



## Final section 367(a)/(d) regulations retroactively prevent tax-free outbound transfers of foreign goodwill and going concern value

On December 15, 2016, the US Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations under section 367(a) and (d) of the Internal Revenue Code that prevent certain property, including but not limited to foreign goodwill and going concern value, from being transferred by a US person to a foreign corporation on a tax-free basis.<sup>1</sup> The final regulations, which generally mirror the 2015 proposed regulations,<sup>2</sup> **retain the retroactive effective date** contained in the proposed regulations, thus applying to outbound transfers occurring on or after September 14, 2015.<sup>3</sup>

### General approach

Consistent with the proposed regulations, the final regulations eliminate the ability of taxpayers, without exception,<sup>4</sup> to qualify outbound transfers of foreign goodwill or going concern value for the active trade or business exception under section 367(a)(3) and historic Treas. Reg. §1.367(a)-2T (now Treas. Reg. §1.367(a)-2). Instead, such transfers will be taxable immediately under section 367(a) or, at the election of the taxpayer, over the useful life of the transferred property under section 367(d).<sup>5</sup> Note that outbound transfers of intangible property specifically enumerated in section 936(h)(3)(B) (e.g., patents, copyrights, trademarks, or trade names) continue to be subject solely to section 367(d).<sup>6</sup>

### Valuation uses section 482 principles

Final Treas. Reg. §1.367(a)-1(b)(3) specifically provides that in any case where a US transferor's transfer of property to a foreign corporation constitutes a "controlled transaction" under the section

482 regulations, the value of the property transferred is determined in accordance with section 482 and the regulations thereunder. (Temporary section 482 regulations were issued on September 14, 2015 and were meant to coordinate with the rules under section 367.)

### **Useful life**

The final regulations, like the proposed regulations, remove the 20-year useful life limitation under section 367(d), although they permit taxpayers to instead recognize increased inclusions over a 20-year period, as described below.<sup>7</sup> For this purpose, the final regulations revise the definition of “useful life” to include the entire period during which exploitation of the property is reasonably anticipated to affect the determination of taxable income, as of the time of the transfer. As in the proposed regulations, this definition takes into account exploitation of the intangible *in the “further development of the intangible property”* (i.e., taking into account future generations of a product that are based on the original transferred property). This approach arguably is inconsistent with *Veritas*, in which the Tax Court held that intangible property transferred in a cost sharing arrangement had a finite (and relatively short) useful life, even though it may have contributed to the development of future generations of a product.<sup>8</sup>

The regulations include an exception for property with an indefinite useful life or with a life that is reasonably anticipated to exceed 20 years; this exception allows the transferor to take the amount into income during a limited 20-year period at the cost of increasing the royalty based on the additional value attributable to the period following 20 years (i.e., a transferor still must take into account the present value of all amounts, including amounts after the 20-year period while the property still has useful life).<sup>9</sup>

### **Active trade or business exception**

In addition, consistent with the proposed regulations, the final regulations generally consolidate the active trade or business regulations into one regulation section, new Treas. Reg. §1.367(a)-2, without substantive change.<sup>10</sup> This regulation taxes the transfer of certain property, denominated in the foreign currency of the foreign transferee’s country, which was acquired in the ordinary course of business of the US transferor that will be carried on by the foreign transferee.<sup>11</sup>

### **Transitional rule**

The retroactive effective date of the change to the treatment of foreign goodwill and foreign going concern value may leave taxpayers who have already filed tax returns under the prior regulations in an uncertain situation. The election to treat foreign goodwill and foreign going concern value as though they were subject to section 367(d) is made with the tax return for the year of the transfer under the authority of Treas. Reg. §1.6038B-1. However, these regulations do not specify a procedure for taxpayers that “missed the deadline” due to the retroactive effective date of the regulations. It is unclear whether and/or how soon the Treasury and IRS will address this procedural matter.

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<sup>7</sup> T.D. 9803 (Dec. 15, 2016). Although the discussion in the preamble to the final regulations (like the 2015 proposed regulations) focuses on foreign goodwill and going concern value, the regulations are equally applicable to outbound transfers of U.S. goodwill, workforce-in-place, and other property.

<sup>2</sup> 80 Fed. Reg. 55,568 (Sept. 16, 2015); see also T.D. 9738 (Sept. 16, 2015) (temporary regulations under section 482). For coverage of the proposed regulations, see [United States Tax Alert dated September 15, 2015](#) and [Transfer Pricing Alert dated September 17, 2015](#).

<sup>3</sup> The final regulations also apply to transfers occurring before September 14, 2015 resulting from section 7701 entity classification elections filed on or after that date. Treas. Reg. §§1.367(a)-1(g)(5), -2(k)(1), 1.367(d)-1(j).

<sup>4</sup> The preamble to the proposed regulations solicited comments on whether to carve out an exception for narrow cases where there is limited potential for abuse. 80 Fed. Reg. 55,568, 55,574. However none of the suggested exceptions, including exceptions for joint ventures, historic foreign branches, specific industries, and transfers made under government pressure or compulsion, were adopted. T.D. 9803.

<sup>5</sup> Treas. Reg. §1.367(a)-1(b)(5). The election to apply section 367(d) rather than section 367(a) to certain intangibles must be applied consistently to all property transferred outbound by related transferors pursuant to a plan. *Id.* The final regulations also make conforming changes to the section 6038B regulations.

<sup>6</sup> Treas. Reg. §§1.367(d)-1(b), (c)(3), 1.367(a)-1(d)(5). As with the proposed regulations, the final regulations do not take a position with respect to whether goodwill, going concern value and/or workforce-in-place are section 936(h)(3)(B) intangible property.

<sup>7</sup> Treas. Reg. §1.367(d)-1(c)(3).

<sup>8</sup> See *Veritas Software Corp. & Subs., et al. v. Comm’r*, 133 T.C. 297 (2009), nonacq. A.O.D. 2010-49, 2010-49 I.R.B. 803.

<sup>9</sup> Treas. Reg. §1.367(d)-1(c)(3)(ii).

<sup>10</sup> See generally Treas. Reg. §1.367(a)-2.

<sup>11</sup> Treas. Reg. §1.367(a)-2(c)(3). The final regulations contain updated language to reflect changes to the foreign currency rules; these modifications are not intended to be substantive. In contrast to the rest of the final regulations, this rule does not apply retroactively.

## Contacts

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