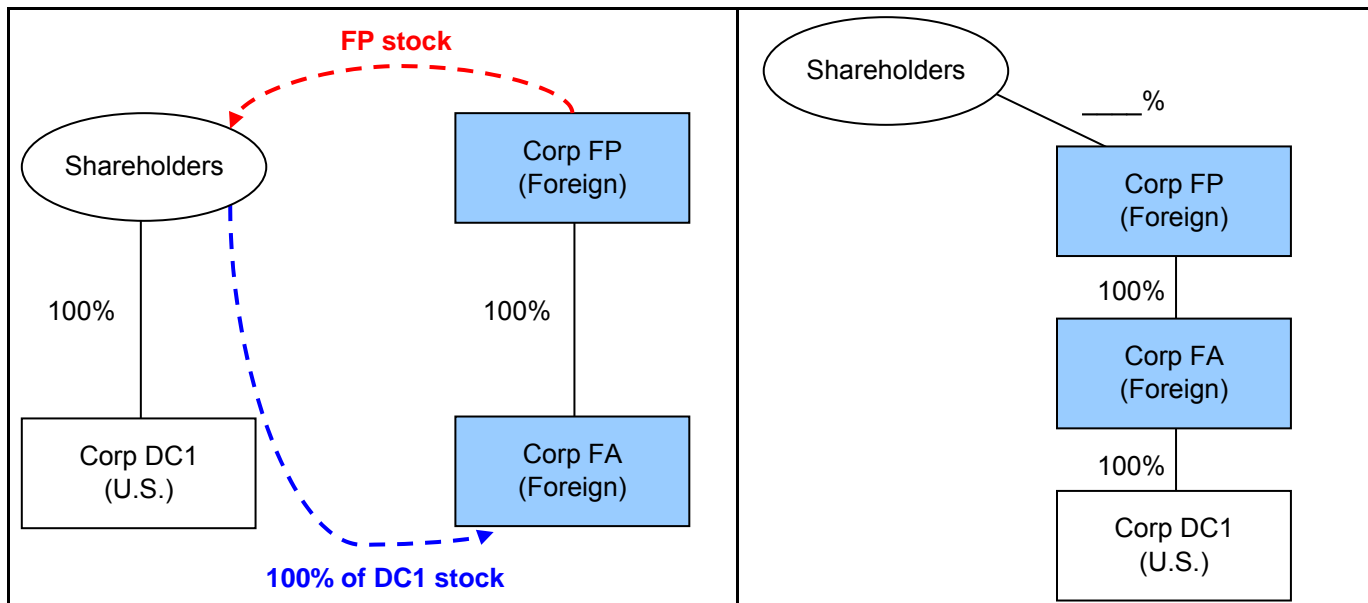
Surrogate Foreign Corporation Acquisition Condition

Indirect Acquisition – Interest in Dom. P’ship:
-2T(n), Example 2



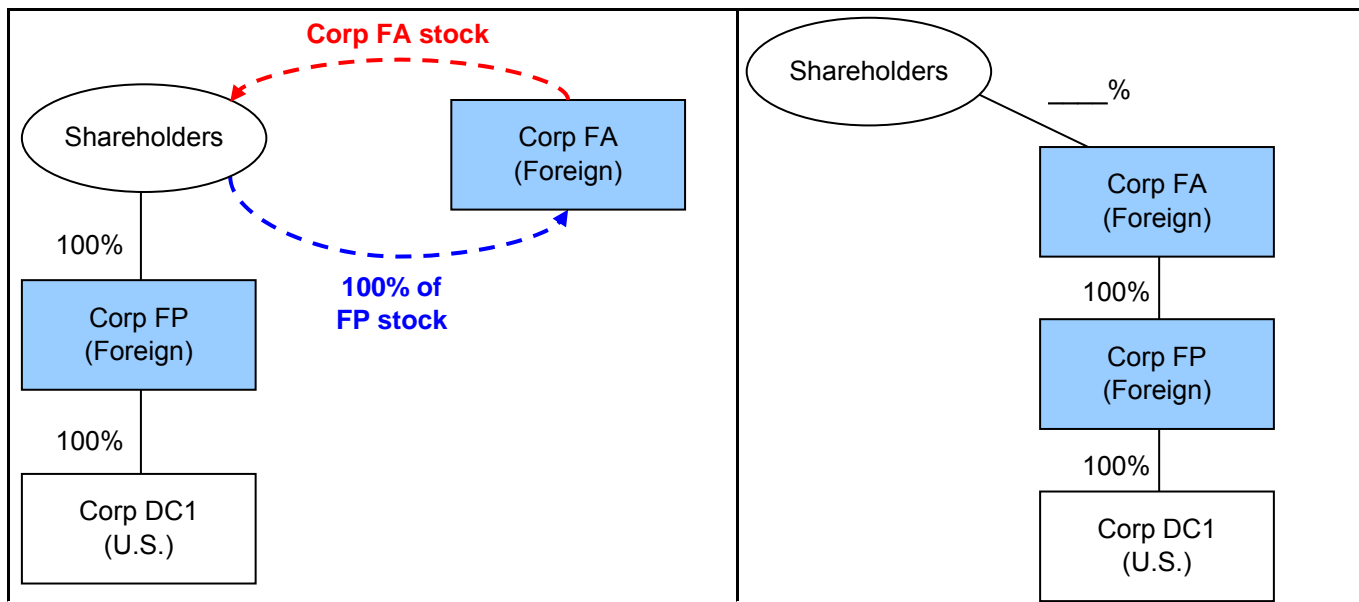
Surrogate Foreign Corporation Acquisition Condition

Indirect Acquisition – Stock of Dom. Corp:
-2T(n), Example 3



Surrogate Foreign Corporation Acquisition Condition

No Indirect Acquisition – Stock of Fgn. Corp:
-2T(n), Example 4

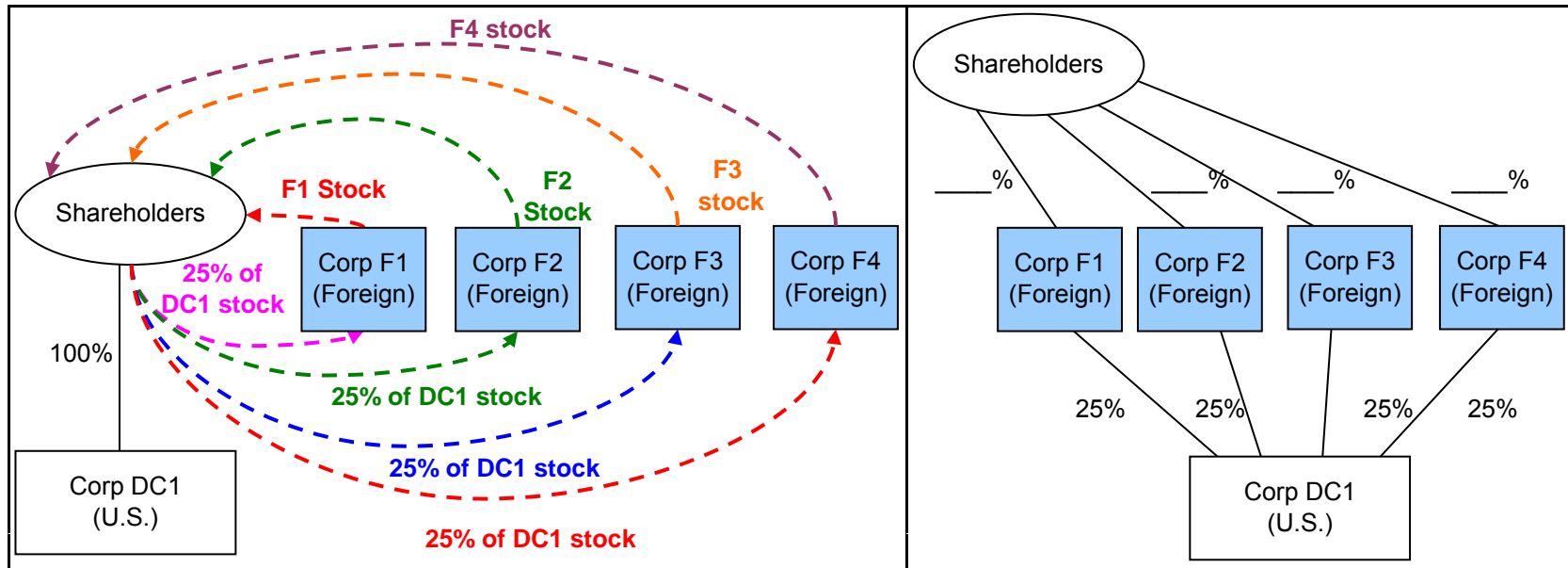


Surrogate Foreign Corporation Acquisition Condition

Indirect Acquisition – Stock of Dom. Corp:

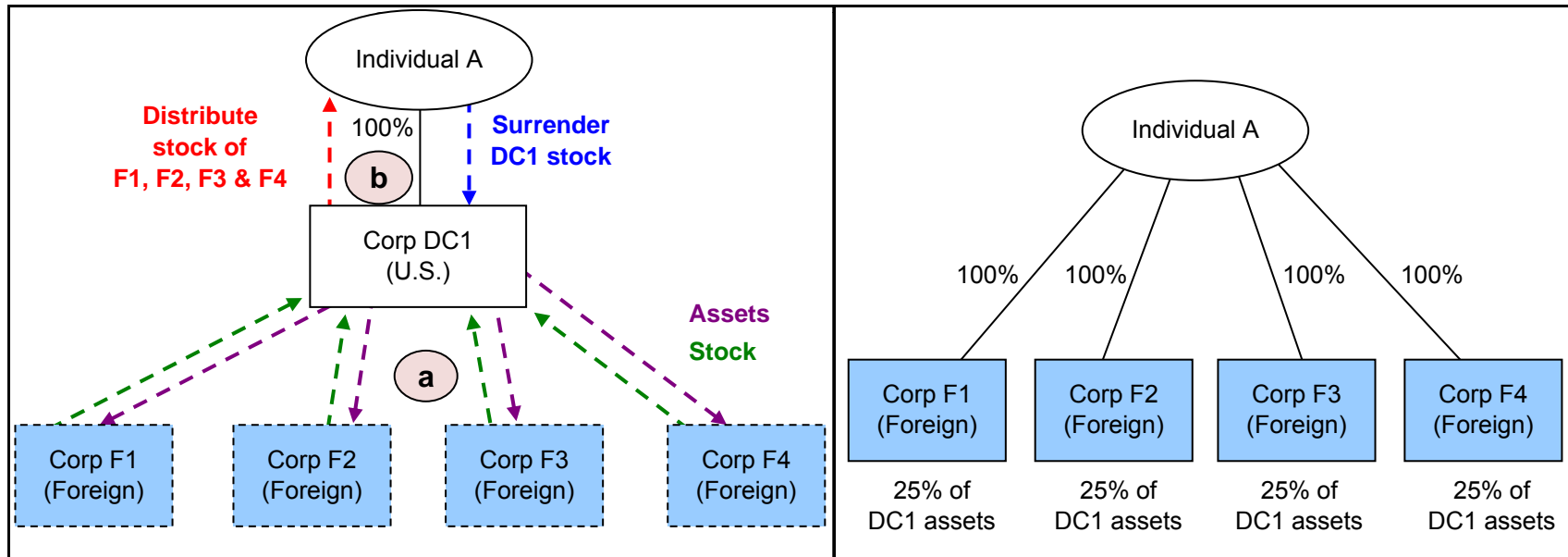
Singular includes plural

-2T(n), Example 5



Surrogate Foreign Corporation Acquisition Condition

Direct Acquisition: Singular includes plural
-2T(n), Example 6

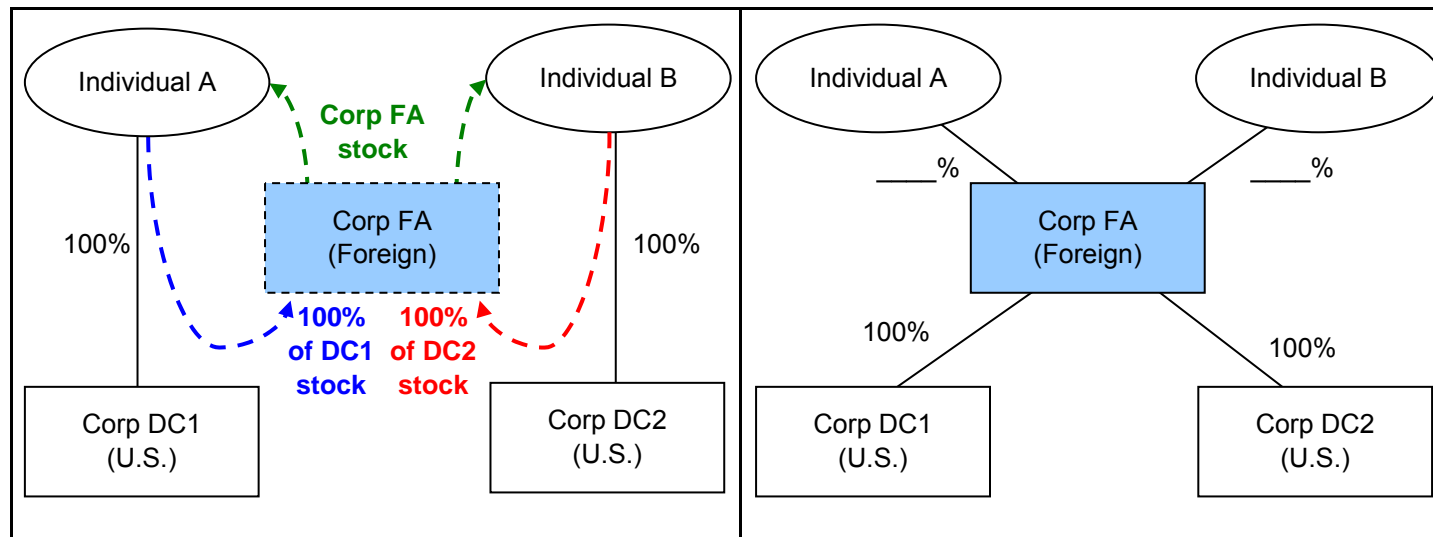


Surrogate Foreign Corporation Acquisition Condition

Indirect Acquisition – Stock of Dom. Corps:

Singular includes plural

-2T(n), Example 7



Surrogate Foreign Corporation

Ownership Condition

Surrogate Foreign Corporation Ownership Condition

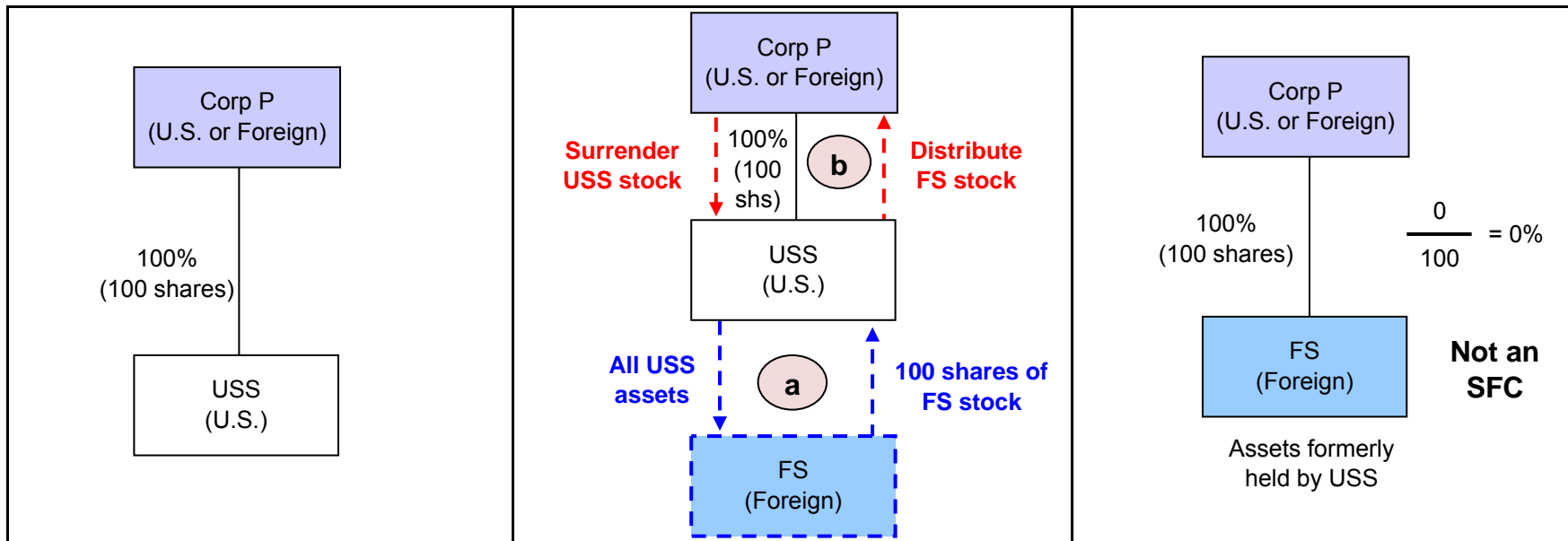
- Stock held by members of the EAG is excluded from both the numerator and the denominator
 - Internal group restructure exception
 - Loss of control exception
- EAG means affiliated group members as defined in Code § 1504(a) but substitute 50% for 80% and include foreign corporations

Surrogate Foreign Corporation Ownership Condition

- Internal group restructure exception
 - Include EAG stock in denominator but not in numerator
 - Before the acquisition, the EAG common parent owns 80% or more (directly or indirectly) of the domestic corp and after the acquisition the EAG common parent owns 80% or more (directly or indirectly) of the foreign corp

Surrogate Foreign Corporation Ownership Condition

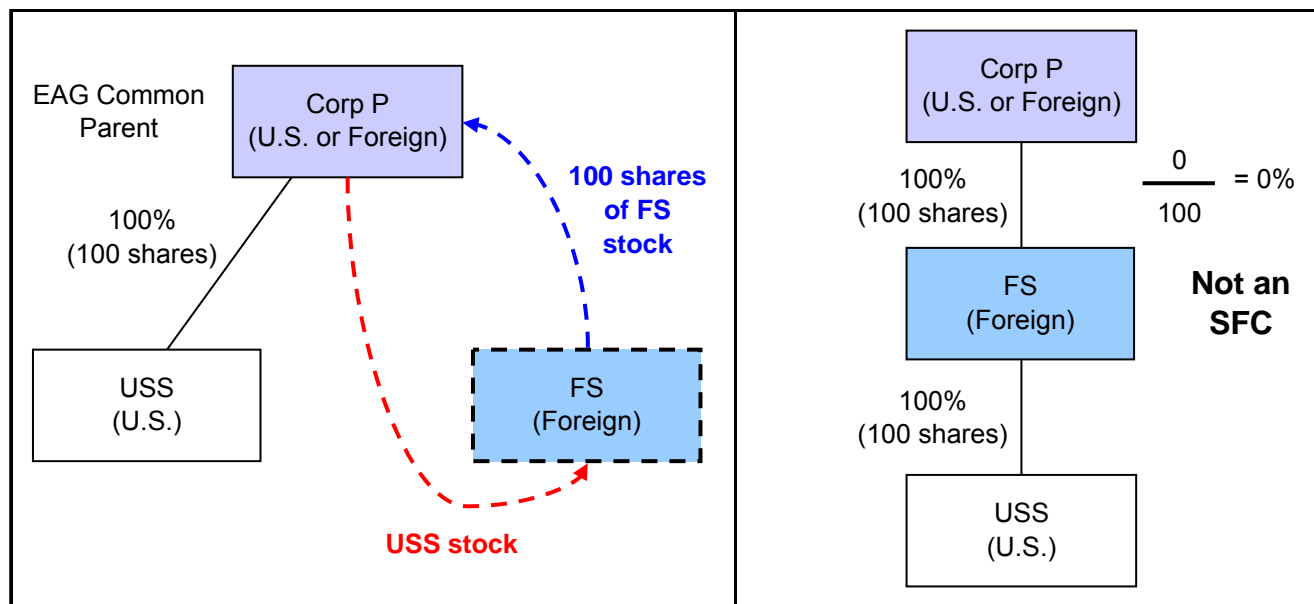
Internal Group Restructure: -1(f), Example 2



Surrogate Foreign Corporation Ownership Condition

Internal Group Restructure:

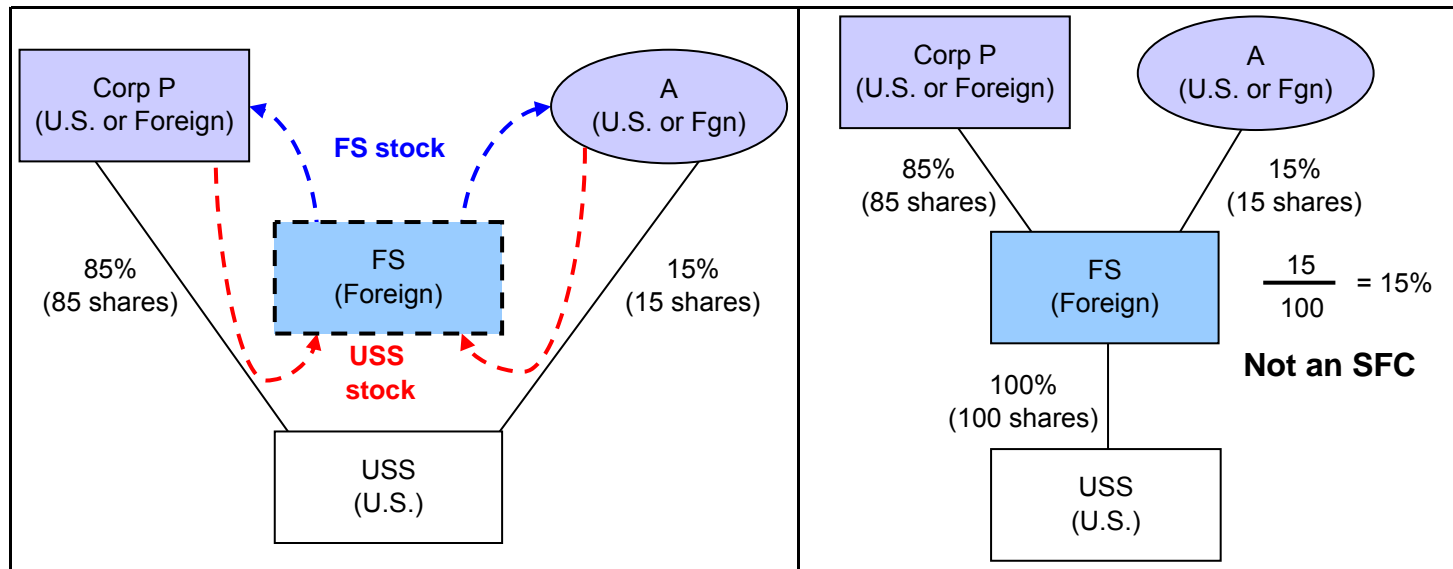
-1(f), Example 3



Surrogate Foreign Corporation Ownership Condition

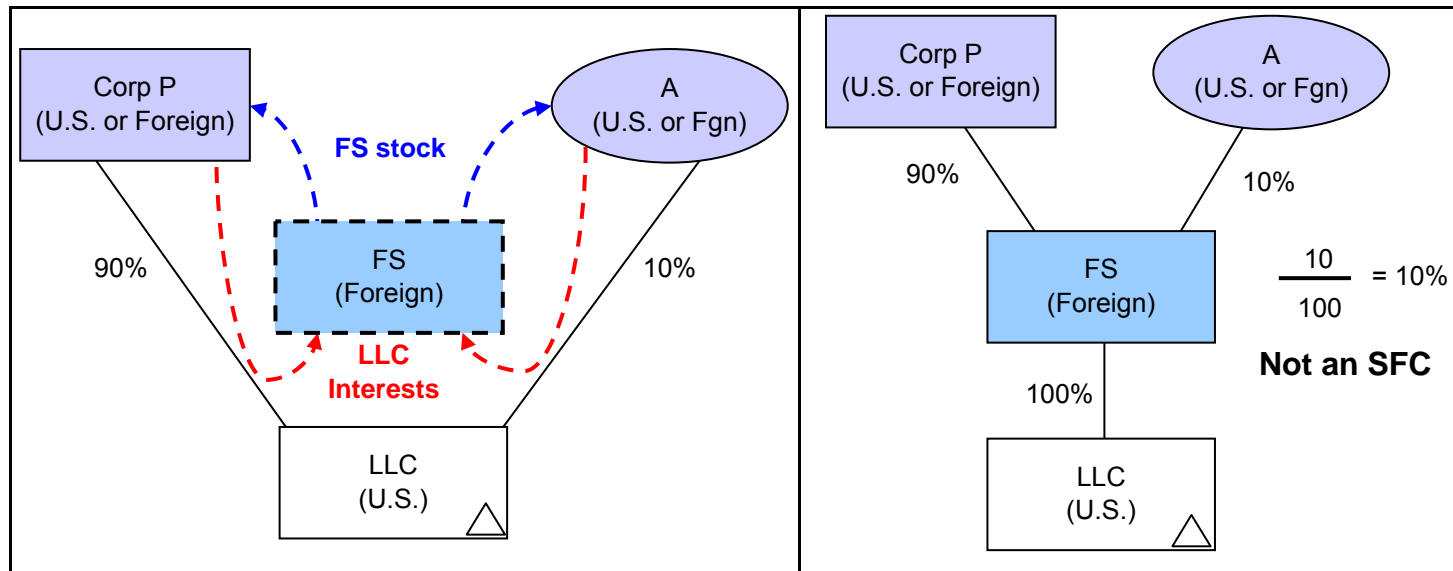
Internal Group Restructure:

-1(f), Example 4



Surrogate Foreign Corporation Ownership Condition

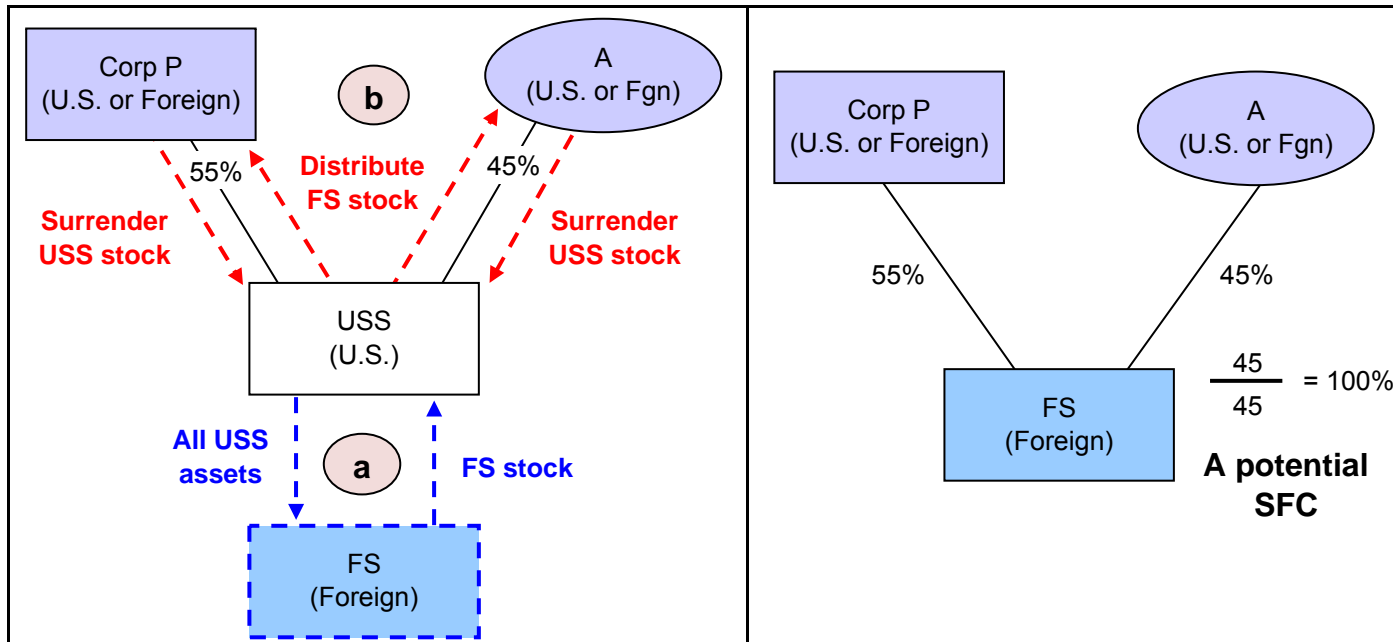
Internal Group Restructure - Partnership: -1(f), Example 8



Surrogate Foreign Corporation Ownership Condition

Not an Internal Group Restructure:

-1(f), Example 5

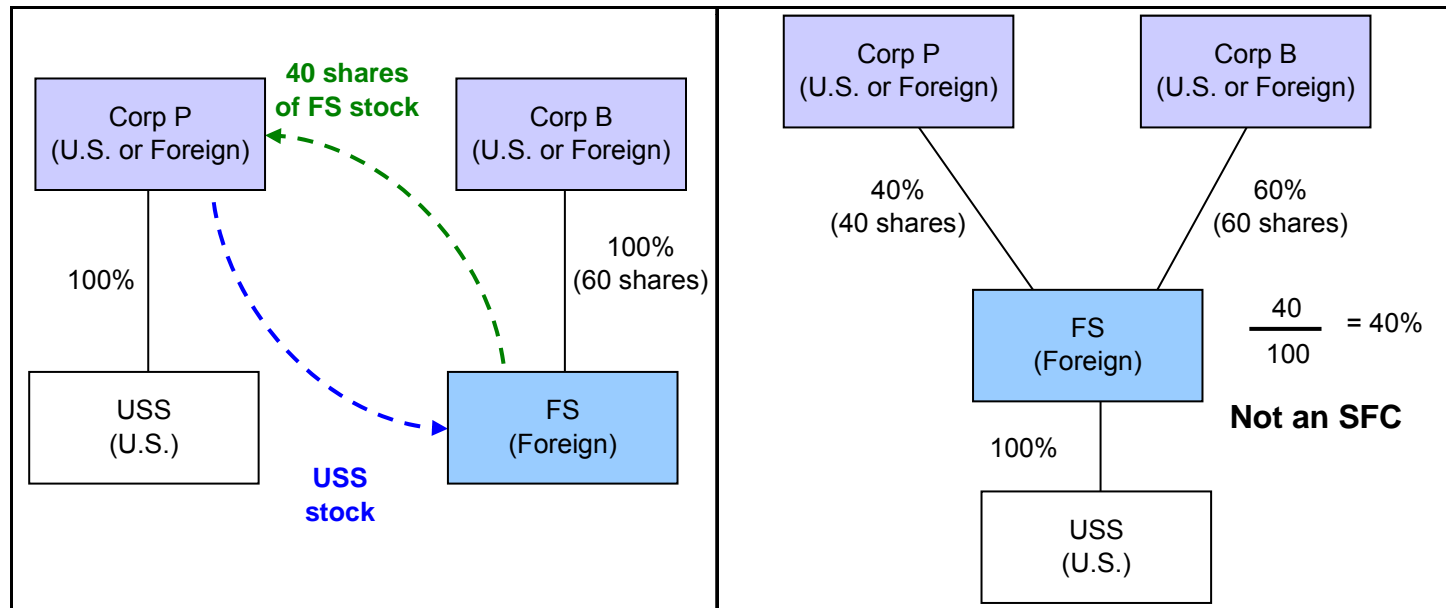


Surrogate Foreign Corporation Ownership Condition

- Loss of control exception
 - Former shareholders do not hold (directly or indirectly) more than 50% of any member of the EAG

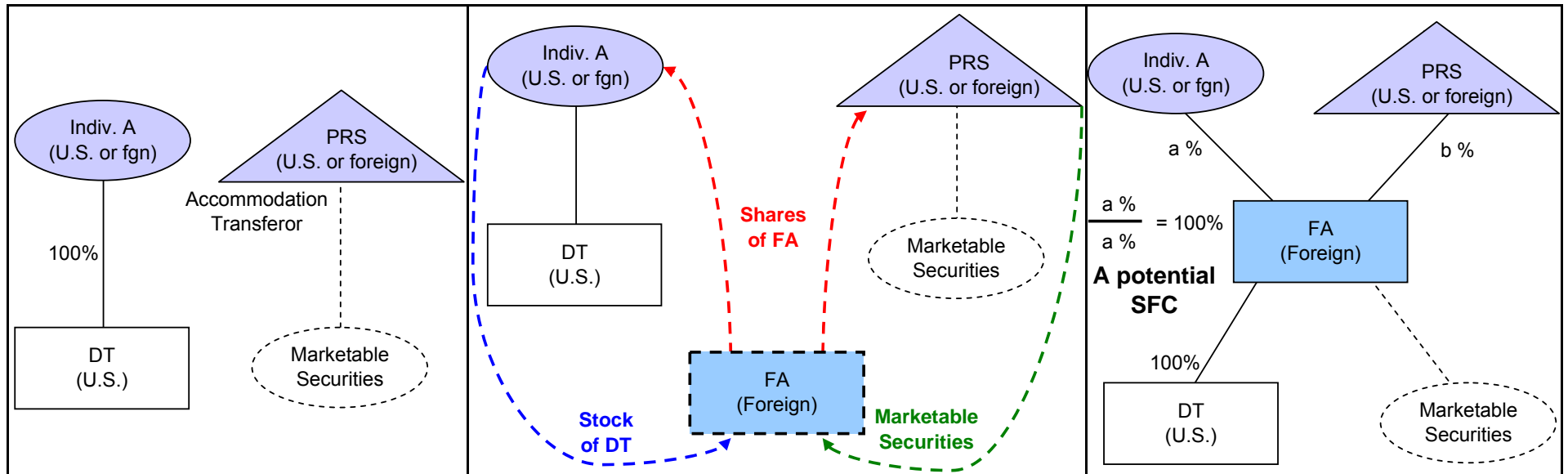
Surrogate Foreign Corporation Ownership Condition

Loss of Control:
-1(f), Example 7



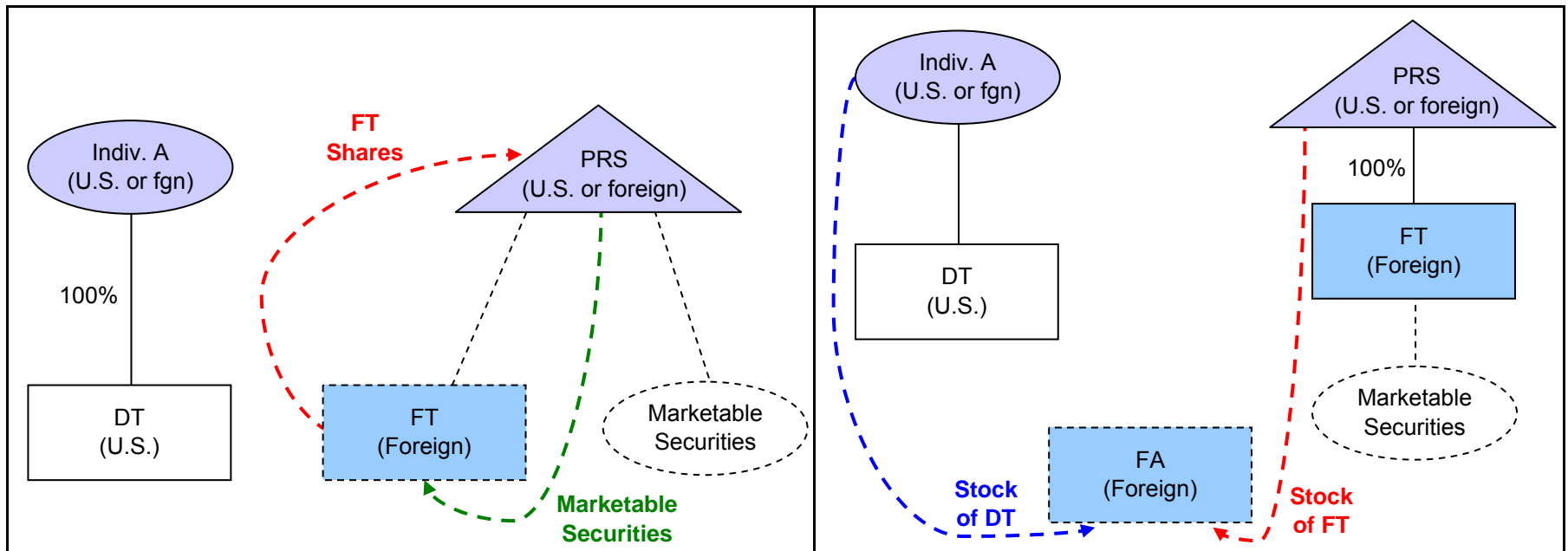
Surrogate Foreign Corporation Ownership Condition

Accommodation Transferor: Notice 2009-78, Example 1



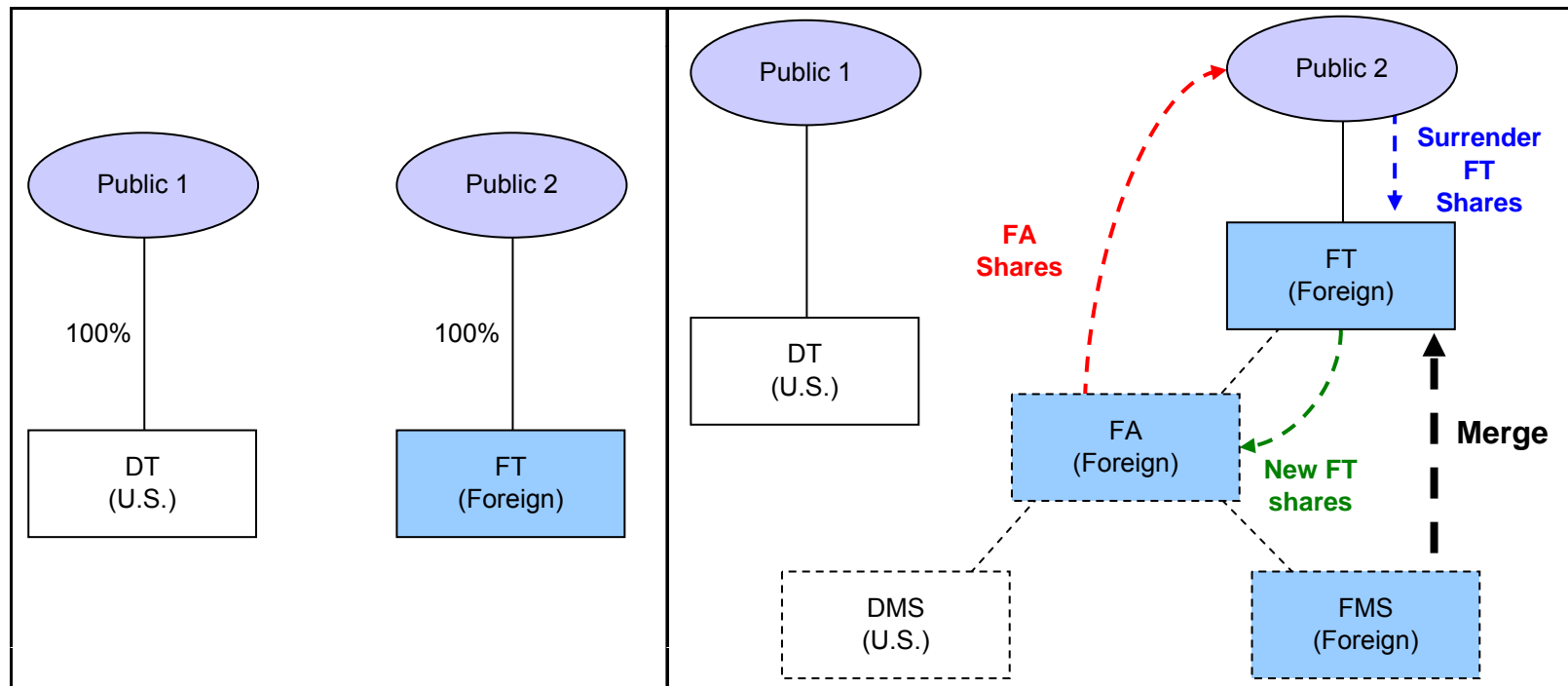
Surrogate Foreign Corporation Ownership Condition

Accommodation Transferor: Notice 2009-78, Example 2



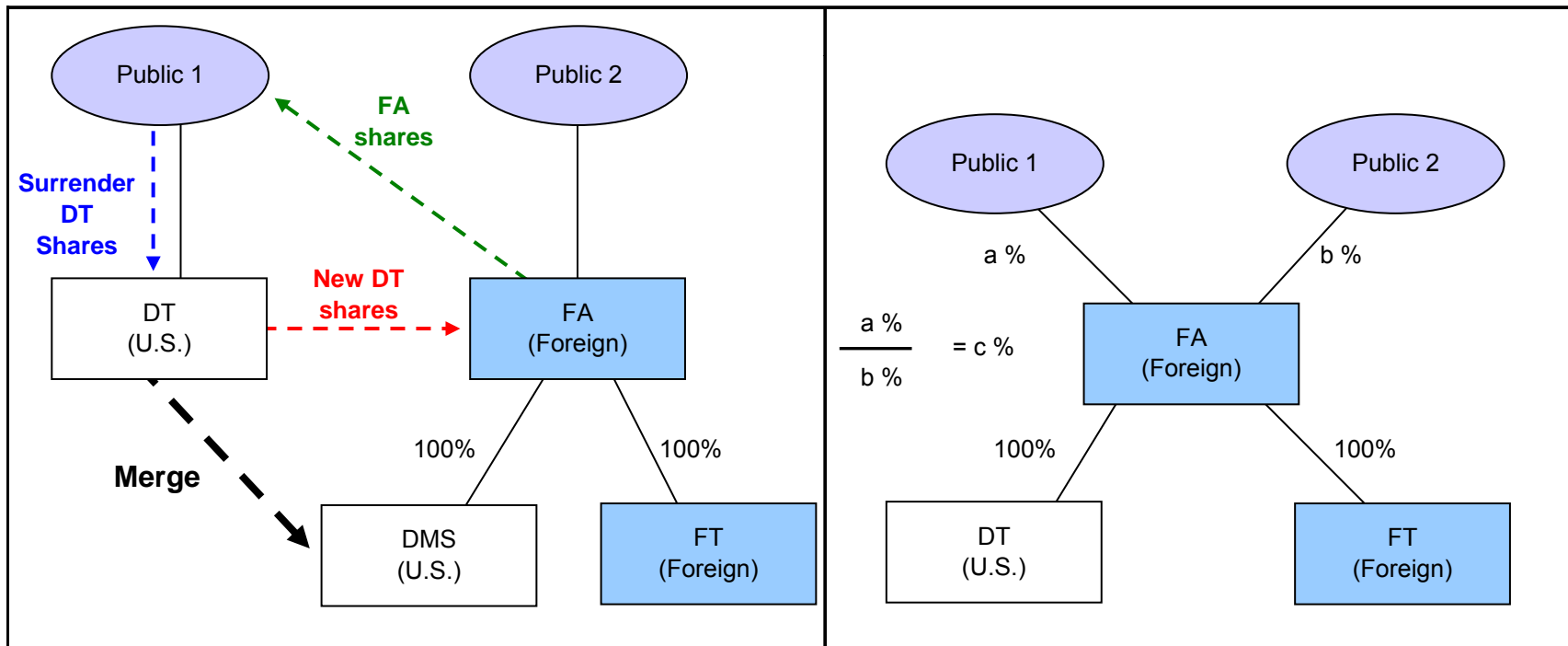
Surrogate Foreign Corporation Ownership Condition

Not an Accommodation Transferor:
Notice 2009-78, Example 3 (slide 1)



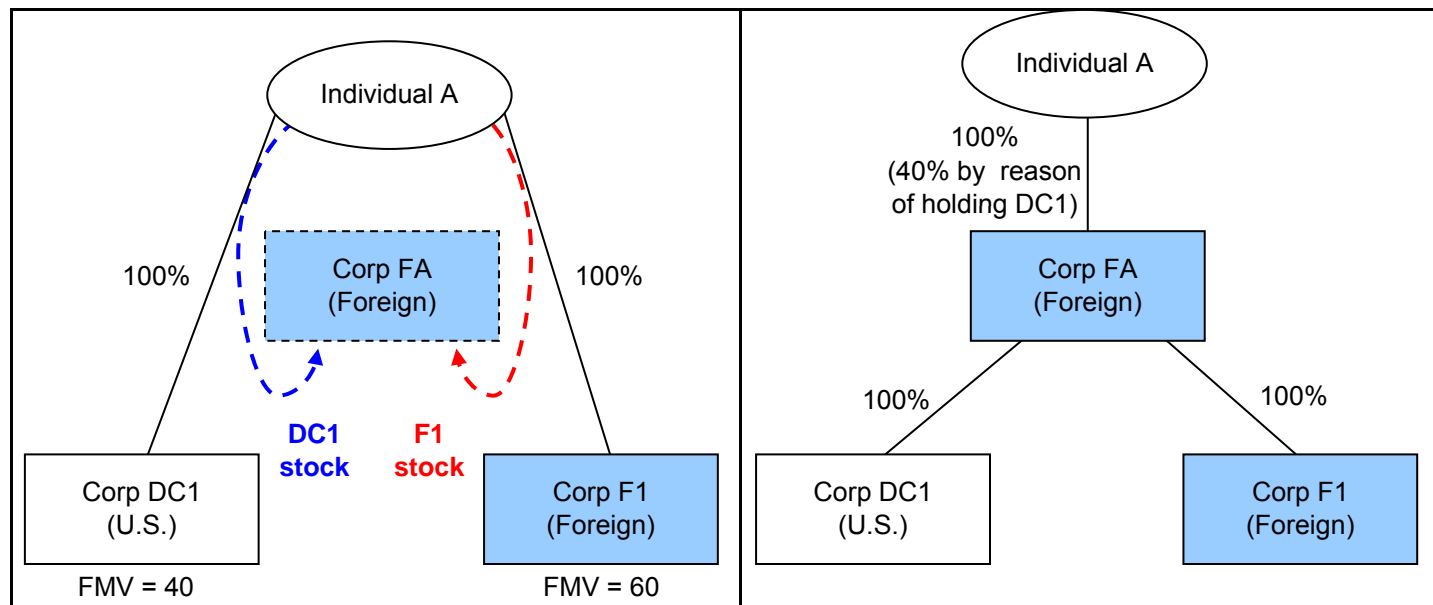
Surrogate Foreign Corporation Ownership Condition

Not an Accommodation Transferor:
Notice 2009-78, Example 3 (slide 2)



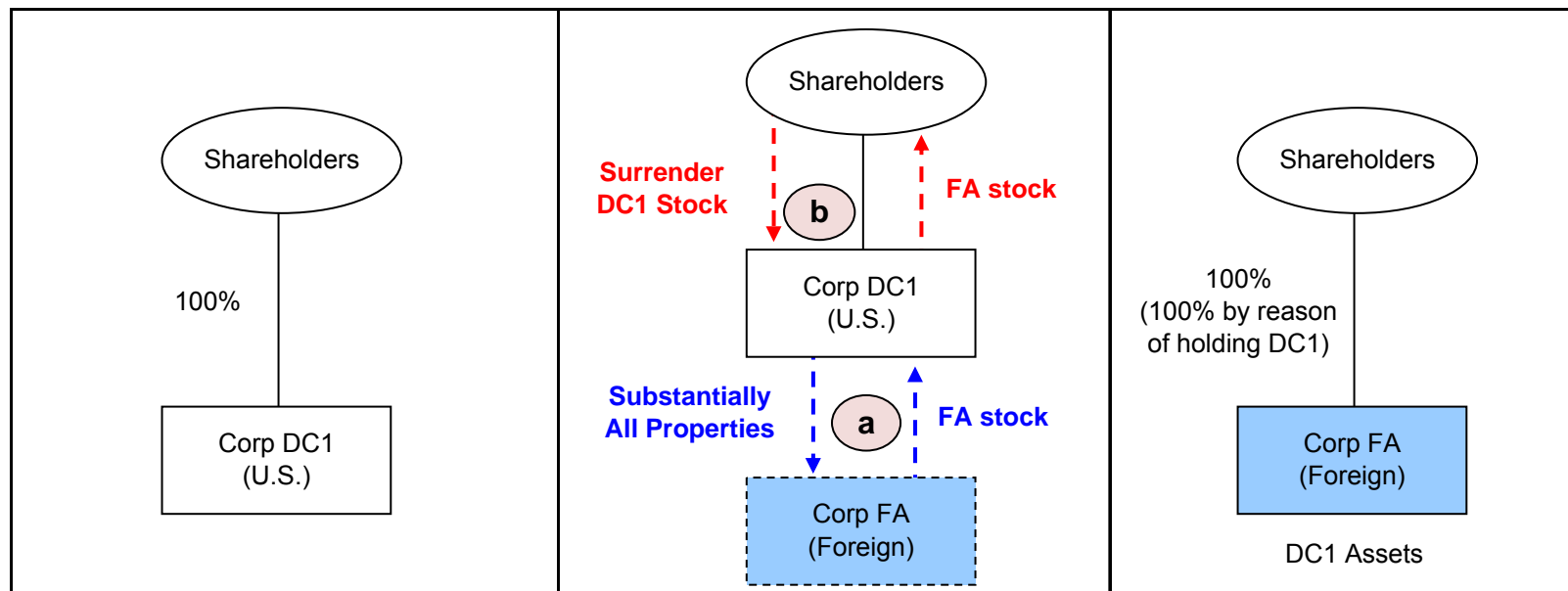
Surrogate Foreign Corporation Ownership Condition

“By Reason Of” - Basic:
-2T(n), Example 8



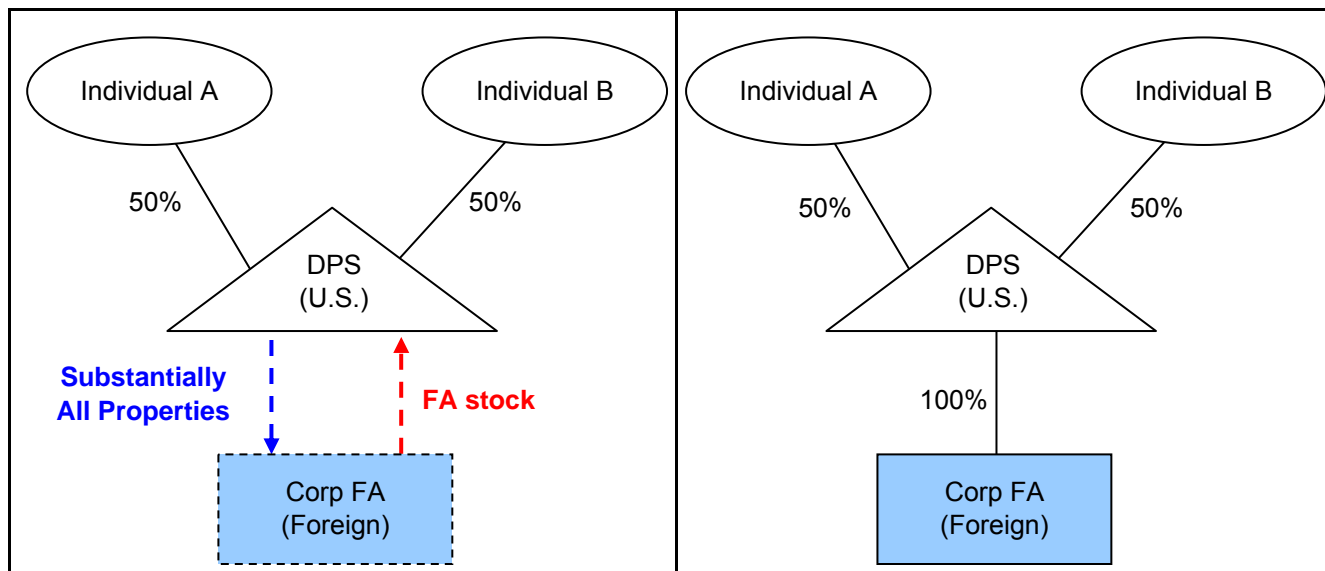
Surrogate Foreign Corporation Ownership Condition

“By Reason Of” - 355 Spin-off:
-2T(n), Example 9



Surrogate Foreign Corporation Ownership Condition

“By Reason Of” - Partnership:
-2T(n), Example 10



Surrogate Foreign Corporation Ownership Condition

Special rules for ownership condition:

- Foreign PTPs
- Options, warrants, etc.
- Creditor interests treated as stock

Surrogate Foreign Corporation

Insubstantial Condition

Surrogate Foreign Corporation Insubstantial Condition

After the acquisition, the EAG of the foreign corporation must not have substantial business activities in the foreign corporation's country of incorporation, when compared to the total business activities of the EAG.

Surrogate Foreign Corporation Insubstantial Condition

- Substantial business activities based on all the facts and circumstances
- Prior Temp. Reg.s had safe harbor
 - Safe harbor deleted in 2009 Temp. Reg.s
- Not based on absolute amount
- Comparison of in country activities with total activities of EAG
- Partnership attribution for 10% or more interest
- Anti-stuffing rule

Surrogate Foreign Corporation Insubstantial Condition

- In-Country Factors
 - Historical activities
 - Property, payroll, & sales
 - Managerial activities
 - Owners located in-country
 - Business objectives

Surrogate Foreign Corporation Insubstantial Condition

- What if the foreign corporation is created or organized in one country (in which the EAG has substantial business activities), but is managed and controlled in another country in which it does not have substantial business activities?



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