

September 24, 2014

## Treasury and IRS Issue Inversion Notice

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Laurence M. Bambino  
New York  
+1.212.848.4213  
[lbambino@shearman.com](mailto:lbambino@shearman.com)

Roger J. Baneman  
New York  
+1.212.848.4894  
[rbaneman@shearman.com](mailto:rbaneman@shearman.com)

Laurence E. Crouch  
Palo Alto  
+1.650.838.3718  
[lrouch@shearman.com](mailto:lrouch@shearman.com)

Kristen M. Garry  
Washington, D.C.  
+1.202.508.8186  
[kgarry@shearman.com](mailto:kgarry@shearman.com)

Alfred C. Groff  
Washington, D.C.  
+1.202.508.8090  
[agroff@shearman.com](mailto:agroff@shearman.com)

Lawrence M. Hill  
New York  
+1.212.848.4002  
[larry.hill@shearman.com](mailto:larry.hill@shearman.com)

Thomas D. Johnston  
Washington, D.C.  
+1.202.508.8022  
[thomas.johnston@shearman.com](mailto:thomas.johnston@shearman.com)

Douglas R. McFadyen  
New York  
+1.212.848.4326  
[dmcfadyen@shearman.com](mailto:dmcfadyen@shearman.com)

**The Treasury Department and the IRS released Notice 2014-52 (the “Notice”) on September 22nd to limit expatriation transactions. The Notice states that Treasury will issue regulations intended to limit the tax benefits of certain post-expatriation transactions and also narrow exceptions to the expatriation rules of Section 7874. The post-expatriation transactions that are the subject of the Notice are transactions in which previously untaxed earnings of the acquired U.S. corporation might otherwise escape U.S. tax. The Notice states that these Treasury regulations generally will apply to transactions completed on or after September 22, 2014 (i.e., no grandfathering).**

Generally, a corporate inversion subject to Section 7874 is a transaction where a foreign corporation acquires a U.S. corporation (or they combine under a new foreign parent corporation), the shareholders of the U.S. corporation receive 60% or more of the stock of the foreign corporation and the foreign corporation does not have 25% or more of its worldwide operations in its country of organization. Under Section 7874(a)(1), such an inverted U.S. corporation could not use pre-acquisition losses to offset gain recognized during an “applicable period” of 10 years following the inversion. Under Section 7874(b), if the shareholders of the U.S. corporation received 80% or more of the stock of the foreign corporation, the foreign corporation would be taxable as a U.S. corporation.

### Treasury Regulations to Prevent Accessing Offshore Earnings

U.S. tax rules generally provide that active earnings of foreign subsidiaries of a U.S. corporation are not subject to current U.S. tax until such earnings are repatriated or deemed repatriated under Section 956. New Treasury regulations will apply to inverted corporations that satisfy the 60% ownership test.

## Contacts (cont'd)

Robert A. Rudnick  
Washington, D.C.  
+1.202.508.8020  
[rrudnick@shearman.com](mailto:rrudnick@shearman.com)

Michael B. Shulman  
Washington, D.C.  
+1.202.508.8075  
[mshulman@shearman.com](mailto:mshulman@shearman.com)

D. Kevin Dolan  
Washington, D.C.  
+1.202.508.8016  
[kevin.dolan@shearman.com](mailto:kevin.dolan@shearman.com)

Jeffrey A. Quinn  
New York  
+1.212.848.7335  
[jeff.quinn@shearman.com](mailto:jeff.quinn@shearman.com)

Ethan D. Harris  
Washington, D.C.  
+1.202.508.8163  
[ethan.harris@shearman.com](mailto:ethan.harris@shearman.com)

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## Hopscotch Rules

Under current U.S. tax rules, a loan to a U.S. corporation by its foreign subsidiaries generally is treated as a deemed repatriation. New Treasury regulations will treat loans to, or stock investments in, the foreign acquiring corporation (or its affiliates) within 10 years of the expatriation transaction as deemed repatriations to the acquired U.S. corporation.

## De-Controlling of CFCs

Immediately following an expatriation, the foreign subsidiaries of the acquired U.S. corporation remain CFCs. As CFCs, these foreign subsidiaries remain subject to the subpart F rules and Section 956. U.S. corporations contemplating expatriation transactions have considered restructuring transactions that would result in foreign subsidiaries no longer being treated as CFCs. If successful, earnings of the former CFCs could be loaned or distributed to the foreign acquiring corporation possibly without such earnings being subject to U.S. tax. The new rules generally would recharacterize de-controlling transactions undertaken within 10 years of the expatriation transaction to preserve the CFC status of the foreign subsidiaries of the acquired U.S. corporation.

## Related Party Stock Sales

An additional rule would prevent transactions in which the foreign acquiring corporation would transfer stock of the acquired U.S. corporation to CFCs in exchange for cash or CFC business operations in a manner that would cause the untaxed earnings of the CFCs to escape U.S. taxation. This rule would not be limited to corporate expatriations.

## Expanding Scope of Section 7874 Stock Ownership Tests

The Notice describes Treasury regulations to be issued that marginally expand the scope of transactions subject to Section 7874.

Under one rule, if more than 50% of the assets of the foreign acquiring corporation group are passive assets, such as cash or marketable securities, then a proportionate amount of the stock of the foreign acquiring corporation will be treated as not outstanding for purposes of the Section 7874 stock ownership tests. Under a second rule, if the acquired U.S. corporation makes an extraordinary distribution to its shareholders during the 36-month period prior to the corporate inversion, the distribution will be disregarded for purposes of these stock ownership tests. For this purpose, an extraordinary distribution will be the amount of all distributions during a taxable year that exceed 110% of the average amount of such distributions during such 36-month period, including spin-off transactions and arrangements where any cash consideration paid to shareholders of the acquired U.S. corporation in the corporate inversion is funded by such U.S. corporation. The Notice states that a similar extraordinary distribution rule will be added to the Section 367(a) rules, which generally provide for shareholder-level taxation on outbound stock transfers where the value of the acquired U.S. corporation exceeds the value of the foreign acquiring corporation.

## Spinversions

One type of “spinversion” is where a U.S. corporation undertakes a partial corporate inversion by transferring assets to a new foreign corporation and distributing the stock of such foreign corporation to its shareholders. Current Section 7874 rules provide that, for purposes of the 80% ownership test, the foreign corporation stock generally will not be treated as received by such shareholders with the result that the foreign corporation is not treated as a U.S. corporation. These rules were intended to permit internal corporate restructurings. The Notice states that new rules will cause the distributed foreign corporation in this type of spinversion to be treated as a corporation for U.S. tax purposes, while retaining an exception for internal restructurings.

## Effective Dates for the New Rules

The Notice provides that the Treasury regulations described therein will apply to transactions that are completed on or after September 22, 2014. No exceptions are provided for expatriation transactions that have executed transaction documents.

## Additional Guidance

The Notice also states that the Treasury Department and the IRS expect to issue additional guidance to further limit inversion transactions that are contrary to the purposes of Section 7874 and the benefits of post-inversion tax avoidance transactions. Notably, the Notice specifically mentions that the Treasury Department and the IRS are considering guidance to address earnings stripping transactions (reductions in U.S. tax through cross-border intercompany debt). Finally, the Notice provides that future guidance will apply prospectively but that the Treasury Department and IRS expect that, to the extent any tax avoidance guidance applies only to inverted groups, such guidance will apply to groups that completed inversion transactions on or after September 22, 2014.

Inversion transactions are an area that is continuing to evolve, including as a result of the new rules announced by the Treasury Department and the IRS in the Notice. Please do not hesitate to contact any of us if you have any questions regarding the inversions transactions generally or the Notice.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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