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International Tax

United States Tax Alert

September 22, 2015

Regulations under section 367(a) relating to outbound "F" reorganizations finalized

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On September 18, 2015, the US Internal Revenue Service (IRS) and Treasury published final regulations under sections 367(a) and 368(a)(1)(F) of the Internal Revenue Code.[1] The regulations issued under section 368(a)(1)(F) expand the list of requirements for a transaction to qualify as a "mere change," and thus receive the tax-free status afforded to "F" reorganizations. Specifically relevant to international tax, the temporary section 367(a) regulations under Treas. Reg. §1.367(a)-1T(e) and (f), providing guidance on outbound F reorganizations (i.e. where the transferring corporation is domestic and the acquiring corporation is foreign), were finalized without substantive changes.

The final regulations under Treas. Reg. §1.367(a)-1(e) (close of taxable year) apply retroactively to transactions occurring on or after March 31, 1987, while the final regulations under Treas. Reg. §1.367(a)-1(f) (deemed asset exchange) apply to transactions occurring on or after January 1, 1985. Both of these effective dates are unchanged from the temporary regulations.

The final F reorganization regulations under Treas. Reg. §1.368-2(m) apply prospectively to transactions occurring on or after September 21, 2015.

Background

Section 368(a)(1)(F) defines an F reorganization as a "mere change in identity, form or place of organization of one corporation, however effected." The existing temporary regulations under section 367(a) disregard an outbound F reorganization's "mere change," and instead characterize the reorganization as a series of corporate-level and shareholder-level exchanges.[2]

Specifically, if the transferor corporation is domestic and the acquiring corporation is foreign, the temporary regulations stated that the following transactions will be deemed to occur:

1. The transferor domestic corporation transfers its assets to the acquiring foreign corporation under section 361(a), in exchange for the stock of the

[1] T.D. 9739.
[2] Similar treatment is afforded to foreign-to-foreign and inbound F reorganizations under the section 367(b) regulations. *See* Treas. Reg. §1.367(b)-2(f).

acquiring foreign corporation and the assumption of liabilities (if any);
2. The transferor domestic corporation distributes to its shareholders the stock of the acquiring foreign corporation; and
3. The shareholders of the transferor domestic corporation exchange their stock in the transferor domestic corporation for the stock of the acquiring foreign corporation under section 354(a).[3]

These deemed transactions apply regardless of whether foreign or domestic law treats the acquiring foreign corporation as a continuance of the transferor domestic corporation.[4]

The temporary regulations provided that the taxable year of the transferor domestic corporation closes as of the date of the outbound F reorganization.[5] Further, the taxable year of the acquiring foreign corporation was treated as ending on the date that the domestic transferor's taxable year would have ended, but for the outbound F reorganization.[6]

Final section 367(a) regulations

The final regulations adopt the rules of the temporary regulations without substantive change. Thus, the "deemed asset exchange" provision of former Treas. Reg. §1.367(a)-1T(f) was finalized intact as new Treas. Reg. §1.367(a)-1(f), while the same is true of the "close of taxable year" provision found in former Treas. Reg. §1.367(a)-1T(e) and new Treas. Reg. §1.367(a)-1(e).

Qualifying for F reorganization treatment: Expanding requirements list and concurrent distributions

The new regulations issued under Treas. Reg. §1.368-2(m) modify and finalize the portion of the proposed F reorganization regs from 2004[7] that were not previously adopted as final in 2005.[8] The final regulations expand the list of necessary requirements to qualify as an F reorganization from four to six items. The first four requirements are effectively the same as those included in the original 2004 proposed rules, while requirements five and six have been newly added by the IRS and Treasury.[9] The regulations now utilize the concept of a "potential F reorganization" in analyzing whether the transaction results in a "mere change" that qualifies as an F reorganization.

The six requirements are as follows:

1) Immediately after a potential F reorganization, all stock of the resulting corporation must be distributed in exchange for stock of the transferor corporation in the potential F reorganization;
2) The same person or persons must own all the stock of the transferor corporation at the beginning of the potential F reorganization and all of the stock of the resulting corporation at the end, in identical proportions;

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[3] Former Treas. Reg. §1.367(a)-1T(f).
[4] *Id*.
[5] Former Treas. Reg. §1.367(a)-1T(e).
[6] *Id.*
[7] *See* REG-106889-04 (Aug. 12, 2004).
[8] *See* T.D. 9182 (Feb. 24, 2005).
[9] Per the preamble, requirements five and six address comments received by the IRS and Treasury with respect to the 2004 proposed regulations concerning "overlap" transactions that could qualify both as an F reorganization and another type of reorganization (such as under section 368(a)(1)(A) or (D)).

3) The resulting corporation may not hold any property or have any tax attributes immediately before the potential F reorganization;
4) The transferor corporation must completely liquidate in the reorganization, for federal income tax purposes;
5) Immediately after the potential F reorganization, no corporation other than the resulting corporation may hold property that was held by the transferor corporation immediately before the potential F reorganization; and
6) Immediately after the potential F reorganization, the resulting corporation may not hold property acquired from a corporation other than the transferor corporation if the resulting corporation would, as a result, succeed to and take into account the items of such other corporation described in section 381(c).

Overlap rules are provided in Treas. Reg. §1.368-2(m)(3)(iv), addressing when a potential F reorganization will be treated as an F reorganization or, instead, as another type of reorganization (e.g. as a section 368(a)(1)(A) or (D) reorganization). The final regulations contain 14 examples illustrating the application of these requirements.[10]

Additionally, the Treasury and IRS provide guidance on whether distributions occurring during a potential F reorganization should prevent a transaction from qualifying as a valid reorganization. The final regulations state that distributions occurring concurrently with the "mere change" should be treated as separate from the F reorganization, consistent with Treas. Reg. §1.301-1(l) and *Bazley v. Commissioner.*[11]

[10] *See* Treas. Reg. §1.368-2(m)(4).
[11] 331 U.S. 737 (1947). *See* Treas. Reg. §1.368-2(m)(3)(iii).