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International Tax ADVISORY ■

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New Regulations on F Reorganizations

In late September, the IRS issued final regulations describing six requirements for a transaction or series of transactions to qualify as a reorganization under Section 368(a)(1)(F) (an "F reorganization"). The IRS simultaneously released final rules under Section 367 concerning the treatment of outbound F reorganizations. The recent final regulations largely reflect prior regulatory and administrative guidance on F reorganizations with little significant alteration.

Background

Under Section 368(a)(1)(F), a tax-free reorganization includes "a mere change in identity, form, or place of organization of one corporation, however effected" (a "mere change"). Although the Code refers to a mere change with respect to "one corporation," an F reorganization can generally be understood as the actual or deemed transfer of assets by one corporation (the "transferor corporation") to another (the "resulting corporation") in exchange for stock, which the transferor corporation distributes to its shareholders in complete liquidation. The tax treatment of F reorganizations generally treats the resulting corporation as a continuation of the transferor corporation—e.g., the taxable year of the transferor corporation does not close and the resulting corporation can carry back losses.

Regulations proposed in 2004 (the "2004 Proposed Regs"), drawing on judicial and administrative interpretations, provided that if a corporation changed its corporate shell while satisfying four requirements for a mere change, the resulting corporation would be treated as the "functional equivalent" of the transferor corporation. The requirements: (1) all stock of the resulting corporation had to be issued as the stock of the transferor corporation; (2) there could be no change in ownership, other than a change that had only the effect of a redemption of less than all the stock; (3) the transferor corporation had to completely liquidate; and (4) the resulting corporation could not hold property or have any tax attributes immediately before the transfer. Notwithstanding the four conditions, the 2004 Proposed Regs allowed for some nominal transactions necessary to facilitate the organization or preserve the existence of the resulting corporation and permitted the resulting corporation to hold funds borrowed in connection with the transaction.

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The 2004 Proposed Regs, relying on the statutory language "however effected" and IRS practice, further acknowledged that a series of transactions could qualify as an F reorganization and that an F reorganization could be a step in a larger transaction. Consistent with Rev. Rul. 96-29, the proposed regulations stated that events occurring before or after and related to a transaction or transactions constituting a mere change (events "in the bubble") would not cause the mere change to fail to be an F reorganization (the "Related Events Rule"). Further, the 2004 Proposed Regs said that a shareholder's receipt of money or property (including in exchange for its stock) from the transferor corporation or the resulting corporation in an F reorganization would be treated as a distribution from the transferor corporation immediately before the transaction and thus not subject to Section 356.

Proposed and final regulations issued in 2005 partially adopted the 2004 Proposed Regs. Significantly, the 2005 regulations provided that the continuity of interest and continuity of business enterprise requirements applicable to other types of reorganizations would not apply to F reorganizations. The Treasury and IRS indicated that they were continuing to study issues in the 2004 Proposed Regs.

In 1990, the IRS issued temporary and proposed regulations (the "1990 Regs") under Section 367(a), (b) and (e) concerning outbound F reorganizations—F reorganizations where the transferor corporation is domestic and the resulting corporation is foreign. The 1990 Regs generally reflected IRS Notices 88-50 and 87-29 and Rev. Rul. 87-27, guidance that stated that the transferor corporation's taxable year closes in an outbound F reorganization and clarified that there was an actual or constructive transfer of assets and exchange of stock in an outbound F reorganization. The taxable year closing carries consequences for the carryover of attributes under Section 381, while the deemed asset transfer and stock exchange implicate Section 367(a).

2015 Final Regulations

The recently issued final regulations generally adopt the 2004 Proposed Regs on qualification that were not previously adopted by the 2005 regulations, with some changes, and finalize the 1990 Regs on outbound F reorganizations, with conforming revisions to other rules. A notable change is the addition of two requirements for F reorganization qualification: (1) the resulting corporation must be the only acquiring corporation and (2) the transferor corporation must be the only acquired corporation. These requirements help ensure that the F reorganization is not an acquisitive or divisive transaction. Like the 2004 Proposed Regs, the final regulations permit some limited exceptions from the six requirements.

While the final regulations embrace the Related Events Rule from the 2004 Proposed Regs, the IRS cautions that related events may have implications for international tax provisions of the Code. The preamble specifically notes that related events may be relevant to the anti-inversion rules under Section 7874—particularly as amplified in Notice 2014-52—and to the determination under Section 367(b) of whether stock of the resulting corporation is stock of a controlled foreign corporation.

The final regulations are effective for transactions on or after September 21, 2015.

Continued Focus on FATCA

Despite the hopes of many, the Foreign Account Tax Compliance Act (FATCA) has not been repealed and continues to be a focus for the Treasury and IRS. Indeed, a federal district court recently denied a preliminary injunction in an anti-FATCA (and anti-FBAR) suit, *Crawford, et. al., v. Dept of Treasury*, concluding that the plaintiffs were unlikely to succeed on the merits for lack of standing. The IRS proudly announced that it met the September 30, 2015, deadline for reciprocal automatic exchange of FATCA information. Meanwhile, the Treasury recently concluded FATCA-related competent authority agreements with the United Kingdom and Australia.

On a more positive FATCA note, the IRS issued Notice 2015-66, which would extend the period of time for certain transitional rules to apply. Amended regulations would further postpone withholding on gross proceeds to dispositions after 2018 and on foreign passthru payments until the later of January 1, 2019, or the publication of final regulations. In addition, limited branch and limited foreign financial institution (FFI) status will not terminate until January 1, 2017, allowing FFIs and other stakeholders more time to decide whether to continue such limited branches or limited FFIs. The Notice also states that the IRS is still working on the process for sponsoring entities to register sponsored entities; in the meantime, the deadline for registration of certain sponsored entities has been pushed to January 1, 2017. Other helpful provisions will ease the administrative burden in cases where collateral secures both grandfathered and non-grandfathered obligations by letting secured parties choose whether to withhold on all collateral or withhold pro rata (rather than mandating pro rata withholding) and treat substitute payments with respect to grandfathered obligations that are posted as collateral as not subject to FATCA withholding. The Treasury and IRS have also offered relief to intergovernmental agreement partner jurisdictions.

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