

Comments on proposed changes to Treas. Reg. sec. 1.367(a)-3 in REG-125628-01

by

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I. Introduction and Executive Summary

These comments address Prop. Treas. Reg. sec. 1.367(a)-3, "Treatment of transfers of stock or securities to foreign corporations" ("Proposed Regulation").¹ Martin B. Tittle exercised principal responsibility for the preparation of these comments. Substantive contributions were received from James Lynch, David S. Kerzner, Jeffrey Davine, and Darden E. Daniel.

The comments are in response to the solicitation for comments in a notice of proposed rulemaking published on January 5, 2005 in the Federal Register.² That solicitation states that "[t]he IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and on how they can be made easier to understand."³

According to the preamble to the Proposed Regulation (the "Preamble"), the twin purposes of the Proposed Regulation are "to account for statutory mergers and consolidations under section 368(a)(1)(A) (including reorganizations described in section 368(a)(2)(D) and (E)) involving one or more foreign corporations"⁴ and "to address

¹ See 70 Fed. Reg. 749 (2005) (visited June 17, 2005)
<http://www.martintittle.com/publications/new_367_368.pdf>.

² *Id.*

³ *Id.* at 756. Cf. Robert J. Peroni, "A Response to Dean Thompson's Paper on the Impact of Code Section 367 and the European Union's 1990 Council Directive on Tax-Free Cross-Border Mergers and Acquisitions," 66 U. Cin. L. Rev. 1271, 1274-75 (1998) (noting that the complexity of the 367 regulations may interfere with compliance by non-specialist practitioners).

⁴ Currently, only domestic corporations can execute section 368(a)(1)(A) mergers. See Treas. Temp. Reg. sec. 1.368-2T(b)(1)(ii); Rev. Rul. 57-465, 1957-2 CB 250, cited in Bernard T. Bress, "The New Cross-Border 'A' Regulations," 16 J. Int'l Tax'n 14, 16 n.2 (2005). The proposal to allow foreign corporations to participate in section 368(a)(1)(A) mergers was published concurrently with the Proposed Regulation. See 70 Fed. Reg. 746 (2005) (visited June 17, 2005)
<http://www.martintittle.com/publications/new_367_368.pdf>. Provisions in paragraphs (a) and (d) of the Proposed Regulation that apply to section 368(a)(1)(A) reorganizations

several other related issues."⁵ The related issues include concurrent application of Internal Revenue Code ("Code") secs. 367(a) and (b), expanded application of the indirect stock transfer (IST) rules, and new anti-inversion provisions.

Section II of these comments reviews the policy issues underlying Code sec. 367 and summarizes the provisions of that section and current Treas. Reg. sec. 1.367(a)-3.

Section III of these comments highlights the changes in the Proposed Regulation and suggests resolutions for various technical issues. *Inter alia*, the comments note several instances of apparent typographical errors, suggest a re-titling of one paragraph to avoid a confusing similarity with another paragraph, and propose cross-referencing of various paragraphs to make the regulation more accessible for practitioners who are new to the regulations interpreting Code sec. 367(a) or who do not deal with them frequently.

Section III also addresses substantive issues, including the arguable application of the "substantially all of its assets" GRA trigger to triangular reorganizations described in Code sec. 368(a)(1)(B), the proposed application of the IST rules to reorganizations described in Code sec. 368(a)(1)(F) followed by controlled asset transfers, and the need to include or reference the "Catchall Rule" in the Proposed Regulation.

II. Background

1. *The Policy Issues Underlying Section 367*

Code sections 61 and 368 express sometimes conflicting goals that mesh and are resolved, at least in part, in section 367. Section 61 expresses a policy of worldwide, as opposed to territorial income taxation.⁶ Sec. 368 (and other sections)⁷ express a policy of facilitating business by exempting certain mergers, reorganizations, and business transactions from taxation.⁸ Unfortunately, it is possible to manipulate these tax-free

involving foreign corporations will only be effective for transactions that occur after publication of the Proposed Regulation as a final regulation in the Federal Register. Proposed Regulation, paragraph (e)(1).

⁵ 70 Fed. Reg. 749, 750 (2005).

⁶ "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . ." I.R.C. ("Code") sec. 61(a).

⁷ *See, e.g.*, Code secs. 351, 354, 355, 356, 358, and 361.

⁸ *See* Treas. Reg. sec. 1.368-1(b) ("The purpose of the reorganization provisions of the Code is to except from the general rule [of recognition of gain or loss upon the exchange of property] certain specifically described exchanges incident to such readjustments of corporate structures made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms."). *See also* Daniel M. Schneider, "Closing the Circle: Taxing Business Transformations," 58 La. L. Rev. 749, 751-52 (1998) (noting the policy enunciated in sec. 1.368-1(b) and suggesting that it be extended "to permit the tax-free conversion of corporations into partnerships").

exchanges, especially in a cross-border context, so that they do not advance any business interest other than escape from worldwide taxation in general and U.S. taxation specifically.⁹

Cross-border, tax-motivated transactions have taken different forms over the years. In 1932, Congress enacted the predecessor of 367¹⁰ to thwart a four-step scenario that began with a U.S. taxpayer contributing appreciated securities to a newly organized Canadian corporation. The corporation would then sell the securities in a transaction exempt from Canadian and U.S. tax, use the cash to form a new U.S. subsidiary, and distribute the shares in the new subsidiary back to the taxpayer in a reorganization.¹¹ Today, the cross-border vehicle of choice is corporate inversion, in which a domestic corporation either expatriates directly by changing its place of incorporation or becomes a subsidiary of a specially created foreign holding company.¹²

2. Code Section 367¹³

Section 367(a)(1) mitigates the misuse of corporate reorganization/nonrecognition transactions by denying corporate status to the foreign transferee in sec. 332, 351, 354, 356, and 361 exchanges when "a U.S. person¹⁴ transfers property to a foreign

⁹ See Samuel C. Thompson, Jr., "Impact of Code Section 367 and the European Union's 1990 Council Directive on Tax-Free Cross-Border Mergers and Acquisitions," 66 U. Cin. L. Rev. 1193, 1209-11 (1998).

¹⁰ Section 112(k) of the Revenue Act of 1932 read as follows:

Foreign Corporations. – In determining the extent to which gain shall be recognized in the case of [exchanges by corporations of stock or property for stock in reorganizations, and exchanges of property for stock of corporations that are controlled by the taxpayer immediately after the exchange], a foreign corporation shall not be considered a corporation unless, prior to such exchange or distribution, it has been established to the satisfaction of the Commissioner that such exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

47 Stat. 169, 198 (1932).

¹¹ H.R. Rep. No. 72-708, at 20 (1932).

¹² See, generally, John M. Peterson, Jr. and Bruce A. Cohen, "Corporate Inversions: Yesterday, Today, and Tomorrow," 632 PLI/Tax 719 (October-November 2004); see also Steven M. Surdell and David A. Waimon, "Evaluating Cross Border M&A Transactions Under the Indirect Stock Transfer Regulations," 632 PLI/Tax 399 (October-November 2004).

¹³ Because the Proposed Regulation that these comments address interprets Code sec. 367(a), that section will be summarized in more detail than secs. 367(b)-(f).

¹⁴ The term "U.S. person" is defined in Treas. Reg. sec. 1.367(a)-1T(d)(1), which incorporates Code secs. 7701(a)(30) and 6013(g), (h) by reference. See Treas. Reg. sec. 1.367(a)-3(c)(5)(iv).

corporation." This denies application of the enumerated tax-free provisions and makes the underlying transaction taxable. There are two exceptions to the application of sec. 367(a)(1), but each of them is itself subject to an exception, and that exception to the exceptions contains yet a third, internal exception which can negate its effect. Three, nested levels of exceptions, each negating the rule that preceded it, can be tricky to conceptualize, especially for practitioners who are new to sec. 367(a)(1) or who do not deal with it frequently, so for purposes of the following discussion, these exceptions will be classified as primary, secondary, and tertiary.

Section 367(a)(2) provides the first primary exception, stating that, except as provided by regulations, sec. 367(a)(1) does not apply to the transfer of stock or securities of a foreign corporation that is a party to an exchange or reorganization. This provision effectively cedes jurisdiction to sec. 367(b) for these transfers unless regulatory authority provides otherwise.

Section 367(a)(3) provides the second, and principal primary exception to 367(a)(1). It states that, except as provided by regulation, sec. 367(a)(1) "shall not apply to any property transferred to a foreign corporation for use by such corporation in the active conduct of a trade or business outside of the United States."¹⁵ Treas. Reg. sec. 1.367(a)-2T provides general rules interpreting this exception, and Treas. Reg. secs. 1.367(a)-4T and -5T address what might be called "tainted" assets -- assets which either cannot take advantage of the sec. 367(a)(3) exception at all or may do so only subject to certain limitations.¹⁶

Section 367(a)(4) states that, unless the regulations provide otherwise, a transfer of a partnership interest by a U.S. person to a foreign corporation is treated as a transfer of that person's "pro rata share of the assets of the partnership."

Section 367(a)(5) is the source of the secondary exception to the sec. 367(a)(2) and (3) exceptions. It states that even if the exceptions in secs. 367(a)(2) or (3) would otherwise apply, the qualifying outbound transfer will nevertheless be subject to tax under sec. 367(a)(1) if it involves "an exchange described in subsection (a) or (b) of section 361." Commentators have noted that this secondary exception "is limited to C, D,

¹⁵ The preamble to the 1998 Final Regulations interpreting Code sec. 367 created something of a stir when it stated that "[s]ection 367(a)(3) contains an exception to section 367(a)(1) for certain outbound transfers of tangible assets other than stock or securities." (Emphasis added.) T.D. 8770, 1998-27 IRB 4, 5. The author of those regulations, Philip Tretiak, contradicted that statement in a contemporaneous article. See Phillip Tretiak, "U.S. Section 367(a) Stock Transfers in 1998: All You Need to Know!" 17 Tax Notes Int'l 39, 40 n.8 (July 6, 1998). Another article that appeared a few months later noted that "the government has indicated informally that Section 367(a)(3) is the source of the exception from Section 367(a)(1) for stock transfers." Bernard T. Bress, "The New Section 367 Regulations: Going Beyond Form Over Substance," 9 J. Int'l Tax'n 10, 21-22 (October 1998).

¹⁶ See Treas. Reg. sec. 1.367(a)-1T(a).

F and G reorganizations in which the target corporation transfers assets that include stock or securities . . . to the foreign corporation."¹⁷ However, if the proposed expansion of A reorganizations is made final,¹⁸ this exception will undoubtedly apply to them, too. The secondary exception in sec. 367(a)(5) is itself subject to an internal, tertiary exception in the last sentence of the section that allows the sec. 367(a)(2) and (3) exceptions to function in a sec. 361 setting if the transferor, or target corporation is controlled (within the meaning of sec. 368(c)) by five or fewer domestic corporations and the transaction complies with basis adjustments and other conditions provided by the regulations.¹⁹

Finally, section 367(a)(6) is a catchall provision that allows the Secretary of the Treasury to exempt additional transactions from the purview of sec. 367(a)(1) by regulation. Sec. 367(a)(5) does not contain any reference to sec. 367(a)(6) and, for this reason, the limitations in 367(a)(5) would not apply to an exception authorized under sec. 367(a)(6). We recommend that the Treasury address this apparent oversight by asking Congress to amend sec. 367(a)(5) to include sec. 367(a)(6).

Section 367(b) applies to inbound, foreign-to-domestic transactions and straight foreign-to-foreign transactions that are described in Code secs. 332, 351, 354, 355, 356, or 361. According to one commentator, it is "essentially a backstop to Section 1248, focusing on the deferred earnings and profits (E&P) of a controlled foreign corporation (CFC)" and insuring that "[i]f the U.S. shareholder/CFC nexus is broken, the deferred E&P of the CFC are subject to taxation as a deemed dividend."²⁰

Section 367(c) provides, in paragraph (1), that Code sec. 355 distributions will be treated as exchanges, and in paragraph (2), that contributions of capital to controlled corporations will be treated as exchanges of property for stock. The latter provision is particularly important if, as is often the case, the contributor already owns all the stock of the controlled corporation.

Section 367(d) provides special rules for the transfer of intangibles to a foreign corporation in 351 or 361 exchanges, and it supplants sec. 367(a) entirely for these transactions.

Section 367(e)(1) provides a general rule for recognition of gain when a corporation distributes stock to foreign persons in an exchange described in Code sec.

¹⁷ T. A. O'Donnell, L. D. Swenson, and L. B. Terr, "Outbound Transfers of Stock and Securities by U.S. Persons," 20 Tax Mgmt. Int'l J. 543, 546 (1991).

¹⁸ See *supra* note 4 and accompanying text.

¹⁹ In applying the "five or fewer" test, sec. 367(a)(5) provides that all members of the same, sec. 1504 affiliated group are treated as one corporation.

²⁰ See Bress, *supra* note 15, at 12 (noting that "[s]ection 1248 requires that gain realized by U.S. shareholders on the sale, exchange, or redemption of stock, or on the taxable liquidation of a controlled foreign corporation (CFC), be treated as a dividend to the extent of the post-1962 earnings and profits (E&P) accumulated during the period that the shareholder held its stock").

355. Treas. Reg. sec. 1.367(e)-1(c) limits application of this general rule to stock of foreign corporations. Section 367(e)(2) suspends Code secs. 337(a) and (b)(1) to create a similar general rule for liquidations to foreign distributees pursuant to Code sec. 332. Under Treas. Reg. sec. 1.367(e)-2, this general rule applies only to domestic-to-foreign liquidations that cannot fulfill certain control and U.S.-trade-or-business limitations.

Finally, section 367(f) replaces the excise tax on certain foreign transfers imposed by former Code sec. 1491²¹ and, when implemented by regulations, will effectively expose those transfers to a gain recognition rule very similar to that in 367(a)(1).²²

3. Existing Treas. Reg. sec. 1.367(a)-3

The current Treas. Reg. sec. 1.367(a)-3 ("Existing Regulation") is divided into four main paragraphs. Paragraph (a) states the general rule. Paragraph (b) addresses foreign-to-foreign (F2F)²³ transfers and states the rule for concurrent application of 367(a) and (b). Paragraph (c) addresses domestic-to-foreign (D2F) transfers and erects standards intended to make domestic inversions either onerous or impossible. Paragraph (d) sets forth the indirect stock transfer (IST) rules, which treat certain asset transfers as putative stock transfers.

Paragraph (a) states that transfers of stock or securities by U.S. persons to foreign corporations that are described in Code secs. 351, 354, 356, or 361 will be taxed under sec. 367(a)(1) unless an exception in paragraph (b) or (c) applies. There are two exceptions from this rule: all sec. 354 exchanges pursuant to Code sec. 368(a)(1)(E), and those 354 exchanges under Code secs. 368(a)(1)(C), (D), and (F) that are not treated as ISTs by paragraph (d).

Paragraph (b) states the simple, two-part rule for F2F transfers: if a U.S. person holds less than five percent of the foreign transferee after the transfer, sec. 367(a)(1) is waived; if more than five percent is received, the U.S. person must either execute a gain

²¹ Code sec. 1491 was repealed by section 1131(b)(2) of the Taxpayer Relief Act of 1997, P.L. 105-34.

²² Enactment of sec. 367(f) was accompanied by secs. 721(c) and (d). *See* Pub.L. 105-34, secs. 1131(b)(3), (b)(5)(B). Sec. 721(c) is, like sec. 367(f), currently inoperative because it is not self-executing and regulations implementing it have yet to be promulgated. Section 721(d) *is* self-executing, but it does no more than cite sec. 367(d)(3), and sec. 367(d)(3) is inoperative because it has yet to be implemented by regulations.

²³ The "F2F" and "D2F" abbreviations are based on the "B2B" and "B2C" abbreviations used by European Union value-added tax authorities to describe business-to-business and business-to-consumer transactions. *See, e.g.*, European Commission, "VAT: Commission Welcomes Council Adoption of Rules for Application of VAT to Electronically Delivered Services," 2002 Worldwide Tax Daily 89-19 (May 8, 2002) ("Under these new rules, no additional obligations will be imposed on non-EU suppliers selling to business customers in the Union (i.e. business to business (B2B) sales which constitute at least 90 percent of the market) . . .").

recognition agreement (GRA) pursuant to Treas. Reg. sec. 1.367(a)-8 or recognize gain on the transfer. The rule set forth for concurrent application of secs. 367(a) and (b) is similarly straightforward: if sec. 367(a) applies, sec. 367(b) does not.²⁴

Paragraph (c) begins with five basic rules for waiver of 367(a)(1) in D2F transfers:

- 1) the U.S. transferors must receive fifty percent or less of the foreign transferee in the transaction;
- 2) directors, officers, and five-percent shareholders of the target must own less than fifty percent of the transferee after the transaction;
- 3) if the U.S. person making the transfer is a five-percent transferee shareholder, it must file a GRA;
- 4) the active trade or business test in paragraph (c)(3) must be met,²⁵ and
- 5) the target company must comply with certain reporting requirements.

The remainder of paragraph (c) provides details and rules for interpreting and satisfying these rules. One provision, the definition of a U.S. person in subparagraph (c)(5)(iv), applies to the entire regulation, and not just to paragraph (c).

Paragraph (d) has three subparagraphs, the third of which consists entirely of twenty-one examples. Paragraph (d)(1) states the general IST rule: if a U.S. person makes a Code-sec.-354 or -356 exchange of domestic or foreign stock or securities for foreign stock or securities in connection with one of six, specified transactions, that exchange will be treated as an indirect transfer of stock that is subject to 367(a) (and, if the stock is foreign, 367(b) also). The six covered exchanges are forward triangular mergers,²⁶ reverse triangular mergers,²⁷ triangular Bs,²⁸ triangular Cs,²⁹ straight Cs with dropdowns,³⁰ and cascading (multiple) Code sec. 351 transactions.³¹

²⁴ The exact language of the Existing Regulation is a bit more circuitous than this. It says, "A transfer of foreign stock or securities described in section 367(a) or any regulations thereunder as well as in section 367(b) or any regulations thereunder shall be concurrently subject to sections 367(a) and (b) and the regulations thereunder, except to the extent that the transferee foreign corporation is not treated as a corporation under section 367(a)(1)." Treas. Reg. sec. 1.367(a)-3(b)(1)(ii).

²⁵ This test is different from "active conduct of a trade or business" exemption in Code sec. 367(a)(3), and its preeminent feature is the substantiality test in subparagraph (c)(3)(iii). The substantiality test requires, among other conditions, that "the fair market value of the transferee foreign corporation [be] at least equal to the fair market value of the U.S. target company."

²⁶ See Proposed Regulation, paragraph (d)(1)(i) and Code secs. 368(a)(1)(A) and (a)(2)(D).

²⁷ See Proposed Regulation, paragraph (d)(1)(ii) and Code secs. 368(a)(1)(A) and (a)(2)(E).

²⁸ See Proposed Regulation, paragraph (d)(1)(iii) and Code sec. 368(a)(1)(B).

Paragraph (d)(2) contains special rules for ISTs that apply both to paragraph (d) and Treas. Reg. sec. 1.367(a)-8, which addresses GRAs. Those rules include definitions of the transferee corporation, the transferred corporation, and transferred property; information specific to GRAs, including a guide to one of the events that can trigger them; and coordination provisions for the asset transfer rules and the IST rules.

III. Specific Comments on Proposed Regulation

The Proposed Regulation follows the four-paragraph structure of the Existing Regulation.

1. Paragraph (a) – In general.

The Proposed Regulation expands the exception for sec. 354 exchanges that occur in the course of Code sec. 368(a)(1)(E) and certain non-IST asset reorganizations to include sec. 356 exchanges.³² This change is congruent with the Preamble's announced intent of amending the Existing Regulation to take into account statutory mergers with foreign corporations³³ because sec. 356 addresses exchanges that would comply with sec. 354 except for the presence of "boot," or consideration in addition to approved stock and securities, and boot is more widely used in statutory mergers than in those reorganizations addressed in the Existing Regulation.³⁴

For the same reason, the Proposed Regulation also reframes the current exception for sec. 354 exchanges that occur in the course of certain Code sec. 368(a)(1)(C), (D), and (F) reorganizations³⁵ as an exception for "asset reorganizations."³⁶ The term asset reorganization is defined as a sec. 368(a)(1) reorganization involving a transfer of assets under sec. 361.

²⁹ See Proposed Regulation, paragraph (d)(1)(iv) and Code sec. 368(a)(1)(C).

³⁰ See Proposed Regulation, paragraph (d)(1)(v) and Code secs. 368(a)(1)(C) and (a)(2)(C).

³¹ See Proposed Regulation, paragraph (d)(1)(vi) and Code sec. 351.

³² Although the current and proposed language exempts only stock-for-stock exchanges, the Treasury Department and the IRS have announced an intent to expand this exemption to include securities-for-stock and securities-for-securities exchanges, too. See Notice 2005-6, 2005-5 IRB 448. The effective date of this change will be Jan. 5, 2005. *Id.*; Preamble, 70 Fed. Reg. 749, 752 (2005).

³³ See *supra* notes 4-5 and accompanying text.

³⁴ See Preamble, 70 Fed. Reg. 749, 752 (2005).

³⁵ To qualify for the exemption, these reorganizations must not be recharacterized by the IST rules.

³⁶ See *supra* note 32. See also Joseph M. Calianno and Jeffrey L. Olin, "Inbound Triangular Reorganizations -- The Interaction of Sections 367(a) and (b) Under the New Proposed Regulations," 16 J. Int'l Tax'n 36, 40 n.12 (2005).

Because a reverse triangular merger frequently involves a contribution of parent stock to the merging subsidiary as part of the merger, the expansion of statutory mergers to include foreign corporations raises the possibility that 367(a) would apply to the transfer of this stock to a foreign target under Code sec. 361. To avoid this result, the Proposed Regulation exempts these transfers. Parent stock not provided as part of the plan of reorganization will continue to be treated as property of the subsidiary, and therefore subject to 367(a).³⁷

2. Paragraph (b) – Transfers by U.S. persons of stock or securities of foreign corporations to foreign corporations

The Proposed Regulation changes only the overlap provision, which governs the concurrent application of secs. 367(a) and (b). In the Existing Regulation, sec. 367(b) does not apply to any transaction that is taxable pursuant to sec. 367(a). As the Preamble notes, this can effectively allow a taxpayer whose 367(b) liability would exceed its 367(a) tax to elect the lower 367(a) amount simply by forgoing a GRA.³⁸ Because this undermines the 367(b) policies regarding inbound transactions, the Proposed Regulation retains the current overlap but creates an exception in which the 367(b) rules apply first for IST transactions from foreign to domestic corporations that are also subject to Treas. Reg. secs. 1.367(b)-3(a) and (b).³⁹

Comment: Examples 11 and 15, which illustrate the new overlap, are analyzed in the discussion of paragraph (d)(3) below.⁴⁰ McCarty and DiFronzo have recently suggested that this change to the overlap provision be forgone as an "unnecessary complexity" for two reasons: first, the transaction to which it would apply will rarely if ever occur,⁴¹ and second, if such a transaction were to arise, the parties would avoid application of sec. 367(b) by selling the shares of the relevant subsidiary in a fully taxable transaction instead of engaging in a reorganization.⁴² This avoidance maneuver assumes a sale to an unrelated third party. If the sale were to a related party, it would be subject to a sec. 304 recast.

³⁷ See Preamble, 70 Fed. Reg. 749, 752 (2005).

³⁸ See Preamble, 70 Fed. Reg. 749, 752-53 (2005).

³⁹ See Proposed Regulation, para. (b)(2)(i)(A) (noting, in addition to stating the new rule, that the rule will not be effective until the Proposed Regulation is published in the Federal Register as a final regulation), para. (e)(1).

⁴⁰ See *infra* text accompanying notes 94-101.

⁴¹ Calianno and Olin agree that these transactions "may not be common" but say the proposed expansion of A reorganizations "may exacerbate this concern." Calianno and Olin, *supra* note 36, at 38. The fact that the Treasury is allowing these transactions to continue until the Proposed Regulation is finalized, *see supra* note 39, suggests a lack of concern, perhaps for the very reason McCarty and DiFronzo suggest.

⁴² See Philip A. McCarty and Michael A. DiFronzo, "New Proposed 367 Regulations Address a Potpourri of Issues," 34 Tax Mgmt. Int'l J. 219, 222 (2005).

3. Paragraph (c) – Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations

The only change in this long, anti-inversion paragraph is a technical one. The definition of "transferee foreign corporation" in paragraph (c)(5)(vi) is changed from "the foreign corporation whose stock is received in the exchange by U.S. persons" to "except as provided in paragraph (d)(1)(iii)(B) below, . . . the foreign corporation that issues stock or securities to the U.S. person in the exchange."

Comment:

1) The reference to paragraph (d)(1)(iii)(B) is treated in the discussion of paragraph (d)(1) below.⁴³ The change in the remainder of the new sentence (from the prior "corporation whose stock is received" to the new "corporation that issues stock or securities") is laudable, especially in light of the Service's expressed interest in making the Proposed Regulation clear and easy to understand,⁴⁴ because it makes the definition here (including the exception) identical to the new definition of "transferee foreign corporation" in paragraph (d)(2)(i). There is an arguable reason for repeating this definition, namely that its presence in paragraph (c) applies only to transfers of stock of a domestic corporation,⁴⁵ while its inclusion in paragraph (d) applies to transfer of either domestic or foreign stock.⁴⁶ However, to avoid confusion and needless comparison, the following parenthetical cross-references should be added after each definition: in paragraph (c)(5)(vi), "(This definition also appears in paragraph (d)(2)(i).)"; in paragraph (d)(2)(i), "(This definition also appears in paragraph (c)(5)(vi).)"

2) In the Preamble, the Service requested feedback on how the regulation could be made easier to understand.⁴⁷ In paragraph (c) of the Proposed Regulation, there are two subparagraphs with almost identical title phrases. Paragraph (c)(7), titled "Ownership Statements," sets forth the procedure for rebutting the presumption in paragraph (c)(2) that all target transferors are U.S. persons. Paragraph (c)(5)(i), titled "Ownership Statement," outlines the form and factors to be included in a statement submitted pursuant to paragraph (c)(7). We believe the almost identical titles of these two paragraphs are potentially confusing, especially for practitioners who are new to this regulation or who do not deal with it frequently. Therefore, we suggest that paragraph (c)(7) be retitled "Rebutting the ownership presumption of paragraph (c)(2)."

⁴³ See *infra* text accompanying notes 54-62.

⁴⁴ See *supra* text accompanying note 3.

⁴⁵ See Proposed Regulation, paragraph (c)(1).

⁴⁶ See Proposed Regulation, paragraph (d)(1), front language.

⁴⁷ See Preamble, 70 Fed. Reg. 749, 756 (2005).

4. Paragraph (d) – Indirect stock transfers in certain nonrecognition transfers

a. Paragraph (d)(1) -- In general.

The Proposed Regulation makes three changes to the general rule for ISTs. First, and simplest, it creates a special term for dropdowns, or transfers to subsidiaries that occur in the context of a reorganization. That new term is "controlled asset transfer" (hereinafter, CAT).⁴⁸ Five new examples in paragraph (d)(3) use this term: 6A, 6B, and 6C, and 6D, all of which involve straight C reorganizations, and 9, which involves a triangular C.

The second change, which is somewhat more complicated, broadens the application of the IST rules with respect to reorganizations followed by a CAT. The Existing Regulation limits the application of the IST rules to only those CATs that follow straight C reorganizations.⁴⁹ The Proposed Regulation replaces straight Cs with all asset reorganizations except forward triangulars, reverse triangulars, and triangular Cs.⁵⁰ In an obvious nod to Prop. Treas. Reg. sec. 1.368(b)-2(b)(1)(ii),⁵¹ which would bring statutory mergers within the purview of Code sec. 367(a),⁵² the requirement that the target shares be exchanged for voting stock of a foreign acquirer is replaced with the requirement that they simply be exchanged for stock. The result, under the Proposed Regulation, is that the IST rules would apply to CATs following A, C, D, F, and G reorganizations.⁵³ Two new examples are cited for this new rule: 6A and 6B. Both will be examined in the analysis of paragraph (d)(3) below.

The third and most complex change in paragraph (d)(1) expands the category of triangular Bs in paragraph (d)(1)(iii) to include reorganizations in which the parent of the foreign acquirer is domestic.⁵⁴ In the Existing Regulation's treatment of triangular Bs, a U.S. person must exchange stock of the target for foreign stock of the acquirer's parent

⁴⁸ See Proposed Regulation, paragraph (d)(1), front language.

⁴⁹ See Treas. Reg. sec. 1.367(a)-3(d)(1)(iv); Code secs. 368(a)(1)(C) and (a)(2)(C).

⁵⁰ See Proposed Regulation, paragraph (d)(1)(v).

⁵¹ See 70 Fed. Reg. 746, 747 (2005).

⁵² See *supra* text accompanying notes 4 and 33.

⁵³ McCarty and DiFronzo, *supra* note 42, note at page 225 that under paragraph (e)(1) of the Proposed Regulation, application of the new IST rule regarding CATs after asset reorganizations appears to be retroactive to July 20, 1998. For a contrary view, see *infra* note 102.

⁵⁴ This provision will not become effective until the Proposed Regulation is published in the Federal Register as a final regulation. Proposed Regulation, paragraphs (d)(1)(iii)(B)(5); (e)(1). Nevertheless, at least one commentator has expressed concern that Treasury could possibly use Treas. Reg. sec. 1.367(a)-1T(c)(1) to apply the proposed rule to transactions before the effective date. See Bress, *supra* note 4, at 21 (discussion of Example 11 in the Proposed Regulation).

before the transaction is subject to the IST rules.⁵⁵ In the Proposed Regulation, the IST rules also apply if a U.S. person exchanges target stock (foreign or domestic) for the domestic stock of the foreign acquirer's parent.⁵⁶ If the target is foreign, the rules in Proposed Regulation paragraph (b) apply, as well as the 367(b) rules if the U.S. person is a section 1248 shareholder.⁵⁷ If the target is domestic, then the rules in Proposed Regulation paragraph (c) apply.⁵⁸

Allowing the acquiring parent to be domestic plays havoc with both the term "transferee foreign corporation" and its definition in the Existing Regulation. The solution in the Proposed Regulation is to keep the term "transferee foreign corporation" and its definition relatively the same⁵⁹ and direct the reader to an exception in paragraph (d)(1)(iii)(B). There, in an expansion of complexity worthy of Lewis Carroll,⁶⁰ the term "transferee foreign corporation" is given two, context-sensitive definitions: for purposes of paragraphs (b) and (c), it is defined as the foreign acquiring subsidiary,⁶¹ but for purposes of Treas. Reg. sec. 1.367(a)-8, which addresses GRA matters, and paragraph (d)(2), it will be the acquiring subsidiary's domestic parent.⁶²

Comment:

1) The definition of the term "controlled asset transfer" in the Proposed Regulation reads as follows:

For purposes of this paragraph (d), if a corporation acquiring assets in a reorganization described in section 368(a)(1) transfers all or a portion of such assets to a corporation controlled (within the meaning of section 368(c)) by the acquiring corporation as part of the same transaction, the

⁵⁵ See Treas. Reg. sec. 1.367(a)-3(d)(1)(iii).

⁵⁶ See Proposed Regulation 1.367(a)-3(d)(1)(iii)(B). Surdell and Waimon note that "[b]ecause the indirect stock transfer regulations are already both complex and not entirely intuitive, [this expansion] is likely to become something of a trap for the unwary." Steven M. Surdell and David A. Waimon, "Analyzing Cross-Border M&A Transactions After the Proposed 367 Regulations and the Jobs Act—Part I of II," 5 J. Tax'n Global Transactions 51, 59 (2005).

⁵⁷ See Proposed Regulation 1.367(a)-3(d)(1)(iii)(B)(2).

⁵⁸ See Proposed Regulation 1.367(a)-3(d)(1)(iii)(B)(3).

⁵⁹ There are minor differences between the definition in the existing and proposed regulations. See *supra* text accompanying note 44.

⁶⁰ Lewis Carroll, *Through the Looking Glass (And What Alice Found There)* ch. 6 (1872) ("When I use a word,' Humpty Dumpty said in rather a scornful tone, 'it means just what I choose it to mean -- neither more nor less.' 'The question is,' said Alice, 'whether you can make words mean so many different things.' 'The question is,' said Humpty Dumpty, 'which is to be master -- that's all.'").

⁶¹ See Proposed Regulation 1.367(a)-3(d)(1)(iii)(B)(1).

⁶² See Proposed Regulation 1.367(a)-3(d)(1)(iii)(B)(4).

subsequent transfer of assets to the controlled corporation will be referred to as a controlled asset transfer. See section 368(a)(2)(C).⁶³

Although the language of the definition is broad enough to apply to D and F reorganizations, the reference to Code sec. 368(a)(2)(C) appears to rule them out because Ds and Fs are not addressed by that section. According to the Preamble, however, Ds and Fs *are* included in the definition by virtue of Proposed Treas. Reg. sec. 1.368-2(k), which would permit any reorganization under sec. 368(a)(1) to include a subsequent CAT.⁶⁴

Expansion of the IST rules to include D reorganizations followed by CATs has been widely anticipated since 2002.⁶⁵ Nevertheless, a new example illustrating this addition would be helpful.

Application of the IST rules to F reorganizations followed by CATs, on the other hand, is surprising because it seems contrary to the established status of Fs as stand-alone transactions. As far back as 1996, the IRS has accorded separate status to an F even if it occurs as a step in a series of related transactions.⁶⁶ Further, this position has been affirmed three times in the past year:

- first, in Prop. Treas. Reg. sec. 1.368-2(m)(3)(ii) (published just four days before Prop. Treas. Reg. sec. 1.368-2(k)), which indicates that an F may retain its status as an F even if it occurs as a step in a series of related transactions;⁶⁷
- second, in an amendment to Treas. Reg. sec. 1.368-1(b), which provides that continuity of interest and continuity of business enterprise are not required for a transaction to qualify as an E or F reorganization;⁶⁸ and

⁶³ Proposed Regulation, paragraph (d)(1).

⁶⁴ See Preamble, 70 Fed. Reg. 749, 753-54 (2005); REG-130863-04, 69 Fed. Reg. 51209, 51211-12 (2004).

⁶⁵ See Rev. Rul. 2002-85, 2002-2 C.B. 986 (holding that "[a]n acquiring corporation's transfer of the target corporation's assets to a subsidiary controlled by the acquiring corporation as part of a plan of reorganization will not prevent a transaction that otherwise qualifies as a reorganization under sec. 368(a)(1)(D) from so qualifying"); Notice 2002-77, 2002-2 C.B. 997 (announcing that "the Treasury and the Service will amend the regulations under Treas. Reg. sec. 1.367(a)-3(d) to provide specifically that a reorganization under section 368(a)(1)(D) followed by the transfer of all or a portion of a target corporation's assets to a controlled subsidiary pursuant to a plan of reorganization constitutes an indirect transfer of stock or securities for purposes of Treas. Reg. sec. 1.367(a)-3").

⁶⁶ See Rev. Rul. 96-29, 1996-1 C.B. 50.

⁶⁷ See REG-106889-04, 69 Fed. Reg. 49836, 49839 (2004).

⁶⁸ See T.D. 9182, 70 Fed. Reg. 9219, 9220 (2005); Daily Tax Report (Feb. 25, 2005) at L-4.

- finally, in Prop. Treas. Reg. sec. 1.368-1(b)(1), which indicates that the net value requirement does not apply to an E or F reorganization.⁶⁹

If the Service now wishes to apply the IST rules to F reorganizations followed by CATs, we recommend that an example reconciling this apparent change in status with the sources cited above be provided.⁷⁰

2) There is a hidden, seventh type of IST exchange -- informally called the "Catchall Rule" -- that appears in paragraph (a) of the Existing Regulation and is carried over to the Proposed Regulation without change. It reads, "For rules regarding other indirect or constructive transfers of stock or securities subject to section 367(a), see sec. 1.367(a)-1T(c)."⁷¹ Treas. Reg. sec. 1.367(a)-1T(c)(1) reads:

"A transfer described in section 367(a)(1) is any transfer of property by a U.S. person to a foreign corporation pursuant to an exchange described in section 332, 351, 354, 355, 356, or 361. Section 367(a)(1) applies to such a transfer whether it is made directly, indirectly, or constructively. Indirect or constructive transfers that are described in section 367(a)(1) include the transfers described in subparagraphs (2) through (7) of this paragraph (c)."

It is speculated that Treasury and the IRS have retained sec. 1.367(a)-1T(c) as back-up authority for recasting and requiring a GRA if a transaction arises that is not specifically enumerated in the current IST rules. Bernard T. Bress has synthesized the intent and effect of the Catchall Rule thusly:

"If, at the end of the day, assets of the target corporation reside in a corporation other than the foreign corporation, the stock of which was used to acquire such assets, the stock transfer rules of Section 367(a)(1) should apply to that acquisition with respect to those assets that lie outside the corporate solution of such foreign corporation."⁷²

⁶⁹ REG-163314-03, 70 Fed. Reg. 11903, 11909 (2005); Daily Tax Report (Mar. 10, 2005) at L-1.

⁷⁰ The fact pattern in such an example might involve an outbound F followed by CATs to both foreign and domestic subsidiaries. According to one commentator, this reorganization would escape the anti-inversion provisions of paragraph (c) in the Proposed Regulation were it not included in paragraph (d)(1)(v). See Bress, *supra* note 4, at 27.

⁷¹ The current regulations have not replaced Treas. Reg. sec. 1.367(a)-1T.

⁷² See Bress, *supra* note 15, at 21. One noted commentator has referred to this condensation of sec. 1.367(a)-1T(c)(1) as "Nardi's Rule." See James P. Fuller, "U.S. Tax Review," 17 Tax Notes Int'l 659, 667 (1998).

We strongly recommend that the Catchall Rule be moved to the IST section of the regulations.⁷³ For instance, it could be placed as paragraph (d)(1)(vii) in the Proposed Regulation. Placing it in this more conspicuous position in the regulations would enable taxpayers not steeped in Code sec. 367 lore to become aware of its existence more readily and to determine whether it applies to a proposed transaction. It would also make it subject to the provisions of paragraph (d)(2).⁷⁴

3) Technical issues

a) In paragraph (d)(1)(iv), which addresses triangular C reorganizations, the last sentence refers the reader to Example 5 in paragraph (d)(3). This reference should be changed to Example 6. Example 5 in the Proposed Regulation involves a triangular B, not a triangular C.

b) In paragraph (d)(1)(vi), which addresses successive transfers of property under Code sec. 351, unchanged text in the last sentence refers the reader to Examples 10 and 10A in paragraph (d)(3). This reference should be changed to Examples 13 and 13A. Examples 10 and 10A in the Existing Regulation are included in the Proposed Regulation with no change other than being renumbered as 13 and 13A. Further, Example 10 in the Proposed Regulation involves a forward triangular merger, and there is no Example 10A.

b. Paragraph (d)(2) -- Special rules.

The Proposed Regulations makes substantive changes in four of paragraph (d)(2)'s six romanette-numbered paragraphs. In paragraph (i), the definition of "transferred foreign corporation" is revised. This change has already been addressed in our discussion of paragraph (c).⁷⁵

Next, three conforming and clarifying changes are made in paragraph (ii)'s definition of "transferred corporation." First, the Proposed Regulation changes the phrase "followed by a section 368(a)(2)(C) transfer" to read "followed by a [CAT]" and applies it to the forward and reverse triangulars described in proposed paragraphs (d)(1)(i) and (ii) as well as the triangular Cs described in (d)(1)(iv). Second, the definition of "transferred corporation" for reorganizations followed by a CAT is changed from "transferee corporation" to "controlled corporation to which the assets are transferred." Finally, the definition of "transferred corporation" for successive section 351 transfers is

⁷³ A significant minority of our members argue that the Catchall Rule has outlived its usefulness and should, in the spirit of tax simplification, be deleted. As part of their argument, they note that the application of paragraph (d)(v) of the Proposed Regulation to "[t]ransfers of assets to subsidiaries in *certain* section 368(a)(1) reorganizations" (emphasis added) makes that paragraph broad enough to be a substitute catchall rule in its own right.

⁷⁴ See Bress, *supra* note 4, at 24 n.29.

⁷⁵ See *supra* text accompanying notes 43-46.

changed from "transferee corporation in the final section 351 transfer" to "the corporation to which the assets are transferred in the final section 351 transfer."

Paragraph (v), titled "Determination of whether the transferred corporation disposed of substantially all of its assets," is expanded to address CATs that follow forward and reverse triangulars, triangular Cs and the "asset reorganizations" of paragraph (d)(1)(v).

Finally, paragraph (vi), "Coordination between asset transfer rules and [IST] rules," is extensively revised.⁷⁶ The Existing Regulation begins by stating the general rule: for a transfer (or deemed transfer) of assets from a domestic corporation to a foreign corporation "(other than in an exchange described in section 354), the rules of section 367, including sections 367(a)(1), (a)(3) and (a)(5), as well as section 367(d), and the regulations thereunder shall apply prior to the application of the rules of this section."⁷⁷ An exception provides that sec. 367(a) will not apply if 1) the foreign acquiring corporation re-transfers the assets back to a domestic corporation in a paragraph-(d)(1)(vi) or Code-sec.-368(a)(2)(C) transfer and 2) the domestic transferee's basis is no greater than that of the original domestic transferor.⁷⁸

The Proposed Regulation does not change the general rule other than to delete the Existing Regulation's negative description of covered exchanges ("(other than in an exchange described in section 354)") and insert a positive description: "in an exchange described in section 351 or 361."

Regarding the exception, however, the Proposed Regulation makes sweeping changes. First, it expands the scope of the exception from sec. 367(a) alone to both sec. 367(a) and sec. 367(d). Then, the exchanges to which the exception applies are changed from all those "described in this paragraph (d)" to those mentioned in the proposed general rule: 351s and 361s.

Next, the Proposed Regulation divides the exception into two parts. Re-transfers to a domestic corporation that occur in the course of multiple sec. 351 exchanges are left virtually unchanged. Re-transfers that involve an exchange described in sec. 361, however, are subject to new anti-inversion limitations.⁷⁹ Either a qualifying transaction

⁷⁶ None of the paragraph (d)(2)(vi) changes will be effective until the final regulation is published in the Federal Register. Proposed Regulation, paragraphs (d)(2)(vi)(G), (e)(1).

⁷⁷ See Treas. Reg. sec. 1.367(a)-3(d)(2)(vi).

⁷⁸ *Id.*

⁷⁹ See Preamble, 70 Fed. Reg. 749, 754 (2005) ("The IRS and Treasury are concerned that asset reorganizations subject to this coordination rule may be used to facilitate corporate inversion transactions. . . . The IRS and Treasury also are concerned that the coordination rule might be used to facilitate divisive transactions. The proposed regulations address both of these concerns by modifying the scope of the coordination rule."). McCarty and DiFronzo, *supra* note 42, note at page 226 that "enactment of [sec.] 7874 in the American Jobs Creation Act of 2004 (P.L. 108-357) on October 22, 2004,

must meet the requirements of the second and third sentences of Code sec. 367(a)(5) (i.e., the transferor, or domestic acquired corporation, is controlled by five or fewer domestic corporations, makes certain basis adjustments, and meets other conditions prescribed in future sec. 367(a)(5) regulations),⁸⁰ or it must satisfy the requirements of paragraphs (c)(1)(i), (ii), (iv), and (c)(6) of the Proposed Regulation and file a "Required Statement" pursuant to new paragraph (d)(vi)(C).⁸¹

The Required Statement is similar to but broader than a GRA.⁸² First, it must be executed, not just by the target, but by the foreign acquiring corporation too.⁸³ Second, it lacks finality and certainty because there is no time limit on its requirement that the target recognize gain if the foreign acquirer disposes of any stock of its domestic controlled corporation in a "gain recognition transaction" (GRT).⁸⁴ A GRT is defined as

a transaction . . . where a principal purpose of the transfer by the domestic acquired corporation is the avoidance of U.S. tax that would have been imposed on the domestic acquired corporation on the disposition of the re-transferred assets. A transfer may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.⁸⁵

Third, there is a rebuttable presumption that a disposition of any stock by the foreign acquiring corporation within two years of the original transfer, whether in a recognition or nonrecognition transaction, has a principal purpose of tax avoidance.⁸⁶ Additional

would seem to make the [new anti-inversion provisions] inapplicable to that type of transaction [*i.e.*, the kind of transaction described in paragraph (d)(2)(vi)(B)] because the acquiring foreign corporation would be treated as a U.S. corporation. Nonetheless, the retention of this proposed change to the [IST] rules may still have practical application to prevent certain types of planning in transactions not subject to 7874." *Cf.* David P. Hariton, "[New York State Bar Association] Calls for Removal of Regs on U.S.-Foreign Stock Transfers," 2005 Worldwide Tax Daily 80-19 (Apr. 27, 2005) (advocating revision or elimination of Treas. Reg. sec. 1.367(a)-3(c) in light of the enactment of secs. 7874 and 4985).

⁸⁰ See Proposed Regulation, paragraph (d)(2)(vi)(B)(i).

⁸¹ See Proposed Regulation, paragraph (d)(2)(vi)(B)(ii).

⁸² The language of the Required Statement appears to be loosely based on the required statements in Treas. Reg. sec. 1.367(e)-2. See, e.g., Treas. Reg. sec. 1.367(e)-2(b)(2)(i)(C), (E)(5)(ii).

⁸³ See Proposed Regulation, paragraph (d)(2)(vi)(C); *cf.* Treas. Reg. sec. 1.367(a)-8(a)(3).

⁸⁴ See Proposed Regulation, paragraph (d)(2)(vi)(C).

⁸⁵ See Proposed Regulation, paragraph (d)(2)(vi)(D)(1).

⁸⁶ See Proposed Regulation, paragraph (d)(2)(vi)(D)(2).

paragraphs prescribe a method involving hypothetical fair market values for calculating the GRT gain and discuss the interest to be paid on the additional tax.⁸⁷

Comment:

1) For years, it has seemed anomalous to many of us that the exception to the coordination rule in Existing Regulation paragraph (d)(2)(vi) exempted only taxation under sec. 367(a) and left sec. 367(d) in play. Therefore, addition of the sec. 367(d) exemption in paragraph (d)(2)(vi)(B) of the Proposed Regulation is most welcome.

2) It would be helpful, especially for practitioners who are new to the regulations interpreting Code sec. 367(a) or who do not deal with them frequently, if the Treasury would clarify the meaning of the phrase "substantially all" in paragraph (d)(2)(v).⁸⁸

3) In our opinion, paragraph (d)(2)(v) would be clearer and easier to understand if an explanation were included for the different standards that paragraphs (v)(C) and (v)(D) state for determining whether the transferred corporation has disposed of substantially all its assets. In paragraph (v)(C), which addresses CATs following paragraph (d)(1)(v) asset transfers, the assets considered are only those transferred to the controlled corporation. In paragraph (v)(D), which addresses CATs following triangular C and forward triangular mergers, however, the assets considered are all the former target's assets, including those transferred to the controlled corporation. It might be easiest to include the explanation in the "results" section of one or more examples that address these paragraphs.

4) The general rule in paragraph (d)(2)(vi)(A) regarding coordination between the asset transfer rules and the IST rules states that it applies "to any of the transactions described in paragraph (d)(1)." If the so-called "Catchall Rule" in Treas. Reg. sec. 1.367(a)-1T(c) is not moved to paragraph (d)(1), then a reference to it should be included in paragraph (d)(2)(vi)(A).

5) Examples 6 and 8 in paragraph (d)(3) refer readers to paragraph (d)(2)(v)(A), and Example 11 refers readers to paragraph (d)(2)(v)(B). It would be helpful to add cross-references to those examples in paragraphs (d)(2)(v)(A) and (B).

c. Paragraph (d)(3) -- Examples

⁸⁷ See Proposed Regulation, paragraph (d)(2)(vi)(E). The foreign acquiring corporation's basis in its stock of the domestic controlled corporation is increased by any gain recognized as a result of a GRT, but the basis of the controlled corporation in the re-transferred assets is not. Preamble, 70 Fed. Reg. 749, 754-55 (2005).

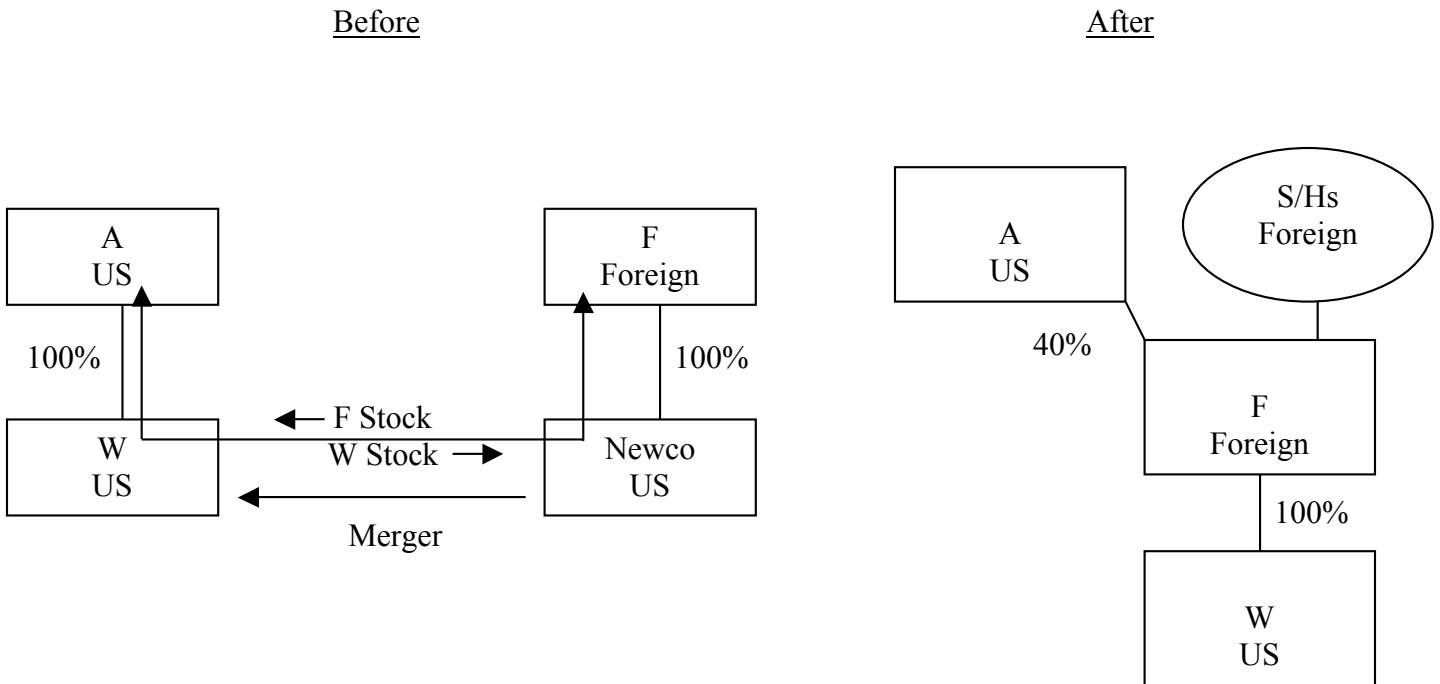
⁸⁸ See, e.g., Rev. Proc. 2005-1, "Letter Rulings, Information Letters and Determination Letters," Appendix E, 2005-1 IRB 1, 79 (citing Rev. Proc. 77-37 as a supplement to the general instructions for requests regarding Subchapter C -- Corporate Distributions and Adjustments).

This paragraph includes twenty-eight examples, ten of which are new. We examine below, in numerical order, all ten new examples and selected existing examples that we believe could be made clearer or easier to understand.

New Example 2 -- Reverse triangular reorganization described in sections 368(a)(1)(A) and (a)(2)(E).

As the diagrams below show, Newco merges into W, and stock of W is distributed to F. A, W's parent & sole shareholder, gets 40 percent of F's stock in an exchange described in section 354. After the transaction, A is a shareholder of F, which owns W, which contains the former assets of Newco (if any).

Result: F is treated as the transferee, and the surviving subsidiary, W, is treated as the transferred corporation. Because this is an IST under paragraph (d)(1)(ii) of the Proposed Regulation, taxation of the exchange under 367(a) will apply unless the requirements of paragraph (c)(1) are satisfied, including execution of a GRA by A.



Comment:

1. The statement of facts should be revised to read as follows: "The facts are the same as in Example 1, except that F infuses Newco with F stock and causes Newco to merge with and into W. As a result of the merger, A exchanges its W stock for F stock." The phrase "infuses Newco with F stock" could be replaced with "issues its stock to A." This revised statement of facts more accurately describes what happens in a reorganization described in Code secs. 368(a)(1)(A) and 368(a)(2)(E), especially where a Newco is used to effect the reorganization.

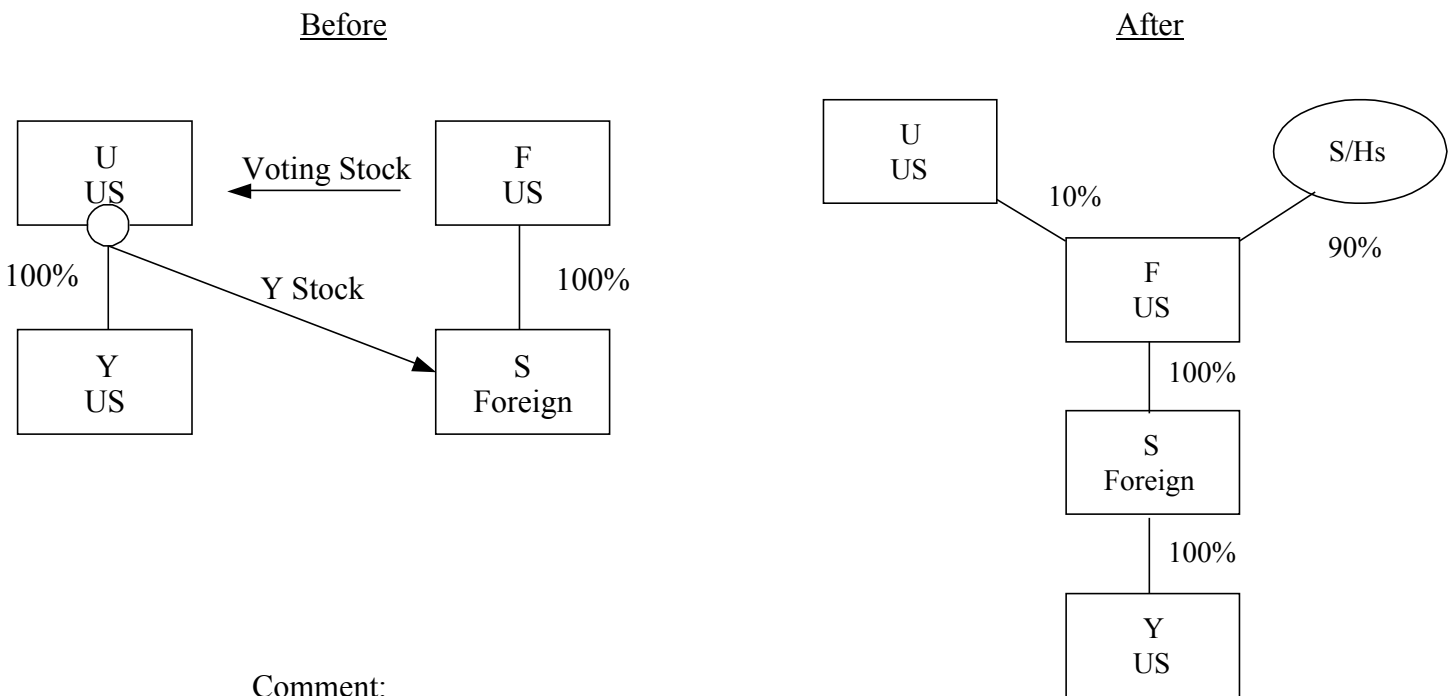
2. There are no examples of a reverse triangular merger in the Existing Regulation. This example, along with Example 11, fills that void.

New Example 5A -- Triangular reorganization described in section 368(a)(1)(B).

As the diagrams below show, acquiring parent F is domestic, and it owns all of acquiring subsidiary S, which is foreign. S acquires all the stock of Y, wholly owned by U, in exchange for 10 percent of F's voting stock.

Result: F is the transferee foreign corporation under paragraph (d)(1)(iii)(B)(1), and Y is the transferred corporation. U's exchange of its Y stock for stock of F is treated as an indirect transfer of Y stock to a foreign corporation, S, under paragraph (d)(1)(iii). This exchange is not taxable under Code sec. 367(a)(1) provided the requirements of paragraph (c)(1) are satisfied. In determining whether the 50-percent-or-less ownership requirement of paragraphs (c)(i) and (ii) is satisfied, U's indirect ownership of S stock (through its direct ownership of F stock) is taken into account.

U must file a GRA to prevent the exchange from being taxed under sec. 367(a)(1). The text in the example notes that the GRA will be triggered if F sells all or a portion of the stock of S, or if S sells all or a portion of the stock of Y.



Comment:

1. Because the actual transfer is of domestic Y stock for domestic F stock, it is only F's controlling interest in S that makes this a transfer to a foreign corporation.
2. This example illustrates both the new rule in paragraph (d)(1)(iii)(B) and the fact that multiple parties may trigger a GRA, and by dispositions of different property. Not addressed is whether the "substantially all of its assets" GRA trigger applies to

triangular B reorganizations.⁸⁹ We believe that the Treasury may have made an oversight in this regard, and we recommend that this matter be clarified in the final regulation.

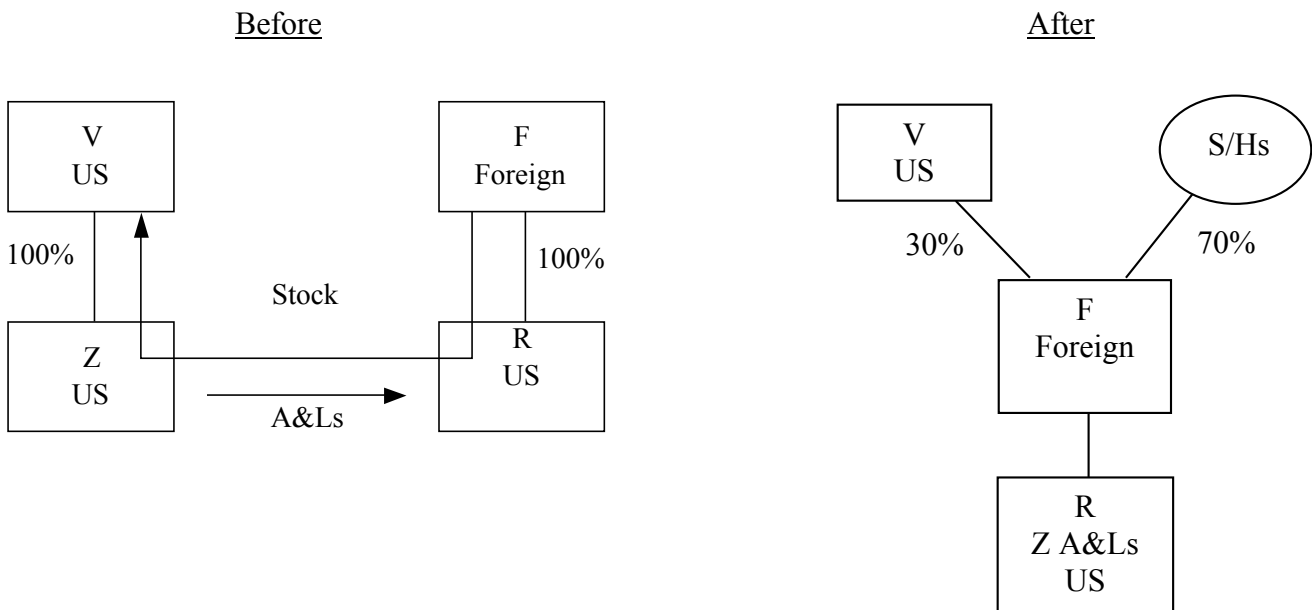
⁸⁹ A good argument can be made that it does not apply. Treas. Reg. sec. 1.367(a)-8(e)(3)(i)(A), which addresses disposition by a transferred corporation of substantially all of its assets, directs readers to sec. 1.367(a)-3(d)(2)(v) "[i]f the initial transfer that necessitated the [GRA] was an indirect stock transfer." There is no provision in sec. 1.367(a)-3(d)(2)(v) of either the Existing or the Proposed Regulation for applying sec. 1.367(a)-8(e)(3)(i) to a triangular B reorganization, nor is there any catchall provision that would encompass triangular Bs. Therefore, the "substantially all of its assets" GRA trigger cannot apply if the transaction underlying the GRA is a triangular B.

Example 6 -- Triangular reorganization described in section 368(a)(1)(C).

This example is Example 5 in the Existing Regulation, and only its number is changed in the Proposed Regulation. It is important to discuss it briefly because its facts are the basis for six of the ten new examples.

As the diagrams below show, domestic target Z transfers its assets to foreign acquiring parent F's domestic subsidiary R, and Z's domestic parent V gets 30 percent of the stock of F in return. R operates an historical business.

Result: This exchange is an IST under paragraph (d)(1)(iv), so V can avoid taxation under sec. 367(a) only if the transaction complies with the requirements of paragraph (c)(1) and V files a GRA. F is the transferee corporation, and R is the transferred corporation. The GRA will be triggered if F disposes of its R stock, or if R disposes of substantially all the assets it acquired from Z.⁹⁰



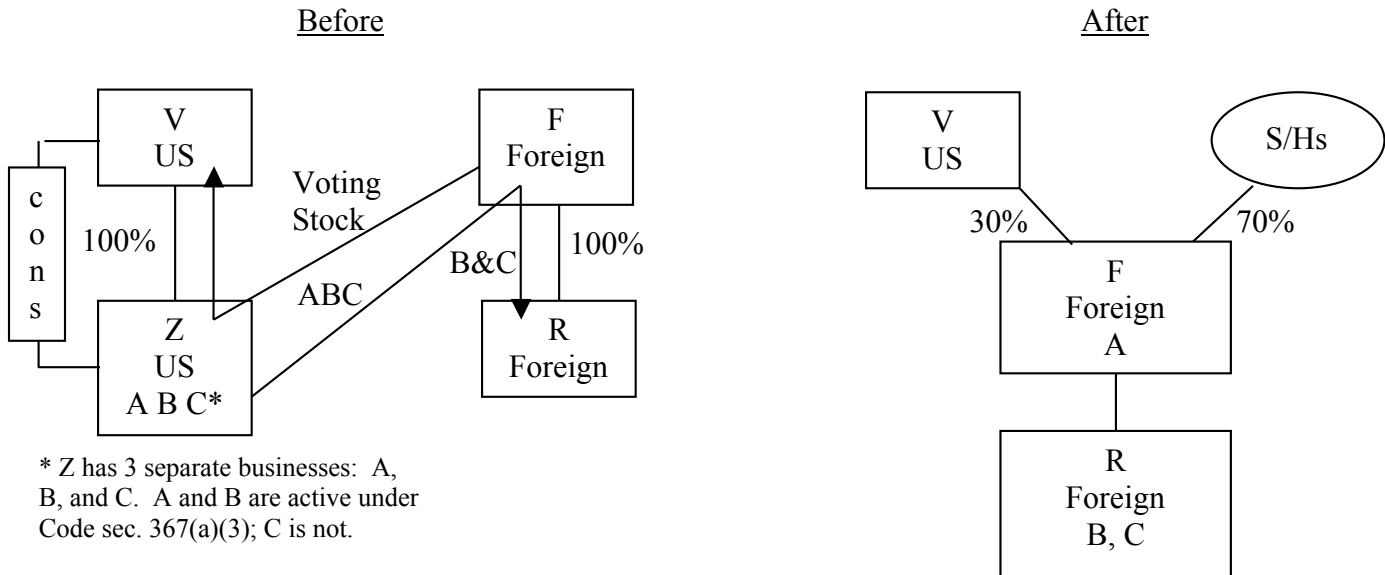
⁹⁰ See Treas. Reg. sec. 1.367-8(e)(3)(i)(A); Proposed Regulation, paragraph (d)(2)(v)(A).

New Example 6A -- Section 368(a)(1)(C) reorganization followed by a CAT.

This example is Example 5A in the Existing Regulation, and the only change made by the Proposed Regulation (other than renumbering) is the substitution of the phrase "controlled asset transfer" for prior references to sec. 368(a)(2)(C) exchanges.

The facts are the same as in Example 6 with the following changes and additions: F's subsidiary R is now foreign; V and Z file a consolidated Federal income tax return; and V's subsidiary, Z, has three businesses -- A, B, and C. Businesses A and B qualify for the exemption in sec. 367(a)(3); business C does not. Z transfers all three businesses to F, and F, in turn, transfers businesses B and C to its wholly-owned subsidiary R.

Result: As in Example 6, F is the transferee corporation, and R is the transferred corporation. Regarding Business A, the example says only that "[t]he transfer of the Business A assets by Z to F is subject to the general rules under section 367, as such transfer does not constitute an indirect stock transfer." Regarding Businesses B and C, it is similarly cursory. Z must recognize gain on the transfer of Business C because it does not qualify for an exception under sec. 367(a)(1), and it must execute a GRA with respect to Business B because Business B *does* qualify for the sec. 367(a)(3) exception and "V is deemed to transfer the stock of Z to F in a section 354 exchange subject to the rules of paragraph (d)."



Comment:

1. Everything this example's "Result" paragraph says is correct, but for maximum clarity and ease of understanding, much more detail is needed. For instance, when Example 6B addresses the same facts and notes that the transfer of Business A is subject only to the general rules of sec. 367, it takes the next step and says "the Business A assets qualify for the section 367(a)(3) active trade or business exception." This addition is

extremely helpful, especially for newcomers to the sec. 367(a) rules and regulations, and it should be added to this example, too.

2. The remainder of the "Result" paragraph would benefit from similar expansion, along these lines:

"The re-transfer of the Business B and C assets makes them potentially subject to the IST rules, and therefore also subject to the rule in paragraph (d)(2)(vi) regarding coordination between the asset transfer rules and the IST rules. Because R is not a domestic corporation, neither of the exceptions in paragraph (d)(2)(vi)(B) applies, and therefore, the Business B and C transfers are evaluated first under the rules of sec. 367(a), and then, if they remain untaxed, under the paragraph (d) IST rules.

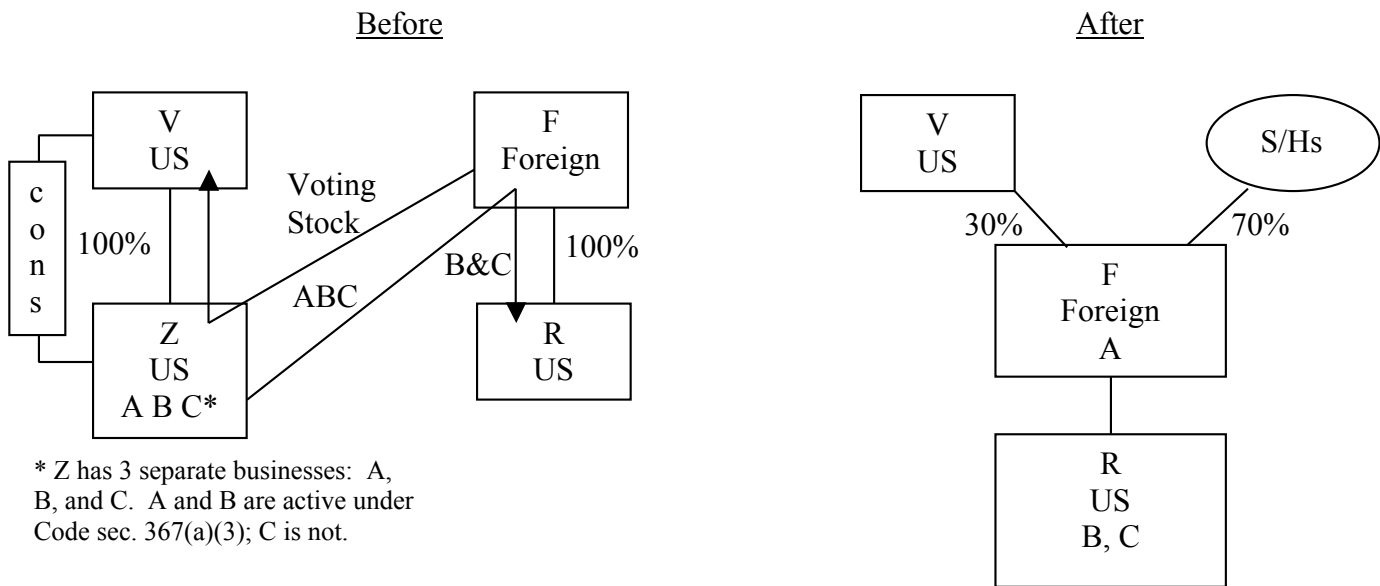
"The transfer of Business C is taxable under sec. 367(a)(1) because there is no exception that applies to it. For that reason, whether it would also qualify to be taxed as an IST is never considered.

"The transfer of Business B is not taxed under sec. 367(a)(1) because, as noted, it qualifies for the sec. 367(a)(3) exception. Therefore, it is next evaluated under the IST rules. Under paragraphs (d)(1) and (d)(1)(v), the transfer of Business B to F, followed by F's re-transfer of it to R, is an IST, and that part of the transaction is deemed a transfer of Z stock to F under section 354. Therefore, if the four conditions in paragraph (c)(1) are met (including execution of a GRA by V), Z may avoid taxation on the gain associated with the transfer of Business B's assets."

New Example 6B -- Section 368(a)(1)(C) reorganization followed by a CAT to a domestic controlled corporation.

This example is Example 5B in the Existing Regulation, but it has been revised extensively to reflect the anti-inversion changes to paragraph (d)(2)(vi)'s internal exception. It uses the same facts as Example 6A, except that R is a domestic corporation.

Result: Business B continues to qualify for the Code sec. 367(a)(3), "active conduct of trade or business" exception. The fact that R is now domestic allows Business C to escape sec.-367(a) taxation, too, thanks to the paragraph (d)(2)(vi)(B) exception. That notwithstanding, V is still deemed under paragraph (d) to have made an IST, this time of both Business B and C, and so must execute a GRA. The GRA is larger here than in Example 6A because Business C's escape from sec. 367(a) brings it within the IST rules, and therefore requires the gain on its assets to be included.



Comment:

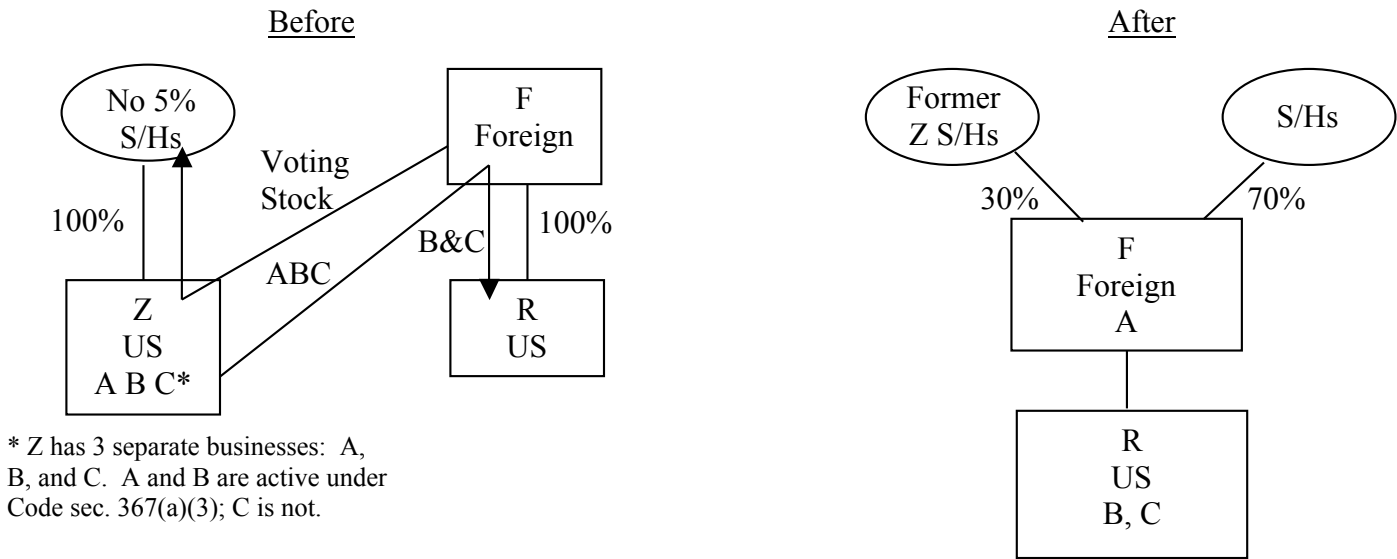
The "Result" paragraph in this example is expanded from an ease-of-understanding perspective. First, there is the new, second sentence that explains the effect of the general, sec. 367(a) rules on Business A. A new third sentence, which is not necessitated by the changes in the regulation, explains that the Business B and C assets must be tested under the sec. 367 rules first even though they qualify as an IST under paragraph (d).

The expanded fourth sentence demonstrates how small a helpful change can be. The parallel sentence in the Existing Regulation reads, "The Business B assets qualified for nonrecognition treatment; the Business C assets did not." The new sentence says, "The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not." Simply identifying the basis for Business B's nonrecognition treatment is a huge boost for less-experienced practitioners, and yet it is brief enough that more knowledgeable readers will be able to browse past it without delay.

New Example 6C – Section 368(a)(1)(C) reorganization followed by a CAT to a domestic controlled corporation.

The facts here are the same as in Example 6B, except that V, Z's domestic parent, has been replaced by an unstated number of individuals, none of whom qualify as 5 percent shareholders. Additional facts include the following: no U.S. persons who are officers or directors of Z own F stock immediately after the transfer, and F is engaged in an active trade or business outside the U.S. that satisfies the requirements of paragraph (c)(3).

Result: First, Business A assets are now taxable under sec. 367(a) because the sec. 367(a)(3) exception is blocked by sec. 367(a)(5). (The internal exception in (a)(5) does not apply as it did in Exs. 6A and 6B because there is no domestic corporation controlling Z.) Second, unless the requirements in paragraph (d)(2)(vi)(B) are met, Businesses B and C are tested under 367(a) and (d) before they are examined under paragraph (d). The requirements in paragraph (d)(2)(vi)(B)(i) cannot be met because Z is not owned by domestic corporations. However, the paragraph (d)(2)(vi)(B)(ii) requirements (namely, compliance with paragraphs (c)(1)(i), (ii), (iv), (c)(6), and (d)(2)(vi)(C)) are or can be met. Therefore, the gain on both Business B and C is eligible for nonrecognition.



Comment:

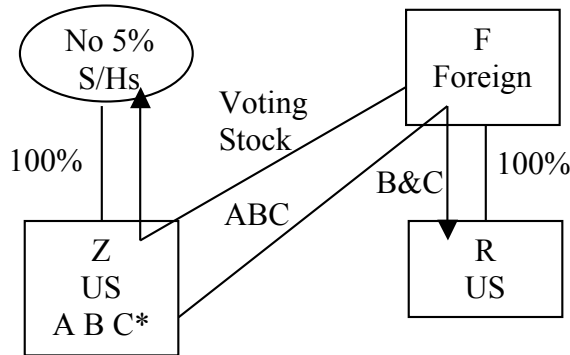
This example highlights the difference between the Code sec. 367(a)(3) "active conduct of a trade or business exception," which applies only if assets are transferred to a foreign transferee for use in the qualifying trade or business outside the US, and the paragraph (c)(3) active trade or business test, which requires, *inter alia*, that the foreign transferee (or its qualified subsidiary or partnership) have been engaged in an active trade or business outside the US for the 36 months immediately prior to the transaction (no "use outside the U.S." requirement).

New Example 6D -- Section 368(a)(1)(C) reorganization followed by a CAT to a domestic controlled corporation.

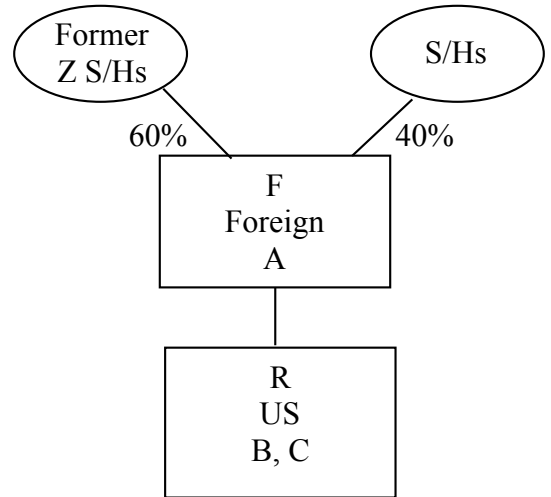
The facts are the same as in Example 6C, but now the individual Z shareholders get 60 percent of F's stock for their Z stock instead of only 30 percent.

Result: for Business A assets, the same; for Businesses B and C, doom. The (d)(2)(vi)(B)(ii) requirements now cannot be met because one of them, compliance with paragraph (c)(1)(i), requires that the U.S. transferors receive "50 percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation." Therefore, the gain on both Business B and C will have to be recognized.

Before



After



* Z has 3 separate businesses: A, B, and C. A and B are active under Code sec. 367(a)(3); C is not.

Example 8B -- Concurrent application of asset transfer and indirect stock transfer rules in a triangular C reorganization involving an individual U.S. shareholder.

Example 8C -- Concurrent application of asset transfer and indirect stock transfer rules in a triangular C reorganization involving a nonresident alien shareholder.

Both these examples appear in the Existing Regulation (albeit numbered as 7B and 7C) and are included in the Proposed Regulation without substantive change. Both examples begin their statements of the facts with "[t]he facts are the same as in Example 8." This phrase in both examples should be changed to read "[t]he facts are the same as in Example 8A."

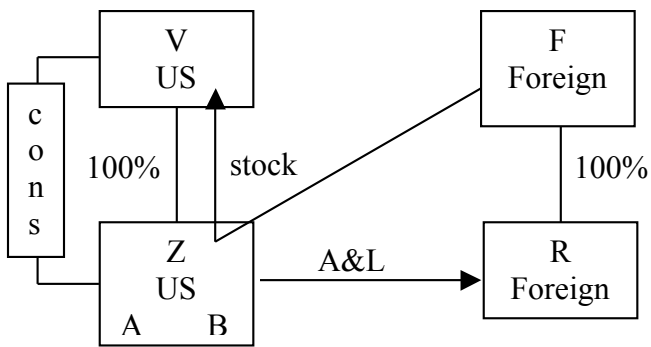
Example 8 states that domestic corporation V and its wholly-owned domestic subsidiary Z file a consolidated Federal income tax return. Example 8A changes these facts to state that V and Z do not file a consolidated return. Examples 8B and 8C alter the identity of V to an individual U.S. citizen and a nonresident alien respectively. Because only an affiliated group of corporations can file a consolidated return,⁹¹ the statements of facts in Examples 8B and 8C should be changed to adopt the statement of facts in Example 8A.

⁹¹ See Code sec. 1501.

New Example 9 -- Concurrent application of the asset transfer and IST rules in the context of a triangular C followed by a CAT.

This example uses the same basic fact pattern as Example 6 with the variations added by Example 8 and a few additional changes. As the diagrams below show, acquiring subsidiary R is now foreign, domestic target Z and its domestic parent V file a consolidated return, and Z owns two businesses, A and B. Business B qualifies for the Code sec. 367(a)(3) exception, but Business A does not. V receives 30 percent of the stock of F when Z transfers A and B to R. R, as part of the same transaction, transfers Business A to its wholly-owned domestic subsidiary M in a CAT.

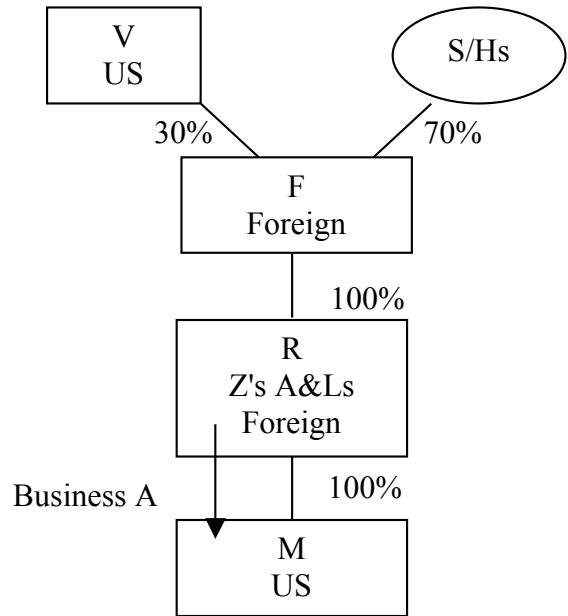
Before



After



Controlled Asset Transfer (CAT)



Result: The transferee corporation is F, and the transferred corporation is M. As in Example 6C, unless the requirements in paragraph (d)(2)(vi)(B) are met, Businesses A and B will be tested under 367(a) and (d) before they are examined under the IST rules of paragraph (d) of the Proposed Regulation. Paragraph (d)(2)(vi)(B) can only apply to Business A, and because its requirements can be met, Business A's built-in gain is eligible for non-recognition. Business B is subject to the general coordination rule, and it also escapes taxation because, when examined first under the asset transfer rules, it qualifies for the sec. 367(a)(3) exception. Because the transaction is an IST in which 5 percent or more of the transferee corporation is received, V must execute a GRA for all the unrecognized gain. Three events will be able to trigger the GRA: disposition of R stock by F, disposition of M stock by R, and a disposition of substantially all the Business A and B assets by M and R.

Comment:

1. Like Example 6C, this example demonstrates the order of precedence in the coordination of the asset transfer and IST rules. The general coordination rule is that transactions are tested against the sec. 367(a) rules first, and only if they are not taxed at that point does the possibility of taxation under the IST rules arise. However, if the "CAT to a domestic subsidiary" exception in paragraph (d)(2)(vi)(B) applies, it does not rescue gain that has already been deemed taxable under the general rule; rather, it steps in front of the general rule and prevents its application entirely.

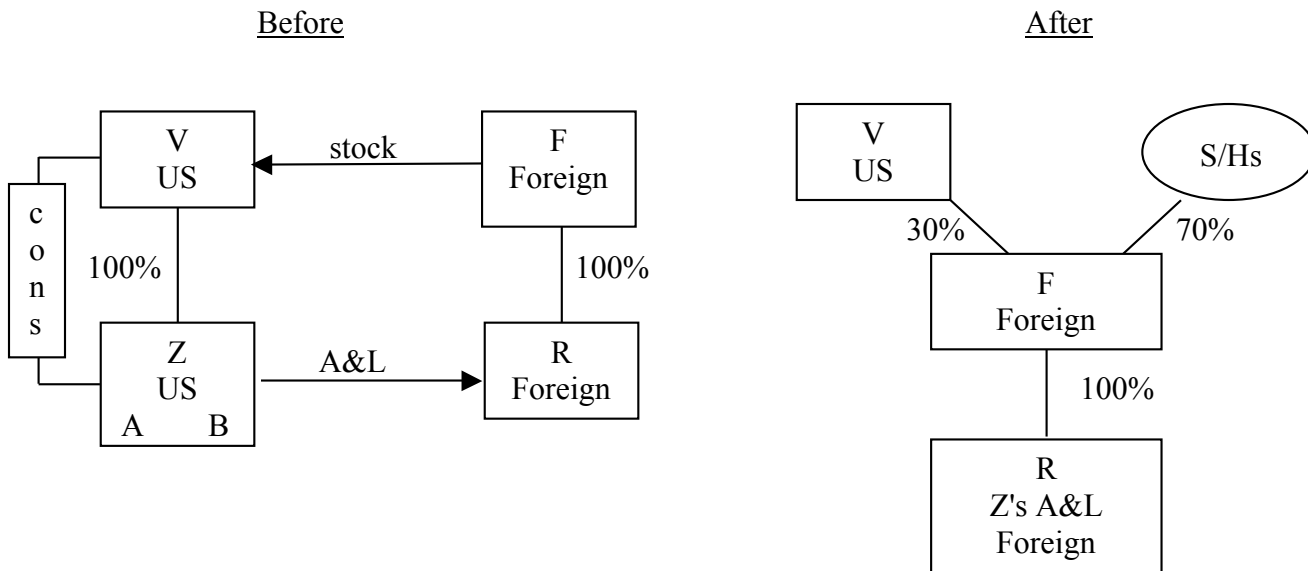
2. The facts in this example state that "V's basis in its Z stock is \$90." Because the facts also import the facts of Example 8, we know that the fair market value (FMV) of the Z stock is \$200. Therefore, when the "Result" paragraph states that "the gain (\$100) realized [by V] on the Z stock" is not recognized if V executes a GRA, it is clear that an error has been made. The facts should be revised either to state that the FMV of Z is \$190, so that the \$100 gain in the "Result" paragraph is correct, or the "Result" paragraph should be revised to state that V's realized gain on the Z stock is \$110, to correspond with the facts as presented.

3. For maximum clarity, the last sentence in the "Result" paragraph, which addresses triggering of the GRA by a "substantially all" asset disposition, should refer the reader to paragraph (d)(2)(v)(D), which defines the assets to be addressed in the case of a triangular C followed by a CAT.

New Example 10 -- Concurrent application of the asset transfer and IST rules in a forward triangular reorganization described in sections 368(a)(1)(A) and (a)(2)(D).

The facts are, again, the same as in Example 8. F owns R; V and Z file a consolidated return; Business B qualifies for the sec. 367(a)(3) exemption, and Business A does not. As before, Business A has a FMV of \$90 and a basis of \$50; Business B has a FMV of \$110 and a basis of \$50; and V's Z stock has a FMV of \$200 and basis of \$100. The only change is that the transaction is a forward triangular instead of a triangular C.

Result: As in Example 8, the transfer of assets directly from Z to R is tested under sec. 367(a) first. There is no sec. 367(a) exception for Business A, so \$40 gain must be recognized. Because V and Z file a consolidated Federal income tax return, that \$40 is added to V's basis in its Z stock, creating a new basis of \$140. Sec. 367(a)(3) exempts Business B from the purview of sec. 367(a)(1) because the application of sec. 367(a)(5) is blocked by its internal exception (Z is owned by a domestic corporation, V). Therefore, if the requirements of paragraph (c)(1) are met, including execution by V of a GRA for \$60 (the \$200 FMV of V's Z stock minus V's updated \$140 basis), the transfer of Business B will be nonrecognition. Only if F sells some of its R stock, or R disposes of substantially all of the Business B assets before the GRA expires, will V be required to pay tax. Only the Business B assets will count with respect to the "disposition of substantially all assets" GRA trigger because the Business A assets were taxed under sec. 367(a).



Comment:

The basic fact pattern in the example -- a domestic corporation and a foreign corporation participating in a statutory merger described in Code sec. 368(a)(1)(A)/(a)(2)(D) -- is predicated on the finalization of Prop. Treas. Reg. sec. 1.368-

2(b)(1)(ii),⁹² which would expand the definition of mergers under Code sec. 368(a)(1)(A) to include transactions effected pursuant to non-U.S. statutes, and thus bring them within the purview of sec. 367(a). At present, statutory mergers are limited to transactions in which both the acquired and the acquiring corporations are domestic.⁹³

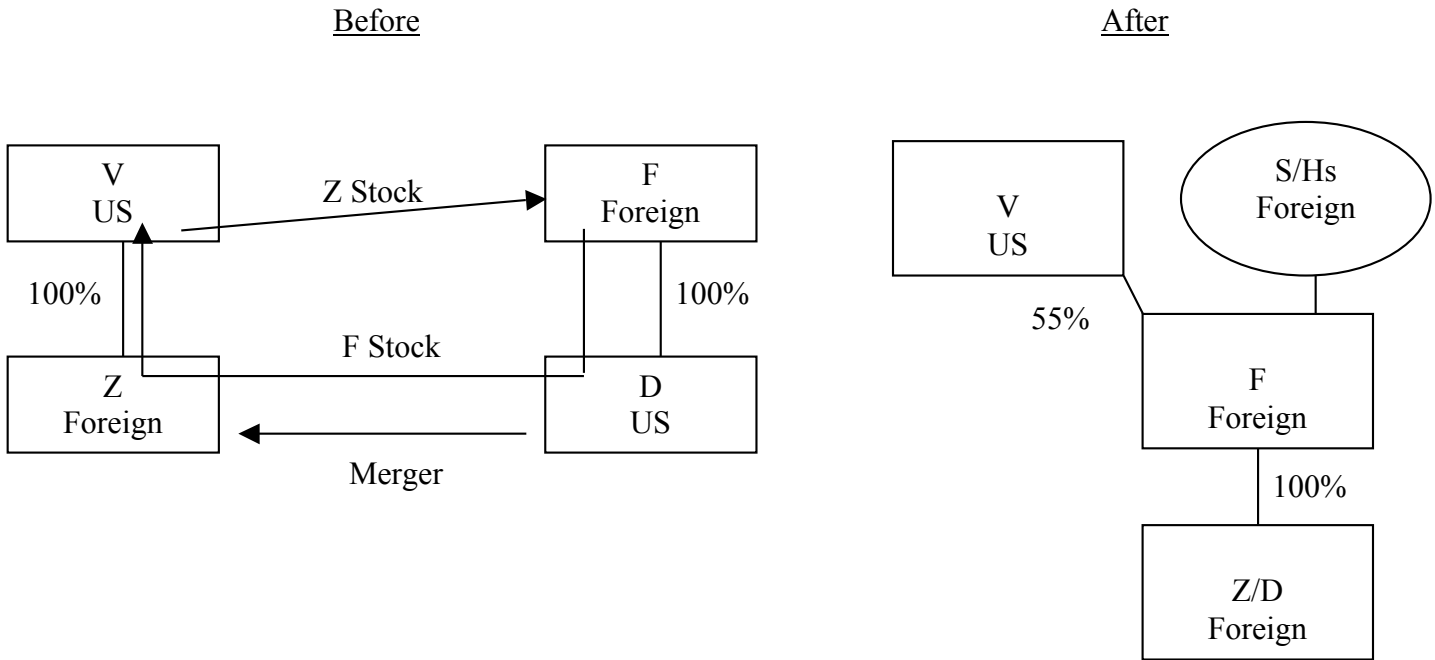
This is one of three new examples that illustrate the application of Prop. Treas. Reg. sec. 1.368-2(b)(1)(ii). The other two are Examples 11 (a reverse triangular merger) and 15 (another forward triangular).

⁹² See 70 Fed. Reg. 746, 747 (2005) ("For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation, . . .").

⁹³ See Treas. Reg. sec. 1.368-2T(b)(1)(ii) ("For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the laws of the United States or a State or the District of Columbia, . . .").

Example 11 -- Reverse triangular reorganization described in sections 368(a)(1)(A) and (a)(2)(E).

The facts are new, but the pattern is still fairly familiar. As the diagrams show, F owns D, which is identified as an "operating corporation," and V owns Z. D, which has a basis of \$60 and FMV of \$100, merges into Z in a reverse triangular, and V swaps its Z stock for 55 percent of F. In the end, V is a controlling shareholder of F, which owns Z.



Result: First, this transaction falls under the purview of paragraph (b) of the Proposed Regulation because it is a foreign-to-foreign, or "F2F" IST exchange (shares of foreign subsidiary Z are exchanged for shares of foreign parent F). If V enters into a GRA, as any 5 percent-plus owner after an F2F can, then pursuant to paragraph (b)(2)(i)(B), the fact that tax was avoided under Code sec. 367(a) allows sec. 367(b) to apply (*i.e.*, sec. 367(a) applies first). According to paragraph (b)(2)(i)(A), only if the transaction had been 1) inbound (a transfer of assets from a foreign to a domestic corporation), 2) subject to Treas. Reg. secs. 1.367(b)-3(a) and (b), and 3) also subject to the IST rules, would sec. 367(b) have applied before sec. 367(a).⁹⁴ So sec. 367(a) gets the first tax bite at the F2F transaction (except for certain inbound, 1.367(b)-3(a) and (b) exchanges), and only if it fails to assess tax does sec. 367(b) come into play.

Second, under Treas. Reg. sec. 1.367(b)-4(b), no income inclusion is required because after the exchange, both the merging subsidiary's foreign parent F (which gives

⁹⁴ This circumstance is illustrated in Example 15.

up 55 percent of its stock) & foreign target Z (which was a controlled foreign corporation (CFC) before transaction) end up as CFCs as to which V is a section 1248 shareholder.⁹⁵

Third, the transfer of D's assets to Z is taxable under sec. 367(a) because sec. 367(a)(5) blocks application of the sec. 367(a)(3) exception.⁹⁶

Comment:

1. This is a particularly interesting example because there are two separate but overlapping exchanges that have sec. 367(a) consequences: first, the transfer of D to Z, and second, the deemed transfer of Z stock to F.

2. As noted above in the comments following Example 10, this is one of three new examples involving statutory mergers between foreign and domestic corporations that are predicated on finalization of Prop. Treas. Reg. sec. 1.368-2(b)(1)(ii).⁹⁷

⁹⁵ Example 14 in the Proposed Regulation, which is brought forward from the Existing Regulation without change other than renumbering, illustrates the result when a CFC is transferred to a non-CFC: the sec. 1248 amount is taxed, and the remainder of the gain can be subject to a GRA.

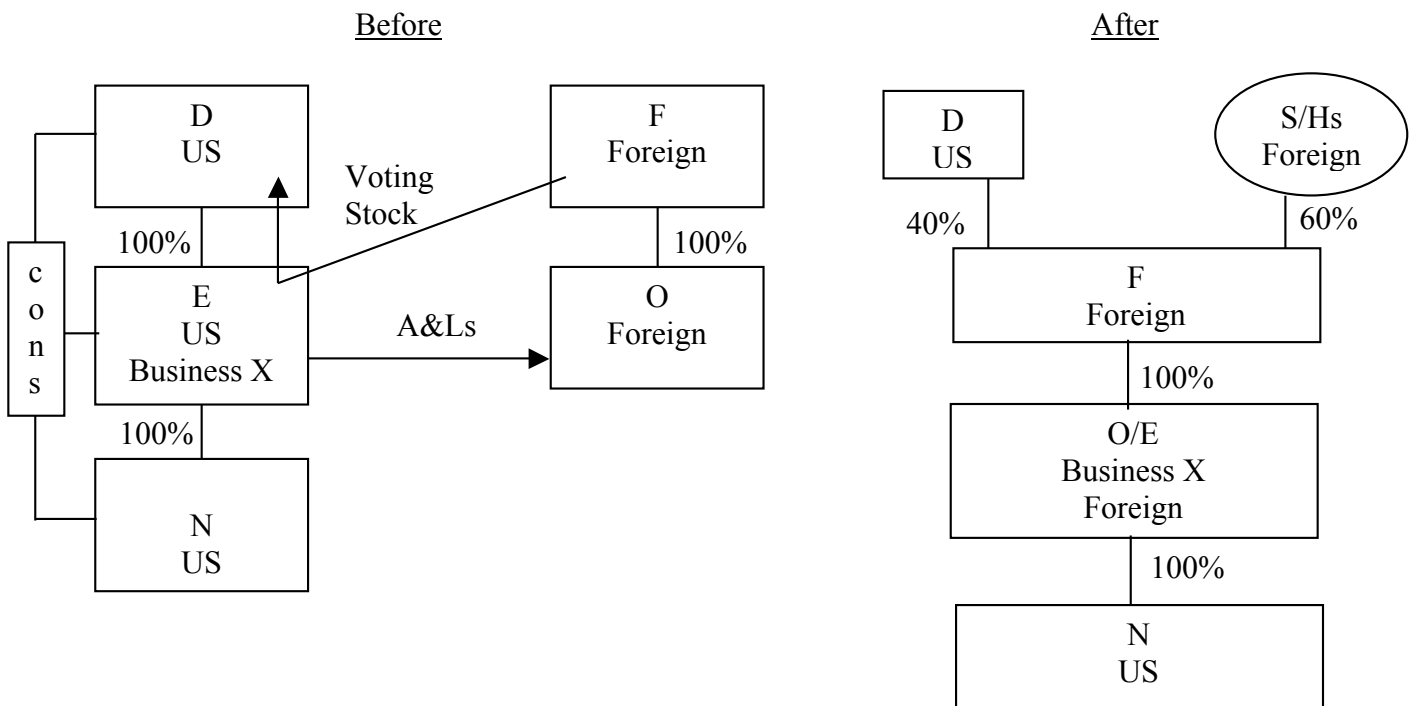
⁹⁶ Code sec. 367(a)(5) cannot be disabled by its internal exception because D, the transferor corporation, has no domestic corporate parents.

⁹⁷ See *supra* text accompanying notes 92-93.

Example 12 - Concurrent application of direct and indirect stock transfer rules in a triangular reorganization described in section 368(a)(1)(C).

This is Example 9 in the Existing Regulation, and it is included in the Proposed Regulation with no change other than renumbering. Consequently, we provide only as many details of the transaction as are required to provide a context for our comments.

As the diagrams below show, the example posits a triangular C reorganization in which domestic subsidiary E (owned by domestic parent, D) transfers both stock of E's wholly-owned subsidiary N and the assets of Business X to O, a foreign subsidiary of foreign parent F. Both D's gain on the IST of E's stock, and E's gain on the transfer of N, may qualify for nonrecognition. However, because D, E, and N file a consolidated return, both GRAs must be executed by consolidated parent D.



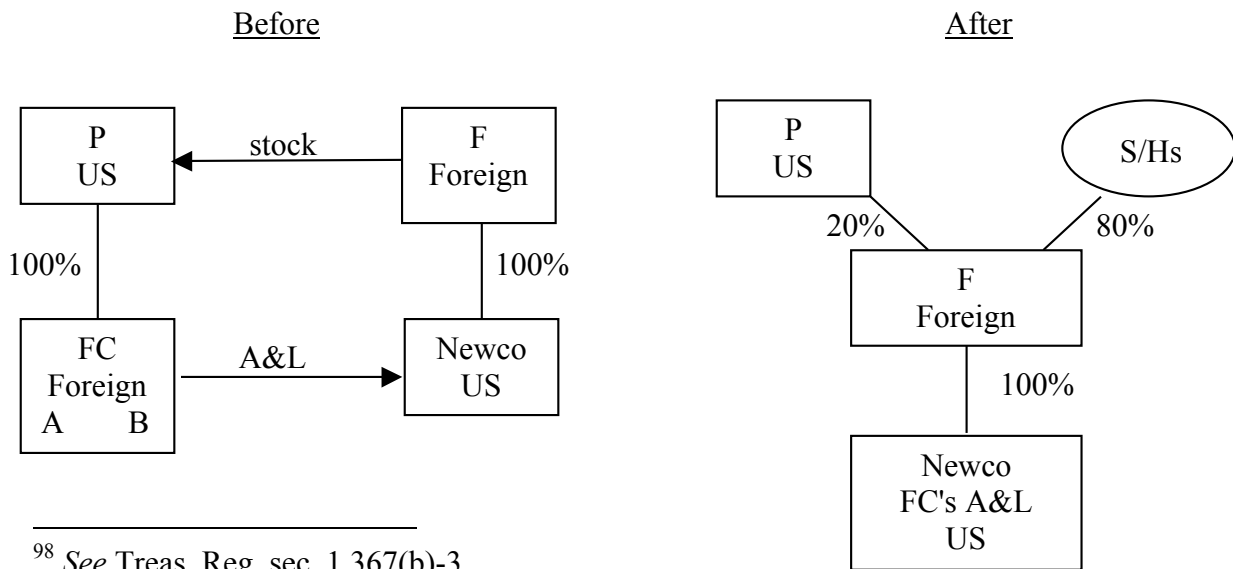
Comment:

1. The example needs to state that either F or O operates a historical business to give a basis for concluding that it is possible, as a predicate for the GRA, for the paragraph (c)(3) active trade or business test to be satisfied.
2. The "Result" paragraph says in separate sentences that both D and E may qualify for nonrecognition if they execute separate GRAs and satisfy "all the requirements of paragraph (c)(1)(i)." Paragraph (c)(1)(i) is just one of the four conditions that must be met to qualify for a GRA with respect to an outbound transfer. Therefore, the reference should be changed to "all the requirements of paragraph (c)(1)."
3. In the interest of clarity and ease of understanding, it would be helpful to state the amount of the GRA executed on behalf of E.

New Example 15 -- Concurrent application of IST rules and section 367(b) in the context of a forward triangular reorganization described in sections 368(a)(1)(A) and (a)(2)(D).

As the diagrams below show, F owns Newco, and P owns FC. P's basis in FC is \$50, FC's FMV is \$100, and FC's all earnings and profits amount ("all E&P") is \$60. In a forward triangular merger, Newco gets the assets of FC, and P exchanges its FC stock for 20 percent of F's stock.

Result: As noted in Example 11, under paragraph (b)(2)(i)(A), the sec. 367(b) rules apply first in an inbound transfer of assets if the IST rules and Treas. Reg. secs. 1.367(b)-3(a) and (b) apply. That is exactly what happens here. Under the sec. 367(b) rules, P must include FC's \$60 all E&P amount in income.⁹⁸ That increases P's basis in FC from \$50 to \$110. This transaction is also taxable as an IST, but there is no gain to tax because P's basis is now higher than FC's FMV.⁹⁹ If FC's all E&P amount had been \$30, then P's basis would have increased to \$80, and it would have been liable under sec. 367(a)(1) for tax on the \$20 difference between that \$80 and FC's \$100 FMV unless it chose to execute a GRA.



⁹⁸ See Treas. Reg. sec. 1.367(b)-3.

⁹⁹ Calianno and Olin note that "the resulting loss (if and when recognized) will often be a capital loss rather than ordinary loss. . . . Further, although not addressed in [this] example, under the approach of the 2000 Proposed Regulations under Section 367(b), Newco would inherit only the NOL and capital loss carryovers (if any) that were effectively connected to a U.S. trade or business that FC conducted in the U.S. (or attributable to a permanent establishment that FC had in the U.S. if there were an applicable U.S. income tax treaty). Also, any other E&P of FC generally would be eliminated, unless such E&P are effectively connected with a U.S. trade or business (or attributable to a permanent establishment that FC had in the U.S. if there were an applicable U.S. income tax treaty). Finally, under Section 362, Newco generally would inherit the basis that FC had in its assets, subject to Section 362(e)." Calianno and Olin, *supra* note 36, at 64.

Comment:

This is another example (along with Exs. 10 and 11) that is predicated on finalization Prop. Treas. Reg. sec. 1.368-2(b)(1)(ii).¹⁰⁰ Under the current regulations interpreting Code sec. 368(a)(1)(A),¹⁰¹ both corporations in a statutory merger must be domestic.

¹⁰⁰ *See supra* note 92.

¹⁰¹ *See supra* note 93.

5. *Paragraph (e) – Effective dates*

The effective date for paragraphs (a), (b), and (d) in the Existing Regulation is July 20, 1998. The Proposed Regulation retains this date¹⁰² but notes that three new provisions have their own effective dates. Those provisions are the "sec. 367(b) first" rule in paragraph (b)(2)(i)(A), the "domestic-for-domestic" triangular B rule in paragraph (d)(1)(iii)(B), and the new coordination rule for the asset transfer and IST rules in paragraph (d)(2)(vi). The effective date for each of these three provisions will be the date the Proposed Regulation is published as a final regulation in the Federal Register.

Paragraph (e) also notes a category of provisions that will not be effective until publication of the final regulation: any rules in paragraphs (a) and (d) that "apply to section 368(a)(1)(A) reorganizations (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or acquired corporation."

¹⁰² When Hal Hicks, IRS Associate Chief Counsel (International), was questioned about this apparent retroactivity at the May 19, 2005 meeting of the Taxation Committee of the United States Council for International Business, he stated that no portion of the Proposed Regulation was intended to be retroactive. *Cf. supra* note 53 and accompanying text.