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Opérations d'inversion : l'IRS annonce l'adoption prochaine de nouveaux règlements

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The IRS, in continuing to respond to pressures from Congress and President Obama, issued Notice 2015-79 (Notice) on November 19, 2015, which further restricts so-called inversion transactions under Section 7874 of the Internal Revenue Code. According to the Notice, regulations will be issued affecting inversion transactions occurring on and after November 19, 2015. Those regulations will cover transactions that are viewed as contrary to the policies behind Section 7874 and tax-avoidance transactions occurring after an inversion transaction. The new regulations will also correct or clarify provisions of Notice 2014-52, issued on September 22, 2014 (2014 Notice).

Section 7874 generally applies to an acquisition of a domestic entity by a foreign corporation when, after the acquisition, the former owners of the domestic entity own a threshold amount of the stock of the foreign acquiring corporation, and the expanded affiliated group (EAG), which includes the foreign corporation, does not have "substantial business activities" in the foreign country where the foreign corporation is organized.

If the former owners of the domestic entity own between 60% and 80% of the stock of the foreign corporation after the acquisition, the expatriated entity must pay tax on its "inversion gain" for 10 years after the inversion. Inversion gain is generally any income from the transfer or licensing of property either in connection with the inversion or, if afterward, to a foreign related person. Inversion gain cannot be offset by tax attributes such as net operating losses (NOLs).

If, instead, the former owners of the domestic entity own at least 80% of the stock of the foreign corporation after the acquisition, the foreign corporation is treated as a domestic corporation for all U.S. federal tax purposes after the acquisition.

For the purpose of calculating the 60% and 80% thresholds, certain stock of the foreign acquiring corporation is disregarded. This includes stock held by other members of the EAG, stock sold to the public in connection with the inversion and stock received in exchange for certain liquid assets.

The regulations announced by the Notice are outlined below.

Regulations on Transactions Contrary to Section 7874

Foreign Corporation Has Substantial Business Activities but Is Not Subject to Tax. As noted above, the anti-inversion provisions of Section 7874 do not apply when the EAG, including the foreign acquiring corporation, has substantial business activities in the relevant foreign country. The Treasury Department and the IRS were concerned that such a foreign acquiring corporation may not be subject to tax in that foreign country as a resident. This could be the case if, for instance, the relevant foreign country's criteria to determine residency are different from the United States' criteria, or the foreign acquiring corporation is treated as tax transparent by the foreign country but not by the United States. The regulations will provide that an EAG cannot qualify for the substantial business activities exception unless the relevant foreign country taxes the foreign acquiring corporation as a resident.

Third-Country Transactions. The Treasury Department and the IRS are aware of structures whereby a newly organized foreign parent acquires two existing target entities, one of which is domestic. The Treasury Department and the IRS determined that such transactions are less likely than direct acquisitions to be motivated by a non-tax business purpose. Accordingly, the Notice provides that, in such cases,

the stock of the new foreign parent corporation issued in exchange for the foreign entity in connection with the potential inversion transaction will be disregarded.

This provision applies if the following requirements are met:

- a foreign parent corporation also acquires a foreign target corporation in a related transaction;
- the gross value of the assets of the foreign target exceeds 60% of the gross value of all "foreign group property" (excluding the domestic entity);
- the tax residence of the foreign parent corporation differs from that of the foreign target; and
- the former owners of the domestic entity hold at least 60%, but less than 80%, of the shares of the foreign parent corporation after the transaction.

This rule seems harsh and may not be supported by the legislative history.

Disqualified Stock Attributable to Avoidance Property. As noted above, Section 7874 disregards certain categories of foreign acquiring corporation stock (known as "disqualified stock") for the purpose of determining ownership fractions after the potential inversion transaction. Disqualified stock generally consists of stock issued in exchange for certain liquid assets (referred to as "specified nonqualified property"), and stock issued for property acquired in a transaction related to the potential inversion transaction *with a principal purpose of avoiding Section 7874* (avoidance property).

The Treasury Department and the IRS were concerned that some taxpayers were not applying the avoidance property rule properly, so the regulations will clarify that avoidance property can be any property transferred with a principal purpose of avoiding Section 7874 (not just stock used for an indirect transfer of specified nonqualified property).

Regulations on Post-Inversion Tax-Avoidance Transactions

Changes to the Definition of Inversion Gain. As noted above, inversion gain cannot be offset by other tax attributes such as NOLs. The Treasury Department and the IRS were concerned that an expatriated entity was previously able to remove foreign operations from the United States' taxing jurisdiction indirectly without paying tax. For example, an expatriated entity could have its controlled foreign corporation (CFC) sell property to a related foreign person in a transaction that generates Subpart F income, which would not be considered inversion gain and could therefore be offset with NOLs.

Accordingly, regulations will provide that inversion gain includes income recognized by an expatriated entity from the indirect transfer or licensing of property either as part of the inversion transaction or, in certain cases, afterward. In addition, the regulations will clarify that the transfer or licensing of property by a partnership is treated as the transfer or licensing by a partner of its proportionate share of the property.

Transfers Subject to Section 1248. If the shareholder of a foreign corporation exchanges stock of a CFC in a tax-free transaction, that shareholder is required in certain cases to recognize a deemed dividend equal to the CFC's "Section 1248 amount" (*i.e.*, an amount generally equal to the earnings and profits of the CFC). The Treasury Department and the IRS were concerned that in cases in which a CFC has little or no earnings and profits, an expatriated entity could transfer the CFC in a tax-free transaction and none of the unrealized appreciation of the CFC would be subject to U.S. federal income tax. The forthcoming regulations will require an expatriated entity to recognize the full amount of unrealized appreciation as taxable gain in such cases, to the extent that the unrealized appreciation exceeds the deemed dividend under Section 1248. This can both accelerate gain to an expatriated entity and cause a mismatch in the use of future foreign tax credits attributable to the transferred CFC.

Regulations as Corrections or Clarifications

PFIC Insurance Income. In the 2014 Notice, the IRS announced that regulations will be issued providing that stock of a foreign acquiring corporation that is attributable to passive assets is disregarded in the calculation of the ownership fraction under Section 7874. Passive assets included property that gives rise to certain insurance income described in Section 1297(b)(2)(B) and certain property held by domestic corporations engaged in the active conduct of a banking or insurance business. The forthcoming regulations will provide that such properties are not treated as passive assets for the purposes of Section 7874.

Pre-inversion Distributions. The 2014 Notice provides that non-ordinary course distributions that occur during the 36-month period ending on the date of an inversion transaction are disregarded when calculating the ownership fraction under Section 7874. The Treasury Department and the IRS determined that this rule could cause the former owners of a domestic entity to be treated as owning stock of the foreign acquiring corporation in excess of the Section 7874 thresholds even when the former owners own no, or only a *de minimis* amount of, stock in the foreign acquiring corporation. This could happen, for instance, if foreign acquiring corporation stock is disregarded for the purposes of Section 7874. The forthcoming regulations will include a *de minimis* rule intended to provide relief.

Transactions That Decontrol or Dilute Ownership of CFCs. The provisions of the 2014 Notice recharacterize reductions in an expatriated entity's ownership of a CFC in certain situations, subject to a *de minimis* rule. The forthcoming regulations will clarify this *de minimis* exception.

Effective Dates

These dates generally are effective with respect to transactions that are completed on or after November 19, 2015. However, the rules relating to changes in the definition of inversion gain, transfers subject to Section 1248 and transactions that decontrol or dilute ownership in CFCs will apply only if the relevant inversion transaction was completed on or after September 22, 2014.

Earnings Stripping Guidance Under Consideration

Finally, the Notice includes a reference to guidance on earnings stripping that may be forthcoming. Specifically, the IRS notes that the Treasury Department and the IRS continue to consider ways to address structures whereby taxpayers shift U.S.-source earnings to lower-tax jurisdictions through earnings stripping, including through the use of intercompany debt. A similar statement appeared in the 2014 Notice. However, no projected release date for such guidance has been published.

Conclusion

Other than the corrections and clarifications, which are relatively minor, the provisions of the Notice significantly broaden the types of transactions that are subject to the inversion rules. Parties that have engaged in an inversion since September 22, 2014 or that are planning transactions that could be subject to the inversion rules should review the Notice carefully with their tax advisers.

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