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Eliminating a Domestic Sandwich

LTR 201250004

LTR 201250004 involved a domestic corporate Parent's purchase of a foreign group that had one domestic subsidiary. This is a common situation and Parent, like most acquirors, wanted the domestic subsidiary to be owned within its U.S. group and not to be separated under the newly purchased foreign group. The purchased FCo could have distributed up the stock of the domestic subsidiary to Parent, but that could have produced foreign earnings and profits and an inbound dividend, among other unnecessary results.

Instead, Parent caused the purchased corporation, FCo, to become a domestic corporation, which had the effect of bringing the one domestic sub into Parent's group. That left Parent also directly owning numerous CFCs that were no longer under a foreign holding company. In order to reimpose a foreign holding company, Parent caused the CFCs to do D reorganizations into a new Foreign Acquiror that it owned.

The net result was a combination of an inbound F reorganization and foreign-to-foreign D reorganizations that sort of look like a liquidation-reincorporation of FCo, but without a liquidation (or without a liquidation that was treated as a liquidation).

The specific steps were as follows:

- Parent bought the stock of FCo for cash loaned to its wholly owned, newly created F-LLC1, a disregarded entity (DRE), in exchange for its notes. Presumably, F-LLC1 is a corporation in its home country and normally will deduct the interest paid to Parent, but as will be seen, evidently the notes were canceled in effect.
- Parent contributed its F-LLC1 stock and notes to DSub, a newly created, wholly owned domestic subsidiary. Several following steps involved DSub. It was used because it would be a new company and the liquidation of FCo into DSub could be treated as an F reorganization, whereas its liquidation into Parent would have been a C reorganization.
- FCo liquidated (The Reincorporation) into DSub. This step had the effect of bringing the subsidiaries (Targets) of FCo into the direct ownership of DSub. Ruled: F reorganization.
- One of the upward movements was accomplished by a foreign DRE selling the domestic Sub in the FCo group up to DSub in exchange for the notes originally obtained from F-LLC1, and then the notes were pushed back up to DSub and

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then into F-LLC1, the obligor, in disregarded transactions. None of this was regarded for U.S. tax purposes. It was done to eliminate a "foreign sandwich," where Parent indirectly owned FCo, which owned Sub, a domestic corporation. Because F-LLC1 acquired its own notes, presumably, even for foreign purposes, it is no longer a debtor. Therefore, the creation of the notes appears to have been done principally for foreign tax treatment of the sale of the stock of domestic Sub to DSub.

- The foregoing steps have been completed without a ruling. Perhaps the taxpayer did not contemplate the following steps when it did the Reincorporation? Thus, the Reincorporation was a one-step, inbound change in the state of incorporation from a foreign country to a U.S. state. The following steps would be a "liquidation-reincorporation," if the Reincorporation were viewed as a liquidation into DSub, which it was not.
- DSub creates a foreign subsidiary (Foreign Acquiror) and contributes the assets of the liquidated FCo, the Targets, to it (stripped of the domestic Sub). This is called the Exchange to the extent of less than wholly owned subsidiaries (ruled Section 351 exchanges to which Section 304 applies as to contributions of stock of corporations not reorganized to the extent of debt assumed), and The Reorganizations to the extent of wholly owned foreign Targets, because they are then liquidated into Foreign Acquirer (ruled acquisitive D reorganizations).
- This final step may have been done for foreign tax purposes because the Foreign Acquiror may be treated for foreign tax purposes as a partnership owned by U.S. corporate partners. For foreign purposes, the Foreign Acquirer will still own foreign corporations because the liquidations were by "checking the box," meaning that Foreign Acquirer is a corporation without subs for U.S. purposes.

The treatment of the contribution of stock of FCo into a new holding company (DSub) followed by the liquidation of the contributed corporation as an F reorganization is unremarkable. In this context, it results in closing the year of FCo (not usual for F reorganizations) and transferring the E&P of FCo to DSub. The treatment of the cross chain asset transfers of the Targets into Foreign Acquiror as D reorganizations is unremarkable.

Perhaps the taxpayer wanted a ruling because it had done in two steps a restructuring that most taxpayers might have done in one set of steps. The common foreign sandwich problem was eliminated in the first step. This way of dealing with it is fairly straightforward.

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