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Domestic Subsidiary Not Taxable on Complete Liquidation into Foreign Parent, Except for Certain Intangibles

In PLR 201348011, the IRS ruled that a U.S. subsidiary would not recognize gain or loss on the distribution of its assets to its foreign parent in complete liquidation—except for gain attributable to Section 936(h)(3)(B) intangibles. The letter ruling offers some positive insight on the IRS' application of the nonrecognition exception and the general anti-avoidance rule in the Section 367 regulations.

Facts

Parent, a foreign parent corporation, conducts business in the United States through USCo, an entity formed in the United States and treated as a corporation for U.S. tax purposes. USCo directly owns two LLCs, Opco 1 and Opco 2, which are disregarded entities for tax purposes. Opco 2 owns Opco 2 Sub, a domestic subsidiary corporation. USCo and Opco 2 file a consolidated return.

Parent proposes to have USCo transfer the assets and liabilities of Opco 1 and Opco 2 to a new U.S. limited partnership (LP) and then liquidate, so that Parent would directly own LP. Specifically, Opco 2 Sub would convert to an LLC; USCo would form a wholly owned LLC ("GPCo"), which would be a disregarded entity for tax purposes; GPCo would purchase nominal interests in Opco 1 and Opco 2 directly from each company; Opco 1 and Opco 2 would transfer all of their assets and liabilities to LP and then dissolve; and finally, USCo would liquidate and distribute its interests in LP and GPCo to Parent.

The transaction is intended to qualify as a complete liquidation of a subsidiary under Section 332. The taxpayer represented, among other things, (i) that the assets of USCo, other than U.S. real property interests and the stock of Opco 2 Sub, had been and would continue to be used in a trade or business for at least 10 years; and (ii) that USCo would recognize gain with respect to its distribution of any intangibles described in Section 936(h)(3)(B).

Background

Generally, under Section 337, a liquidating corporation does not recognize gain or loss on distribution of any property to an 80-percent distributee (defined in Section 337(c)) in a complete liquidation to which Section 332 applies. Absent a regulatory exception, Section 367(e) denies nonrecognition treatment under Section 337 where the 80-percent distributee is a foreign corporation.

The regulations provide an exception to Section 367(e) for distributions of property used in a U.S. trade or business. To qualify for the regulatory exception, the foreign distributee must use the distributed property in the conduct of a U.S. trade or business immediately after the distribution and 10 years thereafter, and the domestic liquidating corporation and foreign distributee must fulfill certain filing obligations. Even this regulatory exception, however, is subject to the limitation that gain must be recognized on the outbound transfer of intangibles described in Section 936(h)(3)(B). The regulatory exception is further subject to a general anti-abuse rule: the IRS may require the domestic liquidating corporation to recognize gain on a distribution in liquidation if a principal purpose of the transaction is to avoid U.S. tax.

Ruling

Based on the taxpayer's information and representations, the IRS concluded that USCo would not recognize gain or loss on distribution(s) in complete liquidation to Parent, except gain attributable to Section 936(h)(3)(B) intangibles (as the taxpayer notably represented). In ruling that the regulatory nonrecognition exception to Section 367 applies, the ruling seemingly accepts that the transaction is not being undertaken to avoid tax, noting that the liquidation is proposed "[f]or what have been represented as valid accounting and financial purposes."

IRS Releases Final, Temporary and Proposed Regulations on Passive Foreign Investment Companies

Just before the close of 2013, the IRS issued final, temporary and proposed regulations (T.D. 9650) relating to determining ownership of passive foreign investment companies (PFICs) and annual reporting requirements.

Background

A foreign corporation is a PFIC if either (i) 75 percent or more of its gross income is passive income or (ii) 50 percent or more of the average value of its assets comprises assets that produce passive income. Currently, the Code has three sets of rules to penalize and/or prevent income tax deferral by U.S. owners of PFICs: (1) the default, excess distribution regime of Section 1291, (2) the qualified electing fund (QEF) regime of Section 1293 and (3) the mark-to-market (MTM) regime of Section 1296.

The IRS issued proposed regulations under Sections 1291, 1293, 1295 and 1297 concerning the taxation of PFIC shareholders on distributions from the PFICs or on disposition of PFIC stock. The Taxpayer Relief Act of 1997 brought the MTM regime of Section 1296 and a PFIC-controlled foreign corporation coordination rule under Section 1297. The HIRE Act of 2010 added Section 1298(f), requiring any U.S. shareholder of a PFIC to file an annual report and extending the limitations period on assessment for failure to comply.

Notice 2010-34 suspended the Section 1298(f) requirement to file Form 8621 (Information Return by a Shareholder of a PFIC or QEF). In Notice 2011-55, the IRS announced its intention to issue more regulations under Section 1298(f) and to revise Form 8621. The 2011 Notice suspended Section 1298(f) reporting until the new form was released.

New Regulations

The temporary regulations generally incorporate definitional provisions of the 1992 proposed regulations, with updates for subsequent statutory changes. The temporary regulations further provide that the stock attribution rules apply to both domestic and foreign entities, including special rules for grantor and nongrantor trusts (e.g., each beneficiary of a domestic or foreign estate or nongrantor trust is considered to own a proportionate share of the stock held by the estate or trust).

The new rules also address filing requirements under Section 1298(f). Generally, a U.S. shareholder of a PFIC must file Form 8621. With some exceptions, this filing requirement applies to domestic estates, nongrantor trusts and U.S. persons treated as owners of any domestic or foreign grantor trust. Regulatory exceptions to the Section 1298(f) requirement include categorical exceptions (e.g., for tax-exempt organizations or individual retirement plans), as well as quantitative filing thresholds. For example, an individual need not file Form 8621 if he or she is not subject to tax under Section 1291 and either (i) the value of all PFIC stock owned by the individual does not exceed $25,000; or (ii) the PFIC stock is owned by the individual through another PFIC, and the value of the shareholder's share of the high-tier PFIC's interest in the lower-tier PFIC does not exceed $5,000. The new rules apply only to annual reporting under Section 1298(f) for years ending on or after December 31, 2013.

Conclusion

The new PFIC regulations should be fairly welcome guidance. The new rules further illuminate a murky area of the law and even eliminate filing burdens with respect to PFICs for a number of investors. (However, the clarified attribution and ownership determination rules may undercut this relief.) Notably, the IRS apparently will not require reporting under Section 1298(f) by taxpayers who otherwise had no obligation to file Form 8621 for the suspended years in the 2010 and 2011 Notices. Nevertheless, the IRS noted in T.D. 9650 that nothing in the new temporary regulations relieves a person from having to file Form 8621 under provisions other than Section 1298(f) or the new regulations.

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