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SECTION 304 TRANSACTIONS

IRS REVISES ITS APPROACH ON APPLYING SECTION 367 TO SECTION 304 TRANSACTIONS

In Notice 2012-15, the IRS reverses course, but significant questions remain.

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Recently, with the February 2012 release of Notice 2012-15, [1] the IRS announced that Section 367(a) and (b) would apply to Section 304 transactions occurring on or after 2/10/12 and that regulations under Section 367 would be amended to reflect this guidance. This represents a significant reversal from the IRS's approach to this issue in recent years and taxpayers and practitioners, invited by the notice to comment, have been quick to question both the administrative burdens and the fundamental policy objectives implicated by this new approach. Yet, as a review of the history of these two statutes—and of the IRS's approach to their interaction and to other unresolved issues relating to corporate taxation—will reveal, actual implementation of the rules proposed in Notice 2012-15 will require the IRS to wrestle with significant technical issues. Given the notice's effective date and the requirement that taxpayers adhere to a "reasonable" manner of applying Section 367(a) and (b) to Section 304 transactions until the promised regulations are actually promulgated, it is incumbent upon the IRS to quickly provide additional guidance that will materially resolve these technical challenges, or else leave taxpayers exposed to significant uncertainties.

Background of 304 and 367 (1248 within context of 367(b))

Section 304(a)(1) generally provides that, for purposes of Sections 302 (dealing with distributions in redemption of stock) and 303 (dealing with distributions in redemption of stock to pay death taxes), if one or more persons ("transferor" or "transferors") are in "control" [2] of each of two corporations and, in return for property (e.g., cash), one of the corporations (the "acquiring corporation") acquires stock in the other corporation (the "issuing corporation") from the transferor or transferors, such property will be treated as a distribution in redemption of the stock of the acquiring corporation. [3] If Section 301 is, thereafter, determined to apply to such deemed distribution, each transferor and the acquiring corporation are treated as if (1) the transferor transferred the stock of the issuing corporation to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which Section 351(a) applies [4]; and (2) the acquiring corporation then redeemed the stock that it is deemed to have issued. Section 304(b) provides further guidance on the application of Section 301 to the transaction, indicating that the Section 301(c)(1) (i.e., dividend) amount (and the source thereof) is made as if the property is distributed first by the acquiring corporation to the extent of its earnings and profits (E&P) and then by the issuing corporation to the extent of its E&P. [5] Section 304(b)(5) and 304(b)(6) provide specific guidance and limitations when foreign corporations are involved. Importantly, Section 304 does not apply express rules on the application of Section 301(c)(2) to a Section 304 deemed distribution.

When Section 304 was originally enacted, capital gains rates were lower than ordinary income rates applicable to dividends. Accordingly, Section 304 was introduced to prevent withdrawals of corporate earnings by controlling shareholders in transactions that result in capital gains treatment. [6] With the subsequent equalization of capital gains and ordinary income rates, particularly for corporate transferors, the abuse that Section 304 was originally aimed at has become less compelling. Indeed, because dividends deemed received under Section 304 may bring with them both foreign tax credits and Section 959 previously taxed income, the positive application of Section 304 is often preferred by taxpayers, particularly corporate taxpayers.

Section 367 has a separate purpose and history. Section 367(a)(1) generally provides that if a U.S. person transfers property to a foreign corporation *in an exchange described in Section* 332, *351*, 354, 356, or 361, the foreign corporation will not be considered a corporation for purposes of determining the extent to which the U.S. person recognizes gain on such transfer. The consequence of this provision, where it applies, is generally to deny the parties to the transaction the nonrecognition of *gain* (but not loss) otherwise available under Subchapter C, Chapter 1, Subtitle A of the Code (i.e., the primary provisions relating to the taxation of corporations). [7] The policy that

animates Section 367(a) is the prevention of U.S. tax avoidance through U.S. persons' transfers of appreciated property to foreign corporations that would not be subject to U.S. tax on the disposition of such property. [8]

Section 367(a) and the regulations thereunder provide for exceptions, including exceptions relating to certain stock transfers. [9] The exceptions to stock transfers generally require that the U.S. transferor timely file a "gain recognition agreement" (GRA), as well as other related documentation information prescribed in the relevant regulations, to avoid current recognition of gain upon an outbound stock transfer. [10] Under the terms of a GRA, a U.S. transferor agrees to include in income the gain realized but not recognized on the initial transfer by reason of entering into the GRA *if* a "gain recognition event" occurs during the five-year period following the close of the tax year in which the initial transfers occurred. [11] Dispositions of stock of the transferee corporation, including dispositions by way of redemption (as discussed in more detail below), may constitute gain recognition events. [12] However, there are various exceptions to these rules (many of which require the U.S. transferor to enter into a new GRA) that will allow for the continued deferral of gain recognition. [13]

In this regard, it is important to observe that the GRA Regulations provide some specific rules that are particularly relevant to the issues discussed below. First, under the GRA Regulations, a redemption of the stock of the transferred corporation or of stock of the transferee foreign corporation received in the initial transfer that is treated by reason of Section 302(d) as a distribution of property to which Section 301 applies constitutes a disposition for purposes of determining whether a GRA has been triggered. [14] The consequences of this rule can be avoided, however, if the U.S. transferor enters into a new gain recognition agreement that includes appropriate provisions to account for the redemption. This rule is illustrated by various examples in the regulations, including one in which a transferred foreign corporation is subsequently sold to another foreign corporation in a transaction to which Section 304 applies. [15]

A second important set of rules relates to the coordination of gain recognized under a GRA and Section 301(c)(3) gain recognized with respect to stock either of the transferred corporation or of the transferee foreign corporation. Under the GRA Regulations, "[i]f gain is required to be recognized under section 301(c)(3) *with respect to the transferred stock*, the U.S. transferor shall recognize gain under the [GRA in accordance with the normal gain recognition rules of Reg. 1.367(a)-8(c)(1)(i)] in an amount equal to the gain required to be recognized under section 301(c)(3), but not in excess of the amount of gain actually subject to the [GRA]." [16] While this ambiguous language might be read to suggest that gain must be recognized *twice*—once under Section 301(c)(3) and once, again, under Section 367(a) (at least to the extent of gain subject to the pertinent GRA), the GRA Regulations contain examples suggesting that gain is recognized only once, under Section 367(a) and in accordance with Reg. 1.367(a)-8(c). [17] In this regard, it is important to recognize that the GRA Regulations also provide that "[f]or this purpose, the amount of gain required to be recognized under section 301(c)(3) shall be determined *before* taking into account any increase in the basis of the transferred stock." [18] Accordingly, it appears that Reg. 1.367(a)-8(n)(2. Reg. 1.367(a)-8(n)(2) is meant to be a mere measurement rule and not intended to lead to the conclusion that the normal basis adjustment rules set forth in the GRA Regulations are to be abandoned so as to require a double gain recognition. [19]

In contrast to the detailed, albeit ambiguous, rules discussed immediately above in the event of a Section 301(c)(3) distribution on stock of the transferred corporation, the GRA Regulations are terse with respect to the stock of the transferee foreign corporation. Specifically, if the U.S. transferor recognizes gain under Section 301(c)(3) *with respect to the stock of the transferee foreign corporation received in the initial transfer*, the rules simply provide that the amount of gain subject to the GRA is reduced by the amount of such recognized gain. There is no discussion of actual recognition under the GRA, nor of coordination to avoid double gain recognition, nor, surprisingly, of the impact on basis (nor, surprisingly, of the impact of basis on the Section 301(c)(3) gain itself).

In cases of transfers to a foreign corporation where Section 367(a) does not apply, Section 367(b) may still result in income recognition in the event of certain exchanges *described in Section* 332, *351*, 354, 355, 356, or 361. By way of background, it is important to recall that Section 1248 generally operates to recharacterize as a dividend (taxable at ordinary income rates) some or all of the gain recognized in a *taxable* sale by a U.S. person that owns (or owned, within a five-year period) at least 10% of the total combined voting power of all classes of stock entitled to vote in a corporation that qualifies as a Section 957 "controlled foreign corporation" (CFC). Section 964(e) extends the Section 1248 rules to cases where the seller is, itself, a CFC. One of the underlying policies of Section 367(b) is the preservation of the potential application of Section 1248 in situations where a U.S. transferor (or a CFC transferor) exchanges stock in a CFC in an otherwise *nontaxable* exchange. [20] If this otherwise nontaxable exchange results in post-exchange inapplicability of Section 1248 (or Section 964(e), as the case may be), an income recognition event may arise under Section 367.

Where Section 367(b) is triggered within the context of a foreign corporation's nonrecognition acquisition of the stock or assets of another foreign corporation that would have been subject to Section 1248 or Section 964(e) in the event of a taxable sale or exchange, the exchanging shareholder must include into income, as a deemed dividend, the so-called "Section 1248 amount." [21] This amount is, generally, determined by reference to the rules

under Section 1248 itself. [22] Thus (and subject to certain modifications prescribed by the Section 367(b) regulations), the amount of the deemed dividend is equal to the E&P attributable to foreign corporate stock that has been transferred, as determined under the relevant regulations. [23]

A few important aspects of the determination of amounts constituting dividends under Section 304, on the one hand, and Section 1248 (and, accordingly, Section 367(b) in appropriate cases), on the other hand, should be highlighted. [24] First, the amount of a deemed dividend arising under Section 1248 is limited to gain realized on the disposition of the foreign stock; in contrast, a Section 304 dividend is limited only by the amount of consideration received in the transaction (i.e., the Section 304 dividend may be equal to the fair market value of the issuing corporation). Second, E&P available to support a Section 1248 amount may include E&P not only of the transferred foreign corporation itself, but also the E&P of certain lower-tier subsidiaries of such foreign corporation. [25] In contrast, a Section 304 dividend is supported only by the E&P of, respectively, the acquiring corporation and the issuing corporation, but not the E&P of their subsidiaries. Finally, the Section 1248 amount is reduced to reflect any actual distributions made by the foreign corporation during the tax year, even if the distributions occur subsequent to the transfer of the foreign corporation. [26] A Section 301 distribution arising under Section 304, in contrast, is treated as would be any other Section 301 distribution paid by a corporation during the year and will constitute a dividend to the extent of available E&P as determined under Section 316. [27]

Historic IRS positions on the application of 367 to 304

Prior to 2005, the IRS appeared to take the position that Section 367(a) and (b) applied to certain Section 304(a)(1) transactions. Evidence of this could be found, for example, in both Rev. Rul. 92-86 and Rev. Rul. 91-5 [28] and the Preamble to REG-150313-01. [29]

In 2005, however, the IRS proposed to exempt the deemed Section 351(a) exchange that occurs under Section 304(a)(1) from the application of Section 367(a) and (b). [30] In the formulation of this approach, the IRS considered the policies underlying both Sections 304 and 367, observing:

> In a section 304(a)(1) transaction in which a U.S. person transfers the stock of an issuing corporation to a foreign acquiring corporation, without the application of section 367(a), the U.S. person will nevertheless recognize an amount of income that is at least equal to the inherent gain in the stock of the issuing corporation that is being transferred to the foreign acquiring corporation. This income recognition results from the construct of the transaction as a distribution in redemption of the acquiring corporation shares. The income recognized may be in the form of dividend income, gain on the disposition of stock, or both. Section 301(c)(1), (3). [31]

The IRS also recognized that the application of Section 367(a) to the deemed Section 351(a) transaction could, in certain instances where the U.S. transferor files a GRA, lead to results in which a U.S. person's total income inclusion could exceed the fair market value of the target stock transferred (a result the IRS believed was inconsistent with the policies of Section 367(a)). [32]

With respect to Section 367(b), the IRS stated that: "...in a section 304(a)(1) transaction, some or all of the earnings that make up the section 1248 amount that section 367(b) seeks to preserve may be immediately included in income by the exchanging shareholder."

Finally, and importantly, the IRS recognized the administrative burdens—which they term "problematic" in at least some instances—associated with the application of Section 367(a) and (b) to Section 304(a)(1) transactions. [33]

For all of these reasons, the IRS concluded in its 2005 proposal that the interests of sound tax administration are served by not applying Section 367(a) and (b) to the deemed 351 exchange.

The IRS finalized its proposed Section 367(a) and (b) regulations in 2006. [34] Again, the IRS took the position that Section 367(a) and (b) do not apply to deemed Section 351(a) exchanges that occur under Section 304(a)(1)) and included the following explanation in the preamble:

> [T]he interests of the government are protected, and the policies underlying section 367(a) and (b) are preserved, in a section 304(a)(1) transaction without regard to the application of section 367. *The IRS and Treasury believe that, in most or all cases, the income recognized in a section 304 transaction will equal or exceed the transferor's inherent gain in the stock of the issuing corporation transferred to the foreign acquiring corporation.* [35]

The IRS also observed that "[e]limination of the application of section 367(a) and (b) in this context *will also serve*

the interests of sound tax administration by creating greater certainty and simplicity in these transactions, and by avoiding the over-inclusion of income that could result when section 367 and section 304 both apply to such transactions."

Yet the 2006 final Section 367(a) and (b) regulations also contained an important indication that the IRS was not truly finished with the process of considering the interplay between Section 304 and Section 367(a) and (b). Notably, the preamble to those final regulations contained the following statement:

> Commentators did note that in certain cases, depending on how the basis and distribution rules are applied, the amount of income recognized under section 304(a) may not equal or exceed the transferor's inherent gain in the stock of the issuing corporation. In the example cited, P, a domestic corporation, owns all the stock of F1 and F2, both of which are foreign corporations. P has an adjusted basis of $0 in its F1 stock and $100x in its F2 stock. P's stock of F1 and F2 each has a fair market value of $100x. Neither F1 nor F2 has current or accumulated earnings and profits. P sells its F1 stock to F2 for its fair market value of $100x in a transaction subject to section 304(a)(1). Under section 304(a)(1), the transaction is treated as if P had transferred its F1 stock to F2 in exchange for F2 stock in a transaction to which section 351(a) applies, and then F2 had redeemed such deemed issued stock.
>
> These commentators posit that P in the above example may not recognize income or gain because the adjusted basis of both the F2 stock that is treated as being issued in the deemed Section 351 exchange, and the adjusted basis of the F2 stock already held by P prior to the transaction, is available for reduction under Section 301(c)(2). On these particular facts (i.e., no earnings and profits in either the acquiring corporation or the issuing corporation), this basis position would mean that income or gain is not recognized as a result of the transaction.

[36]

In response to this comment, the IRS stated the following in the Preamble to TD 9250: "The IRS and the Treasury believe, however, that current law does not provide for the recovery of the basis of any shares other than the basis of the F2 stock deemed to be received by P in the section 351(a) exchange (which would take a basis equal to P's basis in the F1 stock)." [37] Finally, the IRS promised that "[t]his issue will be addressed as part of a larger project regarding the recovery of basis in all redemptions treated as section 301 distributions. This larger project will be the subject of future guidance." [38]

The "larger project regarding the recovery of basis in all redemptions treated as section 301 distributions" appeared in the form of REG-143686-07, issued on 1/21/09 ("2009 Proposed Basis Regulations"). These proposed regulations were, according to the IRS, built "on [basis tracing] themes developed in [Reg. 1.358-2]" and were based on the theory "that a share of stock is the basic unit of property that can be disposed of and, accordingly, the results of a transaction should generally derive from the consideration received in respect of that share." [39]

Under the 2009 Proposed Basis Regulations, a dividend equivalent redemption (including certain Section 304 transactions) results in a pro rata, share-by-share distribution to *all* shares of the "redeemed class" held by the redeemed shareholder immediately before the redemption. [40] The proposed regulations make it clear that the pro rata determination is based on the total number (rather than value) of shares outstanding and define the term "redeemed class" to mean all of the shares of that class held by the redeemed shareholder. [41] In the case of a Section 304 transaction to which Section 301 applies, the redeemed class is deemed to be the common shares of the acquiring corporation and the amount distributed in such redemption is applied to reduce the adjusted basis of *each* share of *common* stock directly held or deemed directly held by the transferor on a pro rata, share-by-share basis. [42] The preamble goes on to caution that "[s]imilar to an actual section 301 distribution, the proportional approach to basis recovery in a dividend equivalent redemption can produce gain with respect to some shares while other shares have unrecovered basis." [43] Finally, it is proposed that unrecovered basis will then either be reallocated among actual, existing shares of the redeeming corporation in a deemed Section 368(a)(1)(E) recapitalization (which would result in the application of the Reg. 1.358-2 basis tracing rules, as modified by the 2009 Proposed Basis Regulations) or, in certain cases, a deferred loss. [44]

Even prior to the consideration of any interplay with Section 367, the complexity that would be introduced if the 2009 Proposed Basis Regulations were finalized without modification should not be underestimated, least of all in the case of Section 304 transactions. Extension of the Section 358 tracing rules (as further modified by the 2009 Proposed Basis Regulations) would, itself, introduce tremendous administrative burdens and, likely, ongoing ambiguities. [45] Further, in the case of Section 304 transactions, the actual number of acquiring corporation shares deemed issued under Section 304(a)(1)'s fictional Section 351 transaction must be determined to properly allow for the application of Section 301(c) in the manner prescribed under the 2009 Proposed Basis Regulations. This, in turn, would appear to require that the acquiring corporation be the subject of a credible valuation in many cases. [46] Taxpayers already value (obviously) issuing corporations in Section 304 transactions, but it is questionable whether

many of them currently expend the time, effort, and money to value acquiring corporations as well.

In early February 2009, less than a month after the issuance of the 2009 Proposed Basis Regulations, the IRS issued temporary regulations that revised their approach concerning the application of Section 367 to transactions described in Section 304 and that specifically addressed those cases—considered, as discussed above, in detail by the IRS in the Preamble to TD 9250—in which taxpayers participating in Section 304 transactions recovered, under Section 301(c)(2), basis in acquiring shares other than those deemed received in the deemed Section 351 transaction arising under Section 304(a)(1). [47] The general rule under these regulations continued to be that Section 367(a) and (b) did not apply to deemed Section 351(a) exchanges involving foreign corporations that occur under Section 304(a)(1). However, in an effort to counter what the IRS stated to be a result in conflict with "current law" (i.e., recovery of basis on pre-existing acquiring shares), Temp. Reg. 1.367(a)-9T(b) provided that if the distribution received by the U.S. person in redemption of the stock of the foreign acquiring corporation deemed issued in the deemed Section 351(a) exchange was applied against and reduced (in whole or in part), pursuant to Section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the U.S. person other than the stock deemed issued in the deemed Section 351(a) exchange, the U.S. person was required to recognize gain equal to (a) the amount of gain realized on the deemed Section 351(a) exchange, less (b) that amount of the deemed distribution that was treated as a Section 301(c)(1) dividend. [48] This gain recognition cannot be avoided through the execution of a GRA. Similarly, Temp. Reg. 1.367(b)-4T(e)(2) provided that the general rule above (i.e., that Section 367(b) does not apply to trigger gain recognition in a deemed Section 351(a) exchange arising under Section 304(a)(1)) will not apply to a transfer of stock of a foreign acquired corporation by an exchanging shareholder to a foreign acquiring corporation in such a deemed Section 351(a) exchange to the extent that the distribution received by the exchanging shareholder in redemption of the stock of the foreign acquiring corporation is applied against and reduces, pursuant to Section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the exchanging shareholder other than the stock deemed issued by the foreign acquiring corporation in the deemed Section 351 exchange.

Somewhat surprisingly, TD 9444 made no direct reference to the 2009 Proposed Basis Regulations that had been issued only days before, nor to the fact that those regulations, if finalized, would have compelled the consistent and automatic application of the Temp. Reg. 1.367(a)-9T(b) and the Temp. Reg. 1.367(b)-4T(e)(2) anti-abuse rules. [49]

One additional aspect of TD 9444 bears mention, the introduction of Temp. Reg. 1.1248-1(b), providing that gain arising under Section 301(c)(3) in connection with the receipt of a distribution of property from a foreign corporation with respect to its stock is treated as gain from a sale or exchange for the purposes of Section 1248.

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In section 3 of Notice 2012-15, the IRS stated that, as of 2/10/12, it now believes that the amount of income taken into account as a result of a Section 304 distribution "*generally* should not affect the application of section 367 to the deemed section 351 exchange." [50] Similarly, the IRS announced that it was no longer troubled by potential administrative burdens—presumably either its own or those of taxpayers—because the current version of the GRA Regulations "should substantially reduce the complexity and uncertainty resulting from the filing of a GRA in connection with a deemed section 351 exchange." [51] Accordingly, the notice announces that the IRS will amend the regulations under Section 367 such that Section 367(a) and (b) will apply fully to the deemed Section 351 exchange in Section 304(a)(1) transactions involving foreign corporations occurring after 2/9/12. [52]

It is clear, based on the language of Notice 2012-15, that the exceptions under Regs. 1.367(a)-3(b)(1) and -3(c) may apply to the deemed Section 351(a) exchange occurring in a Section 304(a)(1) transfer (thus, for example, a GRA is possible if certain requirements are satisfied). It should be recalled, of course, that if a U.S. person enters into a GRA with respect to the deemed Section 351(a) transfer, the deemed redemption of the stock of the foreign acquiring corporation that immediately follows should constitute a disposition of the transferee foreign corporation stock under the GRA Regulations. [53] Of course, such redemption will not be treated as a triggering event if the U.S. person that transfers the stock in the deemed Section 351 exchange (or a U.S. person that is treated as a successor U.S. transferor as a result of the deemed redemption) enters into a new GRA that includes appropriate provisions to account for the redemption, provided the principles of Reg. 1.367(a)-8(k)(14)(ii) and (iii) are satisfied. [54]

Comments

It is tempting to respond to Notice 2012-15 either by citing the possibility that the administrative burdens (on both the IRS and taxpayers) are not as manageable as the IRS suggests or by arguing that the application of Section 367 to Section 304 transactions certainly will result, in many cases, in income inclusions in excess of either the built-in gain or the fair market value of the issuing corporation's stock or the consideration received in the event of a single transaction. [55] But, perhaps, a more pressing concern is to focus on the significant technical issues that must be

resolved in order to issue the regulations promised by the notice. In this regard, it should be observed that the Notice does state that:

> Pending the issuance of the regulations described in [Notice 2012-15], the IRS will not challenge reasonable interpretations of the application of section 367(a) and (b) to deemed section 351 exchanges and related deemed redemptions completed on or after February 10, 2012, including reasonable interpretations of the GRA rules as applied to such deemed section 351 exchanges and deemed redemptions under the principles of Treas. Reg. 1.367(a)-8(k)(14)(ii) and (iii) . [56]

Yet the unanswered technical issues implicated by the extension of Section 367(a) and (b) to Section 304 transactions cloud the meaning of the term "reasonable" within this context. Given the 2/10/12 effective date, taxpayers would be correct to press the IRS for additional, immediate guidance with respect to a variety of issues, some of which are discussed below and many of which appear to be contingent upon the ultimate fate of the 2009 Proposed Basis Regulations.

Perhaps the most pressing example of the complexities will be the need to coordinate the interaction of Section 301 (c)(3) gain and gain subject to a GRA. As a technical matter, if Section 301(c)(3) gain on acquiring stock arises in connection with the Section 304 transaction, must this gain be recharacterized as Section 367(a) gain on issuing stock, recognized immediately before the deemed redemption of the acquiring stock? Observe that this recharacterization is meaningful, as it would operate to change the source and the amount of the Section 1248 amount (i.e., in the event of Section 301(c)(3) gain, the Section 1248 amount will be calculated with respect to acquiring and its Section 1248(c)(2) subsidiaries, whereas in the event of Section 367(a) gain, the Section 1248 amount will be calculated with respect to issuing and its Section 1248(c)(2) subsidiaries).As discussed above, the current GRA Regulations contain various ambiguities and unanswered questions in this regard. For example, appropriate gain calculation and basis adjustment rules seem to be lacking under the current GRA Regulations with respect to Section 301(c)(3) gain on acquiring (i.e., transferee foreign) corporation.The complexities in this area would, of course, proliferate if the 2009 Proposed Basis Regulations were finalized, because the quantum of Section 301(c)(3) gain potentially recognized on the deemed redemption would be de-linked—and therefore more difficult to coordinate—with the quantum of Section 367(a) gain potentially recognized under the GRA.

Recent comments attributed to IRS counsel do not necessarily resolve these coordination issues. [57]According to these reports, the IRS may take the position that, under the notice, "the earnings and profits and share basis of both parties to the redemption are available to cover the deemed secton 301 distribution to the U.S. parent. That way, the parent has full basis recovery before being tagged with section 367 gain." [58]In a cited example, it appears that the IRS envisions that the basis of both the acquiring corporation and the issuing corporation is available for recovery under Section 301(c)(2) within the context of a Section 304 transaction subject to Section 367: "[I]f a U.S. parent sells shares of a foreign subsidiary (basis $50, E&P $20) to its foreign sister (basis $5, E&P $5) for $100, there would be a $25 dividend, a $55 basis recovery, and $30 of section 367 (a) gain (reg. section 1.367(a)-8(o)(3)). Note that the E&P and share basis of both parties are used. Section 301(c)(3) gain of $30 is excluded." [59]Yet, a variation on this example further complicates the picture: "What if the ultimate parent of the group is foreign, but a U.S. sub-parent is making the same sale to a foreign acquirer/affiliate that is directly below the ultimate foreign parent? The U.S. sub-parent would not have access to the E&P or share basis of the foreign acquirer, even though the latter is part of the same multinational group, because its parent is foreign." The example, as reported, then concludes that "[s]ection 301(c)(3) gain of $30 must be recognized, in addition to $20 of section 367(a) gain." [60]

These comments and examples, as reported, raise interesting complexities regarding the coordination of Section 367 (a) and Section 301(c) (as applied within the context of Section 304), complexities that require immediate clarification. First, the suggestion that both issuing corporation *and acquiring corporation* basis is available, under current law, for recovery in the Section 304(a)(1) deemed redemption is directly contrary to the position that the IRS took in the Preambles to both TD 9250 and TD 9444. Instead, it appears more in line with the approach announced in the 2009 Proposed Basis Regulations (but without reference to the pro rata allocation rules, which might, in fact, enhance the Section 301(c)(3) amount in the transaction while leaving unrecovered basis in some of the acquiring corporation's shares, as discussed in detail above). Second, this concession (if that is what it is) with respect to recovery of the acquiring corporation's basis is, apparently, deemed to be subject to some variation of the Section 304(b)(5) limitations that apply to the acquiring corporation's E&P. Of course, Section 304(b)(5)'s current limitations do not simply deny all access to all E&P of the foreign acquiring corporation. Rather, they inquire into when and under which ownership circumstances such E&P was acculmuated. In this regard, the Section 304(b)(5) rules are not perfectly suited to determining when and how to limit the U.S. transferor's access to the acquiring corporation's basis (if such access is, in fact, what the IRS intends as a general rule). Third, the two variations of the example appearing in the report leave unresolved the question of how to characterize recognized gain: will Section 367(a) or Section 301(c)(3) control? In the first variation of the example, the $20 of gain is stated to be Section 367(a) gain (despite the fact that Reg. 1.367-8(o)(3) does not clearly state such a result, as discussed above). [61]In the second variation, however, where the entire amount of gain subject to the GRA is triggered because (it appears) of a failure to satisfy the requirements of Reg. 1.367(a)-8(k)(14)(ii) and (iii) andReg. 1.367(a)-8(k)(14)(ii) and (iii) and Reg. 1.367(a)-8(n)(1)), part of the gain is treated as Section 301(c)(3) gain and part of it

is treated as Section 367(a) gain. Clarification is necessary.

Another example of the uncertainties in this area is the interaction of the proposals set forth in Notice 2012-15 and the anti-abuse rules of TD 9444. An initial question here is whether TD 9444 would not likely be removed entirely in the event that the 2009 Proposed Basis Regulations were finalized and Section 367(a) and (b) made applicable to Section 304 transactions in accordance with Notice 2012-15. Assume, however, that the 2009 Basis Proposed Regulations were not finalized in the near future and that the IRS continues to contend that, under current law, it is improper for a transferor in a Section 304 transaction to recover basis in pre-existing acquiring shares. [62] If so and if, as stated in the notice, the "[a]mount of income taken into account as a result of a section 304 distribution *generally* should not affect the application of section 367 to the deemed section 351 exchange," does that mean that TD 9444 remains in force and must be coordinated with the general application of Section 367(a) and (b). And, if so, how? For example, assume that a taxpayer recognized all realized gain upon the occasion of a deemed Section 351(a) transfer of the stock of a domestic corporation pursuant to a Section 304 transaction. If that taxpayer then still calculated its Section 301(c)(2) recovery with reference to some portion of the basis on existing acquiring shares, would TD 9444 have any role (clearly, in any event, its operational terms would need to be changed, as there would have been no realized but unrecognized gain on the initial deemed outbound transfer). [63] In a more likely example, if the transfer were of a foreign corporation, but a GRA were utilized to avoid current gain recognition, would utilization of basis with respect to existing acquiring shares result in recognition under the GRA? If so, the GRA Regulations must be modified to explain the consequences and to also provide guidance on the corresponding administrative obligations.

Yet another area of unresolved concern exists with respect to the application of Section 367(b). Recall that in 2005 the IRS termed the interaction of Section 367(b) and Section 304 "problematic." Specifically, the IRS observed that in a Section 304 transaction, "the necessary section 1248 shareholder status and controlled foreign corporation status may be satisfied immediately after the deemed section 351 exchange when a U.S. corporation transfers a controlled foreign corporation (the foreign issuing corporation) to a foreign acquiring corporation in a section 304(a)(1) transaction, by taking into consideration the deemed issued stock by the foreign acquiring corporation. However, if both the U.S. corporate transferor and the foreign acquiring corporation are wholly owned by the same foreign parent, the necessary section 1248 shareholder status and controlled foreign corporation status will not be satisfied immediately after the deemed redemption transaction." [64] At the very least, this fact pattern illustrates cases where double income inclusions are likely.

A final point to consider is that the accuracy of the IRS's assertion in the Notice, that "the revised GRA regulations should substantially reduce the complexity and uncertainty resulting from the filing of a GRA in connection with a deemed section 351 exchange," will be highly contingent upon the ultimate fate of the 2009 Proposed Basis Regulations. If those rules are finalized, cross-border Section 304 transactions will expose taxpayers to burdensome valuations and complex tracing obligations, all of which will have to then be reflected on GRAs (at least in cases where current Section 367(a) taxation is deferred).

In summary, while the policy underlying Notice 2012-15 will undoubtedly continue to be debated, and while the true cost of the new adminstrative burdens will become apparent only when taxpayers begin to undertake compliance, very real technical issues must be resolved immediately if taxpayers are expected to begin applying Section 367 to their Section 304 transactions.

1

2012-9 IRB 424, 2/27/12.

2

"Control" is defined in Section 304(c)(1) to mean the ownership of stock possessing at least 50% of the "total combined voting power of all classes of stock entitled to vote," or at least 50% of the "total value" of all shares of stock. For these purposes, both indirect stock ownership rules and the Section 318 constructive ownership rules (as modified by Section 304(c)(3)) apply. Section 304 may apply to a transaction where the transferor or transferors of the issuing corporation obtain control of the acquiring corporation only in the transaction itself. See Section 304(c)(2)(A), enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) (TEFRA). Observe that this rule is not reflected in certain of the regulations under Section 304 (e.g., Reg. 1.304-2(a)) because such regulations have not been amended for decades and, accordingly, do not reflect the current form of Section 304. Cf., Reg. 1.304-5(a) et seq., which *does* reflect the TEFRA amendments to Section 304(c).

3

Section 304(a)(1), which provides rules applicable to so-called "brother-sister" stock acquisitions, does not apply to so-called "parent-subsidiary" stock acquisitions described in Section 304(a)(2).

4

See Section 304(a)(1), flush language. Prior to amendment by the Taxpayer Relief Act of 1997 (P.L. 105-34), the deemed fiction was that of a capital contribution by the transferor or transferors, rather than a Section 351(a) transaction.
5

To the extent the dividend is sourced from the E&P of the acquiring corporation, the transferor is considered to receive the dividend directly from the acquiring corporation. See H.R. Rep. No. 98-861 (1984) (Conf. Rep.) 1222-1224, 1980-2 CB 106.
6

See H.R. Rep. No. 2014, 105th Cong. 1st Sess. at 465 (6/24/97).
7

Observe that some or all of the gain recognized under Section 367(a) by a U.S. transferor with respect to the stock of a foreign corporation may be recharacterized under Section 1248, discussed in more detail below. See Reg. 1.367(a)-3(b)(2)(ii) Example.
8

See S. Rep. No. 98-169, 98th Cong. 2d Sess. at 360 (1984).
9

See e.g., Reg. 1.367(a)-3(b) (transfer of stock of a foreign corporation); and-3(c) (transfer of stock in a domestic corporation)).
10

See Reg. 1.367(a)-8(a) et seq., applicable to transfers occurring after 3/12/09 ("GRA Regulations"). The GRA Regulations, introduced by TD 9446, 74 FR 6952-6976, 2/11/09, replaced temporary and proposed regulations, TD 9311, 72 F.R. 5184, 2/5/07 and REG-147144-06, 2/5/07. Relative to the rules prevailing prior to 2007, both the GRA Regulations and their 2007 predecessors can fairly be said to have introduced additional clarity and some greater measure of simplicity.
11

Reg. 1.367(a)-8(c)(1). Income must generally be reported on an amended return for the tax year of the initial transfer, but this rule is subject to exceptions, including taxpayer elections.
12

Regs. 1.367(a)-8(b)(1)(iv); -8(j)(4); -8(n)(1).
13

Reg. 1.367(a)-8(k). Observe, also, that the occurrence of multiple events in a given tax year, each of which might require its own GRA in isolation, will generally *not* give rise to the requirement to file multiple GRAs. See Reg. 1.367 (a)-8(d)(2)(ii).
14

Reg. 1.367(a)-8(n)(1). The terms "transferred corporation" and "transferee corporation" are defined in the GRA Regulations. See Reg. 1.367(a)-8(b)(1)(xii) and (xiii) .
15

Id. See Reg. 1.367(a)-8(q)(2), Example 14.
16

Reg. 1.367(a)-8(n)(2).
17

See, e.g., Reg. 1.367(a)-8(q)(2), Example 2(ii)(A) (taxable disposition that triggers retroactive gain recognition under a GRA results in a basis increase that reduces the amount of gain recognized on the actual disposition); -8(q)(2), Example 13 (a taxable receipt of boot that triggers retroactive gain recognition under a GRA, pursuant to Reg. 1.367(a)-8(m)(1), results in a basis increase that reduces amount of gain recognized on the actual receipt of boot). Observe that the operative language of Reg. 1.367(a)-8(m)(1) is nearly identical to that of Reg. 1.367(a)-8(n)(1). Observe, too, that in Example 13 a single distribution of $35x of taxable boot results in an aggregate realization of $50x under Section 367(a) and Section 351(b). This appears to be a feature of the operation of Section 351(b). Gain realized under Section 301(c) is determined differently and, accordingly, appears not to give rise to double gain

recognition.
18

Id. (emphasis added). Under Reg. 1.367(a)-8(c)(4), gain recognition under a GRA results in a corresponding increase in the basis of (1) the stock or securities, as applicable, of the transferee foreign corporation received by the U.S. transferor in the initial transfer and (2) the transferred stock or securities. In each case, the basis increase is as of the date of the initial transfer.
19

Again, this clearly seems to be the case under nearly identical language arising under Reg. 1.367(a)-8(m)(1) and as illustrated in Example 13. There the measurement of the Section 351(b) gain for purposes of determining the corresponding gain recognition is made *prior* to the corresponding basis increase under Reg. 1.367(a)-8(c)(4). But the amount of gain actually recognized under Section 351(b) is clearly *reduced* by the Reg. 1.367(a)-8(c)(4) basis increase. See also Reg. 1.367(a)-8(q)(2), Example 17(ii)(B) ("the section 301 distribution received by PRS from TFD is not a disposition (and therefore does not affect the gain recognition agreement) to the extent it is described in section 301(c)(1) or (2). However, under paragraph (n)(2) of this section, to the extent the distribution is described in section 301(c)(3), UST must recognize gain ($30x) under the gain recognition agreement. For this purpose, the amount of the distribution that is described in section 301(c)(3) is determined before taking into account the increase to the basis of the TFD stock under paragraph (c)(4)(ii) of this section"). The only gain described is the Section 367(a) gain and Section 301(c)(3) seems to operate merely in a measurement capacity.
20

See H.R. Rep. No. 94-658, 94th Cong., 1st Sess., at 242 (11/12/75).
21

Reg. 1.367(b)-4(b).
22

Reg. 1.367(b)-2(c).
23

The determination of such E&P is subject to special adjustments described in either Reg. 1.1248-2 (applicable to "simple" cases) or Reg. 1.1248-3 (applicable to "complex" cases).
24

Under some circumstances, Section 367(b) operates to require a taxpayer to include into income "the all earnings and profits amount"— rather than the Section 1248 amount—with respect to a foreign corporation's stock. The rules for determining the all earnings and profits amount differ materially from the rules for determining the Section 1248 amount. Neither an actual sale of foreign stock nor a deemed Section 351 contribution, followed by a deemed redemption, of such stock should implicate a situation in which an inclusion of the all earnings and profits amount are required. Accordingly, the Section 367(b) deemed dividends discussed below are only those attributable to Section 1248 amounts.
25

See Section 1248(c)(2) and the regulations thereunder.
26

See Regs. 1.1248-2(d)(1); 1.1248-3(b)(1) and (3). See also TAM 199906035 (foreign corporation's distribution to a buyer of its stock reduces the amount of the seller's gain that is treated as a dividend under Section 1248).
27

See, e.g., Reg. 1.316-2 providing rules relating to the allocation of current and accumulated E&P in the case of a corporation making multiple distributions during the tax year.
28

1992-2 CB 1999 and 1991-1 CB 114 (applying Section 367 to the deemed capital contribution that occurred pursuant to the version of Section 304(a)(1) prevailing prior to the 1997 amendment to Section 304(a) that introduced the deemed Section 351 construct, discussed above.
29

67 Fed. Reg. 64331, 10/18/02. In the Preamble to these 2002 proposed regulations under Sections 302 and 304, the IRS and Treasury stated, inter alia "In transactions under section 304 that involve one or more foreign corporations, further consequences may apply under the international provisions of the Code. For example, where

target [i.e., issuing] corporation stock is transferred to a foreign corporation in the deemed section 351 transaction, section 367 and the regulations promulgated thereunder apply to the transfer. See Rev. Rul. 91-5 (1991-1 C.B. 114)." REG-150313-01 was withdrawn by Announcement 2006-30, 2006-19 IRB 879.
30

See REG-127740-04.
31

See Preamble to REG 127740-04.
32

Id.("As noted, when a U.S. person transfers stock of a wholly owned foreign corporation (the foreign issuing corporation) to a wholly owned foreign acquiring corporation in exchange for property, section 304(a)(1) treats the U.S. person as having received foreign acquiring corporation stock in a deemed section 351 exchange, and then as having that stock immediately redeemed by the foreign acquiring corporation. If the U.S. person were to enter into a GRA, the application of section 367(a) to such a transaction will likely result in the GRA remaining in existence after the deemed redemption of the foreign acquiring corporation's stock. A U.S. person may, in fact, recognize income but, as a result of the GRA, not recognize any gain in the section 304(a)(1) transaction (e.g., the section 304(a)(1) transaction results in dividend income to the U.S. corporate transferor equal to the consideration paid by the foreign acquiring corporation). In such a case, because the U.S. person has not recognized the inherent gain in the transferee foreign corporation's stock deemed to be received in the section 304(a)(1) transaction, the GRA will not be terminated. *See* §1.367(a)-8(h)(1) (requiring a transaction in which all realized gain (if any) is recognized currently to terminate a GRA). As a result, the U.S. transferor would remain subject to the GRA provisions contained in §1.367(a)-8. If the GRA subsequently were triggered pursuant to §1.367(a)-8(e) (e.g., if the foreign issuing corporation disposes of substantially all of its assets to an unrelated party during the 5-year GRA period), the U.S. transferor may be subject to a total income inclusion that is greater than the fair market value of the stock being transferred").
33

Id. ("Moreover, the application of §1.367(b)-4(b)(1) to a section 304(a)(1) transaction often can be *problematic* because the necessary section 1248 shareholder status and controlled foreign corporation status may be treated as satisfied in the construct of the deemed section 351 exchange even though such status is immediately lost as a result of the deemed redemption transaction. For instance, the necessary section 1248 shareholder status and controlled foreign corporation status may be satisfied immediately after the deemed section 351 exchange when a U.S. corporation transfers a controlled foreign corporation (the foreign issuing corporation) to a foreign acquiring corporation in a section 304(a)(1) transaction, by taking into consideration the deemed issued stock by the foreign acquiring corporation. However, if both the U.S. corporate transferor and the foreign acquiring corporation are wholly owned by the same foreign parent, the necessary section 1248 shareholder status and controlled foreign corporation status will not be satisfied immediately after the deemed redemption transaction") (emphasis added).
34

TD 9250 (2/21/06).
35

Preamble, TD 9250 (emphasis added).
36

Id.
37

Id. The preamble continues "Thus, in the case described, P would recognize $100x of gain under section 301(c)(3) (the built-in gain on the F1 stock), and P would continue to have a $100x basis in its F2 stock that it holds after the transaction."
38

Id.
39

Preamble, REG-143686-07. This guiding principle has Section 1012 as its underpinning and has become fundamental to the tax treatment of shareholders, regardless of the specific nature of a shareholder's exchange. See Reg. 1.358-2 and Reg. 1.367(b)-13.
40

Preamble, REG-143686-07. See also Prop. Reg. 1.302-5(a)(1) (providing that "In any case in which an amount received in redemption of stock (as defined in section 317(b)) is treated as a distribution to which section 301 applies, that portion of a distribution that is not a dividend shall be applied to reduce the adjusted basis *of each share held by the redeemed shareholder* (as defined in paragraph (b) of this section) in the redeemed class (as defined in paragraph (b) of this section). Such reduction shall be applied pro rata, on a share-by-share basis, to all shares of the redeemed class held by the redeemed shareholder. Gain, if any, on a share shall be determined under section 301(c)(3)") (Emphasis added). Prop. Reg. 1.304-2(a)(4) and related examples confirm this result.
41

See, e.g., Prop. Reg. 1.301-2(a), Example; Prop. Reg. 1.302-5(b) (definition of redeemed class); Prop. Reg. 1.302-5(e) (examples of pro rata allocation); Prop. Reg. 1.304-2(c) (examples of pro rata allocation).
42

Prop. Reg. 1.304-2(a)(3) and (4).
43

Preamble, REG-143686-07.
44

Prop. Reg. 1.302-5(a). The paradigm of the deferred loss attributable to unrecovered basis is similar to that introduced by REG-150313-01, 67 Fed. Reg. 64331, 10/18/02, withdrawn by Announcement 2006-30, 2006-19 IRB 879.
45

See "IRS Remains Committed to Proposal on Basis Recovery and Identification," 30 TMWR 667 (5/30/11) (quoting William Alexander, IRS Associate Chief Counsel (Corporate) as stating "The [2009 Proposed Basis Regulations], overall, are fairly appealing but one of the things that gives us some pause is the practicality of tracing" and adding that "My guess is that one of the reasons why this hasn't been immediately finalized, quite frankly, is the formidable logistics involved with tracing").
46

The need for a valuation of the acquiring corporation may not be readily apparent when reviewing the 2009 Proposed Basis Regulations because the two examples of Section 304 transactions to which Section 301(c) applies that are set out under Prop. Reg. 1.304-2(c) conveniently utilize hypothetical issuing and acquiring corporations with the same number of shares and the same fair market value.
47

TD 9444, 74 FR 6824, 2/11/09.
48

Observe that this result, which triggers all gain realized on the deemed Section 351(a) exchange even where less than all of such gain is sheltered by pre-existing acquiring basis under Section 301(c)(2), does not result in double taxation of the same amount of gain, because the acquiring stock deemed received in the deemed outbound Section 351(a) exchange will receive an enhanced basis under Section 358 and Reg. 1.367(a)-1T(b)(4) . However, the rule may have the curious consequence of converting what would be Section 301(c)(3) gain with respect to acquiring stock into Section 367(a) gain with respect to issuing stock.
49

The closest that the IRS came to acknowledging the 2009 Proposed Basis Regulations was the statement, in the Preamble to TD 9444, that "[t]he IRS and Treasury Department continue to study the basis recovery issue as part of a larger project and have determined that it is necessary to revise the final 2006 [Treasury Regulations under section 367] prior to the completion of that project."
50

Notice 2012-15, section 3 (emphasis added).
51

Id. Presumably an example of this reduced complexity and uncertainty is cited later in the notice, where the IRS states "*Generally*, the requirement to file an initial GRA for the deemed section 351 exchange and a new GRA by reason of the deemed redemption will be satisfied if the U.S. person that transfers the stock in the deemed section 351 exchange files a single GRA with respect to the entire section 304 transaction." Notice 2012-15, section 4.01 (emphasis added).
52

Notice 2012-15, section 5 also announced that the IRS would finalize Temp. Reg. 1.1248-1(b) in separate published guidance. The preamble to that guidance, TD 9585, 77 FR 24380–24381, 4/24/12, observes that the "final regulations ensure that the earnings and profits of lower-tier foreign subsidiaries described in section 1248(c)(2) are taken into account when gain is recognized with respect to stock of a controlled foreign corporation."
53

See Reg. 1.367(a)-8(b)(1)(iii) and (n)(1).
54

It is interesting to observe that Reg. 1.367(a)-8(n)(1). Reg. 1.367(a)-8(n)(1) merely describes "a new gain recognition agreement that includes appropriate provisions to account for the redemption." Reg. 1.367(a)-8(q)(2), Example 14. Reg. 1.367(a)-8(q)(2), Example 14, Reg. 1.367(a)-8(q)(2), Example 14 Reg. 1.367(a)-8(q)(2), Example 14 uses similar language. The notice, in contrast, expands upon this language to describe "a new GRA that includes appropriate provisions to account for the redemption, *provided the principles of Treas. Reg. § 1.367(a)-8(k)(14(ii) and (iii) are satisfied.*"Notice 2012-15, section 4.01 (emphasis added). References to Reg.1.367(a)-8(k)(14)(ii) and (iii) are repeated in Notice 2012-15, section 6. While this additional language in the notice arguably does not represent any sort of expansion upon the requirements of Reg. 1.367(a)-8(n)(1), it does highlight the IRS's concern that the transferor be able to comply with all of the requirements of Reg. 1.367(a)-8(k)(14)(ii) and (iii), including the requirement to own at least 5% (applying the attribution rules of Section 318, as modified by Section 958(b), of the total voting power and the total value of the outstanding stock of the transferee corporation where such transferee corporation is a foreign corporation. It may also signal a continuing concern at the IRS with the tax results that foreign-parented groups may pursue through the utilization of Section 304. Cf., Section 304(b)(5)(B), as added by P.L. 111-226, applying to acquisitions after 8/10/10. This provision, according to the relevant Joint Committee on Taxation report, "prevents [a] foreign acquiring corporation's E&P from permanently escaping U.S. taxation while being deemed to be distributed directly to a foreign person (i.e., the [foreign parent] transferor)." Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the Senate Amendment to H.R. 1565, Scheduled for Consideration by the House of Representatives on 8/10/10 (JCX-46-10).
55

While, as discussed above, the IRS has clearly evidenced concern about just this sort of duplicative income recognition in the past, it seems to currently have grown comfortable with the concept that the collective income inclusions arising under Sections 367 and 301 in a Section 304 transaction represent no more than an aggregation and acceleration of income recognition events (e.g., a taxable Section 367(a) transaction in one year, followed by a taxable Section 302(d)/Section 301(c)(1) dividend equivalent redemption in a subsequent year). Of course, taxpayers may be quick to respond that the actual income recognition events that may arise within the context of Section 304, as modified by Notice 2012-15, may be very hard to replicate in separate transactions (e.g., the Section 302(d)/Section 301(c)(1) dividend equivalent redemption referenced immediately above, if a truly separate transaction, would generally not involve any recourse to the E&P of the transferred corporation, because Section 304(a)(2)(B) would not apply). (Admittedly, Section 1248 might capture some of these same earnings with respect to the Section 367(a) gain, but the results will not be identical.) Further, there is the question of the propriety of imposing the additional layer of income recognition arising under Section 367(a) and (b) to a fictional transaction that is, itself, a feature of an anti-abuse rule (i.e., Section 304). This is particularly the case given that the fundamental form of the transaction is a sale, where the consideration received by the taxpayer will never be greater than the fair market value of the transferred corporation. (Of course, as observed above in the discussion of Reg. 1.367(a)-8(q)(2), Example 13, the IRS has elsewhere evidenced comfort with income recognition in excess of a taxpayer's receipt of consideration.)
56

Notice 2012-15, section 6.
57

See "U.S. Official Clarifies Outbound Transfer and FTC Splitter Notices," 135 Tax Notes 814 (5/14/12).
58

Id.
59

Id. The Section 301(c)(3) gain in this example would appear to be $20, with the reference to $30 a typo. The subsequent variation of this example in the report, where $5 of the acquiring corporation's E&P and $5 of the acquiring corporation's basis are not accessible, resulting in $30 of Section 301(c)(3) gain, appears to confirm this point.
60

While the reported example is somewhat difficult to parse (e.g., what happened to the $20 Section 301(c)(1) dividend?), the facts suggest that the U.S. transferor would not be able to satisfy Reg. 1.367(a)-8(k)(14)(ii) and (iii) andReg. 1.367(a)-8(k)(14)(ii) and (iii) and Reg. 1.367(a)-8(n)(1) and, accordingly, the entire $50 of gain subject to the GRA would effectively be triggered and reconized. What is still not clear, as discussed immediately below, is whether such gain would arise wholly under Section 367(a) or under both Section 367(a) and Section 301(c)(3).

61

Again it is assumed that the reference to $30 of gain in this variation of the example was a typo; the proper amount appears to have been $20.

62

In this regard, it is worth noting that, in early May 2011, it was reported that "[William Alexander, IRS Associate Chief Counsel (Corporate), stated that] the IRS and Treasury are also rethinking [the 2009 Proposed Basis Regulations]. The regs' finalization isn't a priority guidance item, he said, warning that 'it will be a while.' ... 'I'm not saying that we've abandoned our proposal in any way. What I am saying is that we take notice and comment seriously,' Alexander said. 'We're going to sit back and take another look at this probably from the ground up and then sort of figure out where we are.'" 2011 TNT 85-3 (5/3/11).

63

This fact pattern is, admittedly, highly unlikely to occur in practice.

64

Preamble to REG 127740-04.

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