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U.S. Anti-Inversion Basics and Cross-Border Private Equity Considerations

Introduction to Inversions

- What is an inversion?
  - An inversion occurs when a corporation restructures so that a current U.S. parent is replaced by a foreign parent and the original U.S. parent company becomes a subsidiary of the foreign parent.
- In the early 2000s, Congress was concerned primarily with inversion transactions that take place within a single corporate group, i.e., transactions in which U.S. corporations reincorporate in foreign jurisdictions and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation from the same group.

Introduction to Inversions

- The legislative history also indicates that Congress focused on transactions with "little or no non-tax effect or purpose," after which U.S. corporations "continue to conduct business in the same manner as they did prior to the inversion" and the acquiring/parent foreign entities have only "a minimal presence in a foreign country of incorporation."
- Congress enacted Section 7874 (the "U.S. Anti-Inversion Rules") in the wake of an increase in inversion transactions starting in the 1990s to discourage transactions in which:
  - (i) a U.S. target is acquired by a non-U.S./foreign corporation and
  - (ii) the historic owners of the U.S. target own 60% or more of the foreign corporation by reason of owning interests in the acquired U.S. target

Simple Inversion Example

INITIAL STUCTURE

U.S. Target Shareholders

U.S. Target

INVERSION TRANSACTION

U.S. Target Shareholders

Foreign Acquirer Shareholders

New Foreign Acquirer Shares

Foreign Acquirer

U.S. Target

Merger

Merger Sub (U.S.)

FINAL STRUCTURE

U.S. Target Shareholders

Foreign Acquirer Shareholders

Foreign Acquirer

U.S. Target

Inversions Under Section 7874

- Section 7874(a) – the U.S. Anti-Inversion Rules - generally will apply to an inversion if four conditions are met:
  - Pursuant to a ***plan*** (or series of related transactions);
    - Plan deemed to exist where acquisition occurs during 2 years before or 2 years after the ownership requirements below are met
  - A non-U.S./foreign corporation directly or indirectly acquires ***substantially all*** of the assets of a U.S. corporation or partnership
    - Note that "substantially all the assets" includes acquiring stock of the U.S. target under the "indirectly" language; inversions are not limited to asset deals and most frequently take the form of stock acquisitions
  - After such acquisition, former owners of the U.S. target own ***at least 60%*** (by vote or value) of the foreign corporation by reason of having been owners of U.S. target (the "**Ownership Fraction**"); and
  - After such acquisition, the foreign corporation's "expanded affiliated group" does not have "***substantial business activities***" in the foreign country in which, or under the laws of which, the foreign corporation is created and organized.

When Does an Inversion Occur?

- Thus, under the U.S. Anti-Inversion Rules, an “inversion” occurs where a non-U.S. entity acquires substantially all of a U.S. business whose former owners own 60% or more (by vote or value) of the foreign acquiring corporation after the transaction by reason of their ownership in the U.S. business **and** when the non-U.S. corporation’s “expanded affiliated group” doesn’t have substantial business activities (the “**SBA test**”) in the country where the non-U.S. acquirer is incorporated.
- If former owners of the U.S. business own 80% or more (by vote or value) of the non-U.S./foreign acquiring corporation, then the non-U.S./foreign corporation is treated as a U.S. corporation for all US tax purposes.
  - 60% and 80% tests are referred to herein as the “Ownership Tests”
  - Must follow special anti-inversion rules when calculating Ownership Tests, which can result in “tax” ownership that differs from actual ownership
- The SBA test (as discussed later herein) may apply to except expatriation from Section 7874.

Section 7874(a) – Inversion Gain

60% Ownership Fraction

- If former owners of the U.S. target own ***60%*** or more but less than 80% of the foreign/non-U.S. acquirer ("**FA**") by reason of owning stock in the U.S. target, there is an inversion but the resulting tax consequences are limited:
  - For the 10 year period following the inversion:
    - The acquired U.S. target will be subject to tax (and will not be able to use tax attributes to reduce such taxable amounts) on gains related to certain transfers and licensing income (the "**inversion gain**")
      - Largely designed to preclude "out from under" planning to get CFCs, IP and other assets out from the U.S. target and into the new foreign parent
    - For purposes of determining foreign tax credits, any inversion gain will be treated as U.S. source (thus denying the U.S. target the ability to use such credits to shelter such gain)
  - Section 4985 imposes a 15% excise tax on the value of options and other equity-based compensation owned by officers, directors and 10% shareholders of an inverted U.S. corporation on the inversion date, but only if other shareholders recognize gain

Section 7874(b) – Deemed U.S. Corporation

80% Ownership Fraction

- If former owners of the acquired U.S. target own ***80%*** or more of the FA, then the FA is treated as a U.S. corporation for all federal tax purposes
- If the 80% threshold is passed, the entire reason for inverting has been defeated and FA may be taxed in both the U.S. and in its country of incorporation.
  - Treaties cannot override this result.
- It should be noted that if FA is owned 60% or more by the former shareholders of the acquired U.S. target, then FA will be subject to the new 1% excise tax on stock buybacks.

Section 7874 – Statutory Exclusions

- When calculating the Ownership Fraction there are statutory exclusions for:
  - “Expanded affiliated group” (“**EAG**”) owned stock
    - Generally, an “expanded affiliated group” means 1 or more chains of corporations connected through stock ownership with a common parent corporation.
    - Stock ownership meets the requirements if it possesses at least 50% of the vote and value of the stock of such corporation.
  - Stock of the FA which is sold in a public offering related to the acquisition
  - Avoidance purpose
- There are additional exclusions provided in Treasury Regulations and other IRS/Treasury guidance which can make the Ownership Fraction more or less likely (but usually more likely) to exceed the 60% or 80% thresholds, as described later herein.

TRAPS FOR THE UNWARY IN CROSS-BORDER PRIVATE EQUITY

Traps for the Unwary

Introduction

- Because Section 7874 applies to acquisitions of domestic entities only if "after the acquisition at least 60 percent of the stock (by vote or value)" of the foreign acquiring corporation is held "by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation" or "by former partners of a domestic partnership by reason of holding a capital or profits interest in the domestic partnership," it would seem as if the U.S. Anti-Inversion Rules should apply only if most — or at least a good portion — of the purchase consideration consists of share consideration that provides the domestic entity owners with a continuing proprietary interest in the foreign acquiring corporation.
- However, the U.S. Anti-Inversion Rules can cause a foreign acquiring corporation to be viewed as a surrogate foreign corporation (or a domestic corporation under Section 7874(b)) even when the purchase consideration consists solely of cash or other non-stock consideration.

Traps for the Unwary (Cont'd)

Introduction

- The reason, discussed further below, is the interaction of the so-called disqualified stock rule and the non-ordinary-course distributions ("**NOCD**") rule.
  - The disqualified stock rule in Section 7874(c)(2) and Treas. Reg. Section 1.7874-4 causes stock of the foreign acquiring corporation to be disregarded from the ownership calculation if it was transferred in a transaction related to the acquisition of the domestic target entity and in exchange for money or other nonqualified property.
- For tax and regulatory reasons, private equity investors will often use a new foreign corporation to acquire a domestic target entity.

Traps for the Unwary (Cont’d)

Introduction

- Thus, the shares that are issued by the new foreign corporation to its investors will often be issued for cash or other non-stock consideration and in a transaction related to the acquisition of the domestic target entity and therefore fall within this disqualified stock rule. In that case, those newly issued foreign acquiring corporation shares are not taken into account in the calculation, in which case the ownership percentage in an all-cash, non-stock transaction will be “zero divided by zero.”
- More specifically, the numerator (which measures the value (or vote) of foreign acquiring corporation stock received by reason of holding an equity interest in the domestic entity, adjusted under the Section 7874 regulations) is zero because it is a cash purchase and there is no rollover, and the denominator (which measures the total value (or vote) of the foreign acquiring corporation’s shares, again adjusted under the Section 7874 regulations) is zero because all of the foreign acquiring corporation’s shares are disqualified stock and therefore not taken into account when computing the ownership percentage described in Section 7874(a)(2)(B)(ii).

Traps for the Unwary (Cont’d)

Introduction

- If that were the end of the analysis, the tax result might be manageable.
- While it is not totally clear how the mathematical result of a fraction divided by zero should be viewed in this context, the IRS has ruled in non-precedential guidance that a fraction of zero over zero will not satisfy the requirement described in Section 7874(a)(2)(B)(ii) (that is, that at least 60 percent of the vote or value of the stock of the foreign acquiring corporation is held by former owners of the domestic entity by reason of holding equity in the domestic entity). See LTR 201432002 (May 1, 2014).
- Despite a taxpayer’s inability to rely on non-precedential guidance, the ruling that zero over zero does not equal or exceed 60 percent is generally sufficient for tax advisers to feel confident that their client is not subject to Section 7874.
- However, the so-called NOCD rule can apply and cause a commensurate increase to both the numerator and the denominator of the “zero-over-zero” fraction, resulting in an ownership percentage of 100 percent and possibly causing the newly formed parent foreign corporation to be viewed as a domestic corporation for U.S. tax purposes.

Leveraged Buyouts and Non-Ordinary Course Distributions

- In order to prevent U.S. target from making distributions of property to its shareholders prior to transactions with foreign acquirers (to lower their ownership fraction), the U.S. Anti-Inversion Rules deem former shareholders of the U.S. target to receive additional shares of the foreign acquirer equal to the value of such non-ordinary course distributions made during the 36-month period ending on the acquisition date.
- So, if a U.S. target repurchases stock from its shareholders, the U.S. Anti-Inversion Rules treat it as if those same shares were transferred in the acquisition if the repurchase occurs within 36 months from the transaction with the foreign acquiring corporation (i.e., as if U.S. target didn’t repurchase stock).

Leveraged Buyouts and Non-Ordinary Course Distributions (Cont'd)

- The operation of the NOCD rules are complex and the definition of a "distribution" also includes "a transfer of money or other property to the former domestic entity shareholders (or partners) that is made in connection with the domestic entity acquisition to the extent the money or other property is directly or indirectly provided by the domestic entity."
  - Should the NOCD rule apply when a domestic borrower provides credit support for a debt the proceeds of which funded the cash acquisition?
  - For example, a newly formed domestic sub of the foreign acquiring corporation will often borrow and use those proceeds to purchase a domestic target.
  - In those cases, if the lender relies on credit/a guarantee of the domestic subsidiary to repay the loan, is there risk that the cash consideration furnished to the domestic target shareholders will be viewed as "directly or indirectly" provided by the domestic target and treated as a distribution that gives rise to an NOCD?

Leveraged Buyouts and Non-Ordinary Course Distributions (Cont'd)

- The effect of the NOCD rules are to increase the numerator and the denominator of the fraction (determined by value, not vote) so as to counteract the effect of the skinny-down distribution.
- Because of the broad definition of "distribution," the NOCD rules might apply in many private equity transactions even if the domestic target did not make any distributions in the 3 years preceding its acquisition.
- *De minimis* safe harbor?
  - The *de minimis* safe harbor requires that there be limited cross-ownership between the acquiring and target groups, and the exception tests whether such cross-ownership exists under broad constructive stock ownership rules.
  - Because private equity groups often have complex ownership structures, it often won't be possible for them to disprove common ownership (and thus show that they qualify for the safe harbor), especially when the complexities of constructive stock ownership are taken into account.

Leveraged Buyouts and Non-Ordinary Course Distributions (Cont'd)

- The deemed acquisition of foreign shares under the NOCD rules applies regardless of whether the distributions are related to the transaction.
- Of note, the U.S. target must take into account distributions made by a "predecessor" for purposes of calculating the NOCDs made by the U.S. target.
  - Predecessor is broadly defined to include any entity acquired by the U.S. target in a transaction in which the former shareholders of the acquired entity receive 10% or more of the U.S. target's stock in the transaction.
  - Consideration paid to former shareholders of the predecessor entity in the acquisition will be treated as NOCDs if it is provided by the acquired entity (e.g., in a leveraged buyout) and not the U.S. target as buyer.

Alphabet Soup: NOCDs, LBOs, and the Anti-Inversion Rules – Example 1

Alphabet Soup: NOCDs, LBOs, and the Anti-Inversion Rules – Example 1 (Cont'd)

Rollover

Legacy Partners

Rollover and Legacy to hold 400/1000 shares of Non-U.S. Fund

PE Fund

Non-U.S. Fund

U.S. Holdco Parent

FA

Merger

DT2

FA Sub

Year 3 (July)

Rollover & Legacy U.S. Partners

Non-U.S. Fund Existing Partners

40%

60%

Non-U.S. Fund

FA

U.S. Holdco Parent

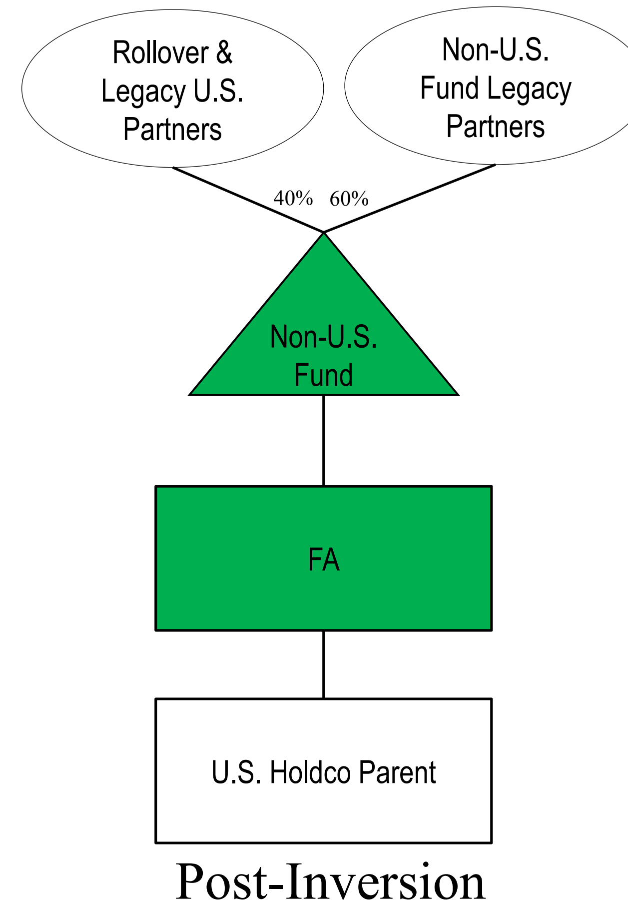
Post-Inversion

Alphabet Soup: NOCDs, LBOs, and the Anti-Inversion Rules - Example 1 (Cont'd)

While the 40% ownership by former U.S. shareholders, may not seem to put the Anti-Inversion Rules in play, in fact, the resulting FA would be considered "inverted".

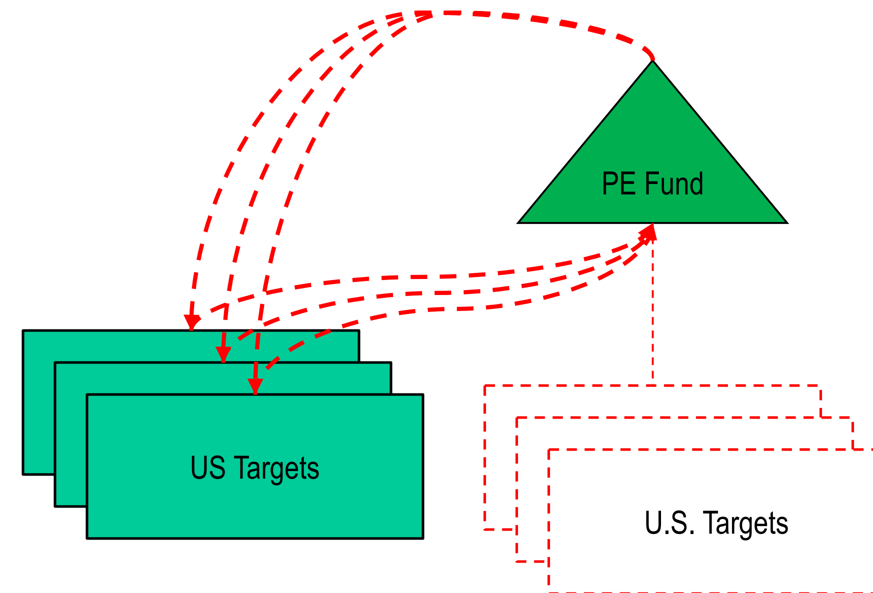
- The $100mm of stock repurchased by DT2 in Year 1 is counted for purposes of the inversion calculation/treated as an NOCD, as the entity is considered a "predecessor", since its rollover shareholders received 10% or more of the U.S. target's stock in the acquisition in the Year 2 LBO. This was within 36 months of the inversion transaction in July of Year 3.

- The $600mm of acquisition financing in Year 2 is counted for purposes of the inversion calculation/treated as an NOCD, as the shareholders of the predecessor entity (DT2), will be treated as if the consideration was provided by DT2.



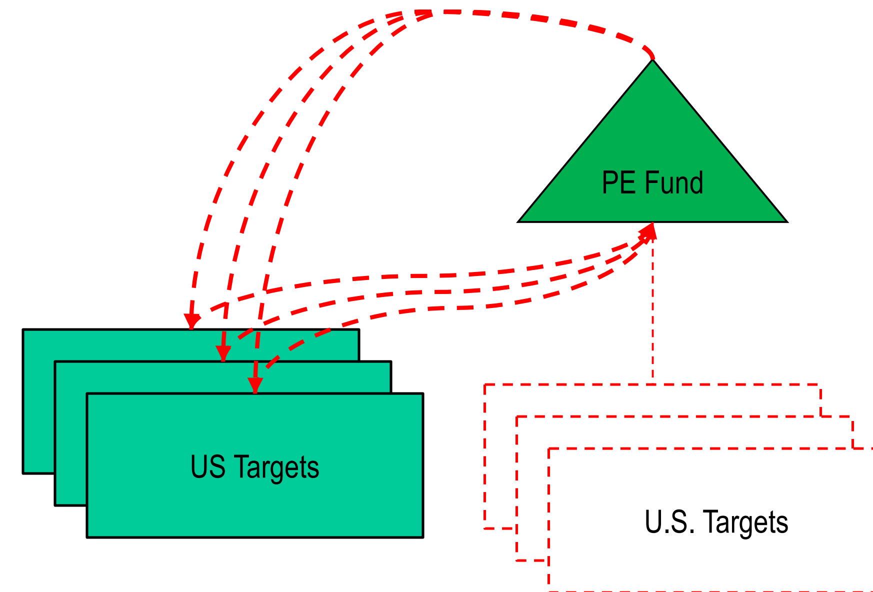
Serial Acquisitions and Bolt-Ons

- The regulations include a rule that targets foreign acquirers whose size has increased as a result of acquiring other U.S. companies for stock consideration (or stock and cash).
- The rule generally applies whenever a foreign company previously acquired a U.S. company in exchange for stock (or stock and cash) during the 36-month period, even if the previously acquired U.S. company was small in relation to the foreign acquirer and thus did not resemble what is typically thought of as an inversion.



Serial Acquisitions and Bolt-Ons

- If a foreign corporation issues equity in exchange for a US business (e.g., in a roll-over), that equity must be tracked for 36 months pursuant to a rule that links such acquisitions for purposes of the inversion rules. In particular, § 1.7874-8 generally reduces the denominator of the inversion fraction by the amount of FA Stock attributable to "domestic entity acquisitions" – i.e., acquisitions of U.S. targets - that FA (or its predecessor) completed within the prior 36 months.
- For purposes of determining the inversion ownership fraction (the 60% or 80% tests), the rule **excludes** from the denominator shares of the foreign acquirer (or a predecessor) issued to former shareholders of previously acquired U.S. companies during the 36 months preceding the signing date of the relevant inversion transaction.



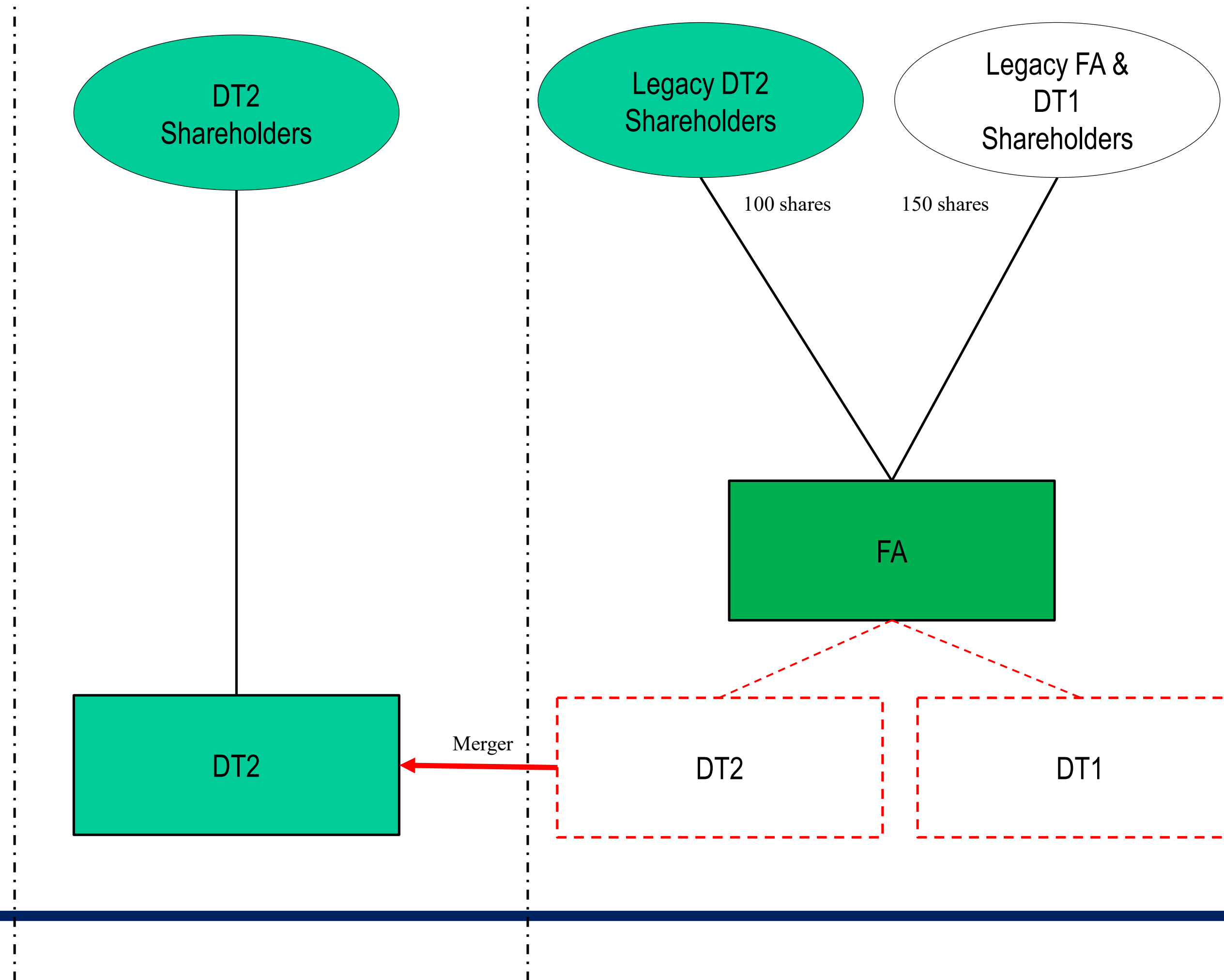
Serial Acquisitions and Bolt-Ons

- Accordingly, the new rule is not limited to so-called “serial inverters.” However, under what is truly a *de minimis* exception, the new rule does not apply if the former shareholders of an acquired U.S. company receive stock that amounts to less than 5% (by vote and value) of the foreign acquirer and is worth less than $50 million at the time of the prior acquisition.
- Stock issued by a foreign acquirer in what might otherwise be considered as a commercial matter a “cash acquisition” of a U.S. target would appear to count as “bad” for these purposes.
- Thus, for example, rollover equity (including options) issued to management in a cash acquisition would appear to be excluded from the denominator for purposes of this regulation, unless the total amount of equity issued satisfies the *de minimis* exception.

Serial Acquisitions – Example 2

Facts:

- FA has 50 “old” shares.
- FA acquires DT1 for 100 FA shares in Year 1 and DT2 for 100 FA Shares in Year 2.
- The acquisitions of DT1 and DT2 are not part of a plan or series of related transactions.

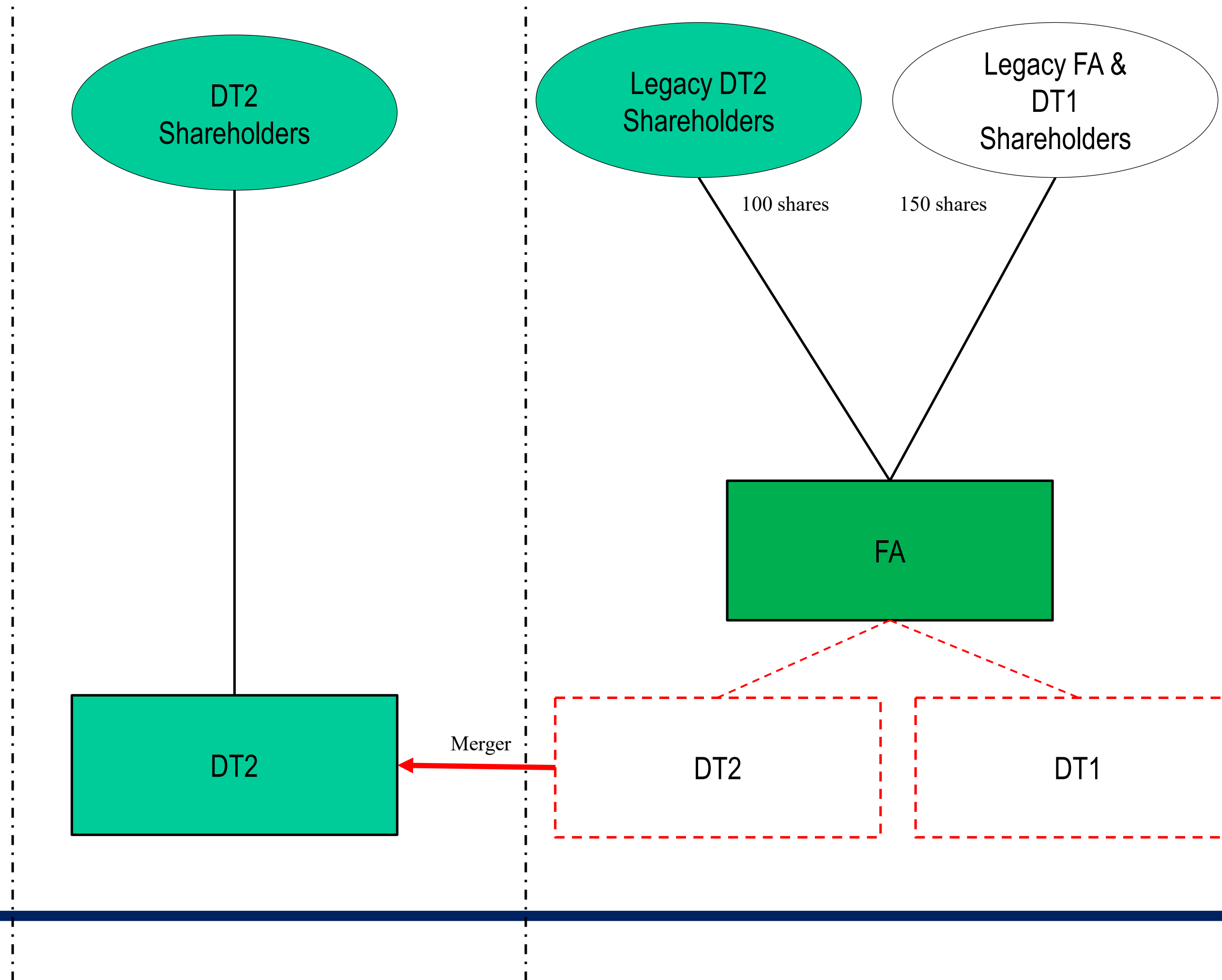


Serial Acquisitions – Example 2 (Cont'd)

Results:

- Under the serial acquisition rule, in calculating the inversion fraction for the DT2 acquisition, the FA shares attributable to the DT1 acquisition are excluded from the denominator resulting in an inversion fraction of 67% (100/150).

- If the acquisitions occurred more than 36 months apart, the inversion fraction for the DT2 acquisition would be 40% (100/250).



Disqualified Stock/Public Offering Rule

- A foreign corporation’s stock is ignored if it is sold in a “public offering” relating to the acquisition of the U.S. target, regardless of whether the stock has been or will be publicly traded (and regardless of whether it is in an actual “public offering” as such term is colloquially used).
- The reason for the disqualified stock rule is clear: It would be easy to decrease the ownership requirement percentage (and thus avoid an inversion) if a foreign acquiring corporation could acquire a domestic entity and then issue new shares in a primary offering around the same time as the acquisition.

Disqualified Stock/Public Offering Rule (Cont'd)

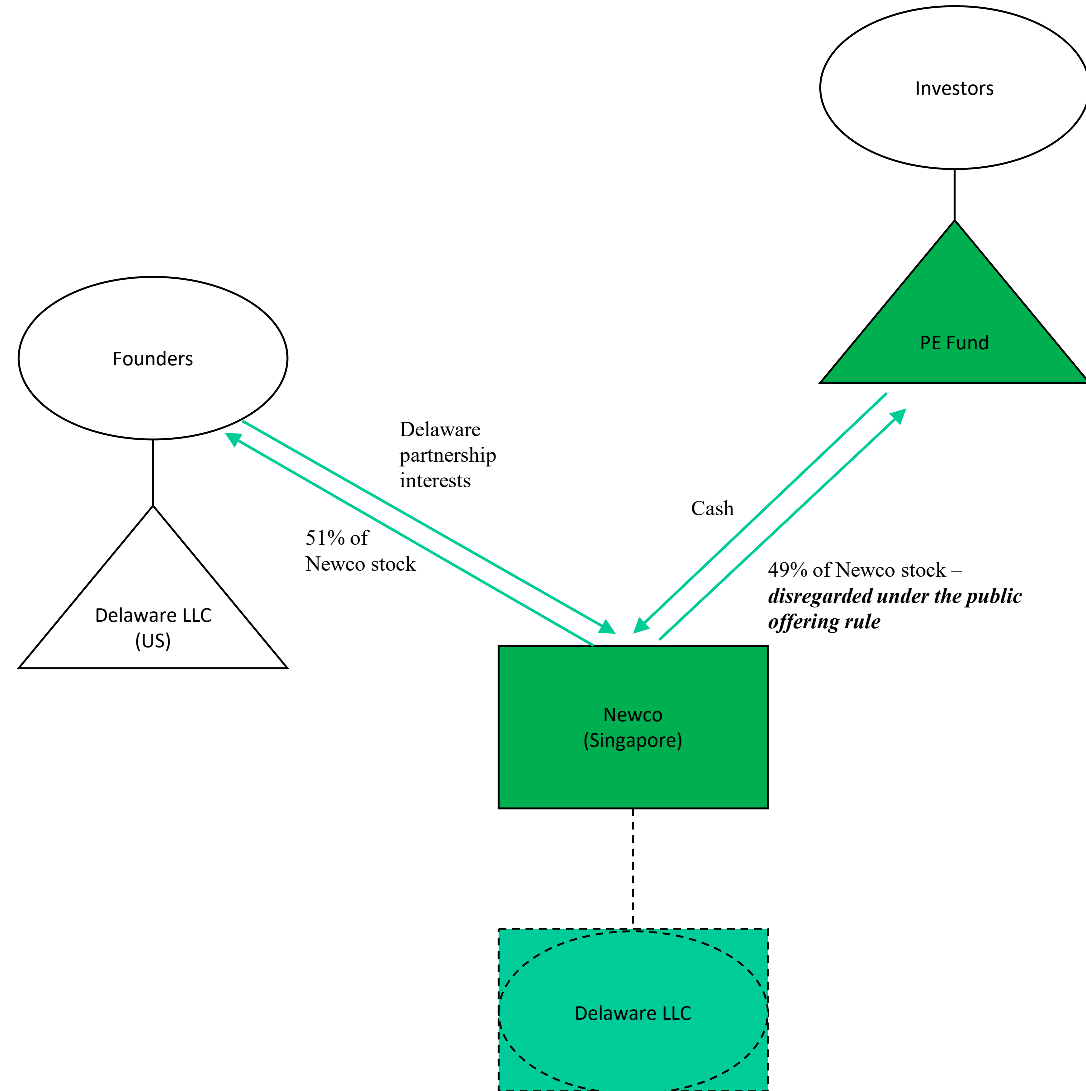
- Section 7874(c)(2)(B) provides that such stock shall be disregarded only if it is "sold in a public offering" related to the domestic entity acquisition, but if the rule were so limited, private equity transactions would not be affected.
- However, the IRS decided that it was necessary to extend the disqualified stock rule to private issuances as well, otherwise the aforementioned planning could be used to avoid an inversion when the stock of the foreign acquiror was not "sold in a public offering."
- Effectively, such stock will be ignored for the Ownership Fraction calculation if:
  - It is stock of FA and that stock is transferred (e.g., any sale, issuance, distribution, exchange, or other disposition)
  - To a person other than the U.S. target (e.g., new investors);
  - In exchange for passive assets (e.g., cash, cash equivalents, marketable securities, specified obligations and property); and
  - If the Ownership Fraction (calculated without regard to the application of the public offering rule) is 5% or more (by vote and value).

Disqualified Stock/Public Offering Rule (Cont'd)

- No rollover but all the stock issued by the foreign acquiring corporation is disqualified stock?
  - For example, assume investors form a foreign corporation and fund it with cash that it uses to purchase all the stock of a domestic corporation. As it so happens, that arrangement describes a structure that is similar to many private equity acquisitions.
- In that case, there is no rollover and thus no "by reason of" stock, so the numerator of the fraction is, absent further adjustment, zero. But all the stock is disqualified, so the denominator is zero as well, meaning the ownership requirement arguably is not satisfied.
- Rely on LTR 201432002 (May 1, 2014)?

Public Offering Rule (with Rollover) – Example 3

Facts:
- Founders form Delaware LLC.
- PE Fund wishes to invest a substantial amount on favorable terms in exchange for 49% of the company.
- PE Fund advises Founders to set up a new entity in Singapore ("**Newco**"), as the investors are more comfortable investing in Singapore entities directly due to Singapore's business-friendly environment and the investors' familiarity with the legal and financial systems there.
- Given that the company already has some operations and employees in Singapore, and Singapore is in close proximity to the vast majority of the company's other employees and its customer base, the founders decide that this is the best choice.

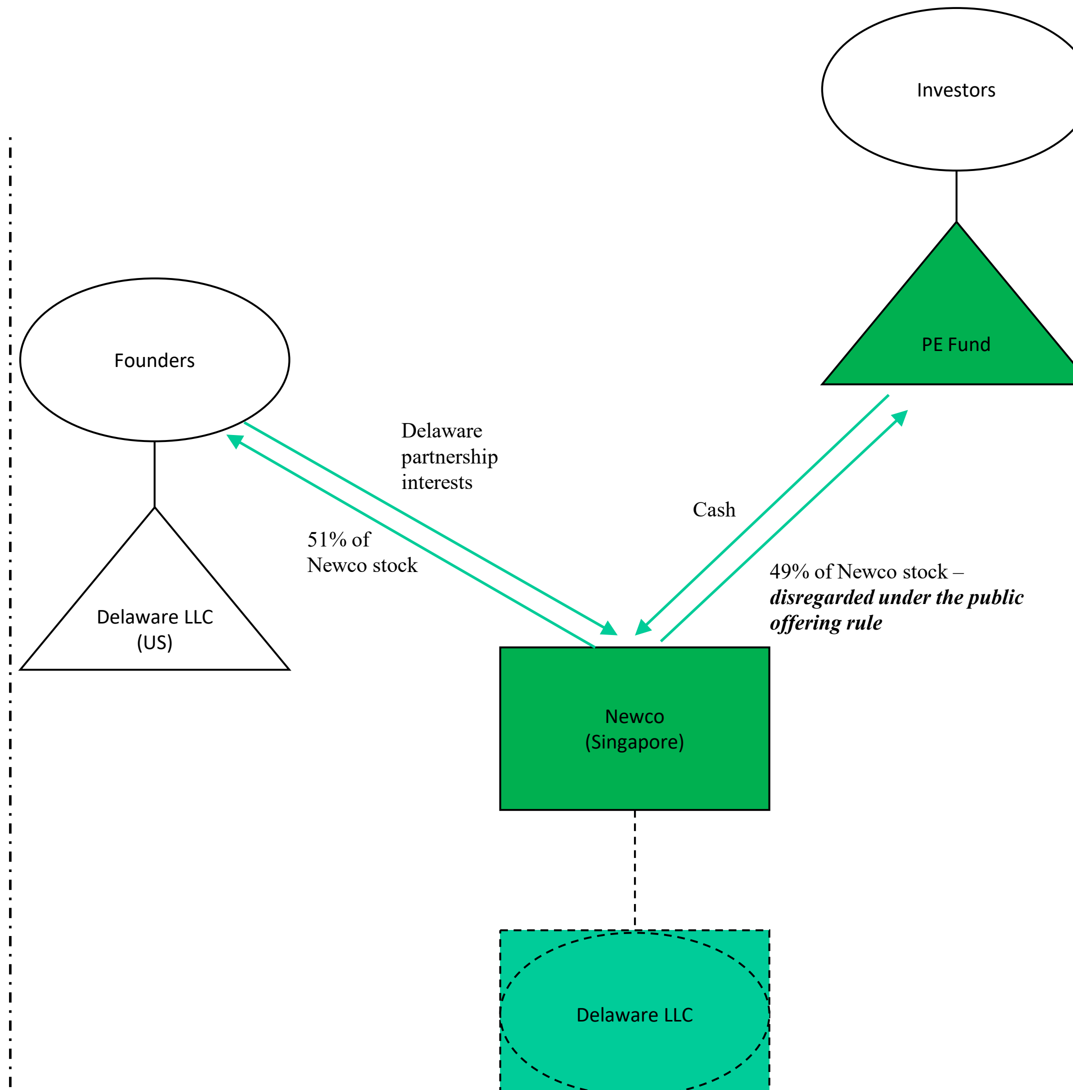


Public Offering Rule (with Rollover) – Example 3 (Cont'd)

Results:

- The transaction would be a "domestic entity acquisition" (i.e., acquisition of the U.S. entity) because Delaware LLC owns valuable business assets that Newco will indirectly acquire.

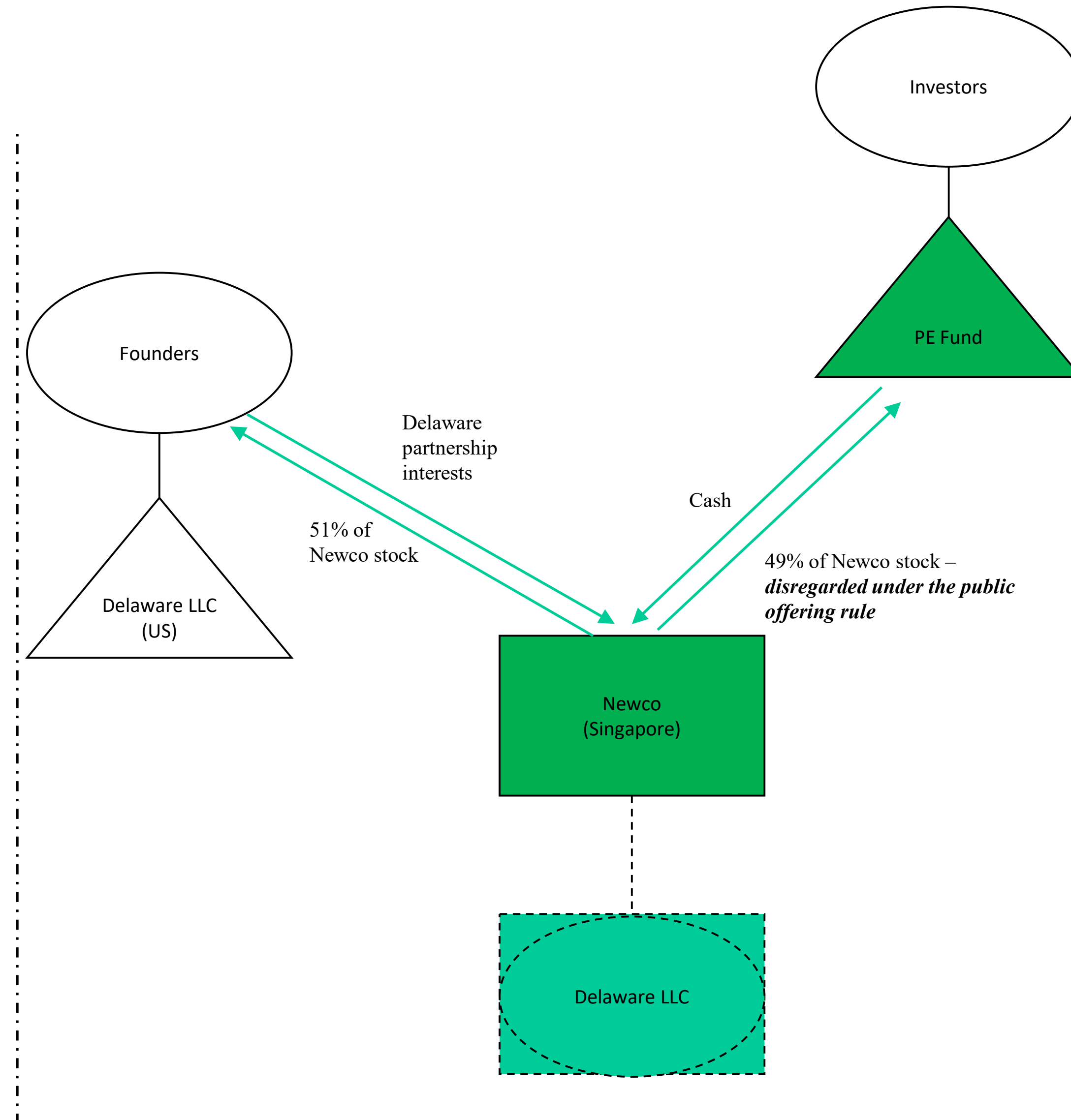
- Even though the existing owners of the Delaware LLC will own only 51% of the company after the transaction, for Sec. 7874 purposes their ownership percentage is treated as 100% due to the so-called "public offering" rule in Reg. §1.7874-4. The "public offering" rule disregards any Newco shares that the new investors receive in exchange for cash or other passive assets such as marketable securities.



Public Offering Rule (with Rollover) – Example 3(Cont'd)

Results (Cont'd):

- The result is that if the founders proceed with their plan, Newco will be treated as a U.S. corporation and a U.S. tax resident for all future tax years. Even if the company does not end up paying incremental U.S. tax (due to the ability to credit any Singaporean taxes), it will need to file U.S. tax returns. Moreover, because the United States does not have a tax treaty with Singapore, any dividends to Singaporean shareholders (including some of the new investors, as well as any employee shareholders who are Singapore residents) will be subject to 30% dividend withholding tax



SECTION 269 GUIDANCE

CCA 202501008 – Application of Section 269

<u>Original Structure</u>

	Entity
Calendar year	US Parent
Calendar year	US Sub
Calendar year	Corp Y Country A
	Company Z Country B

Corp Y: Sells products to customers

Buys products from Z and then on-sells to customers (disregarded for US tax purposes)

- *Company Z checks the box to be a corporation and becomes Corp Z effective 12-31-17*
- *Make a section 898(c) election for 11/30 US tax year end*
- *Election revoked in 2020*

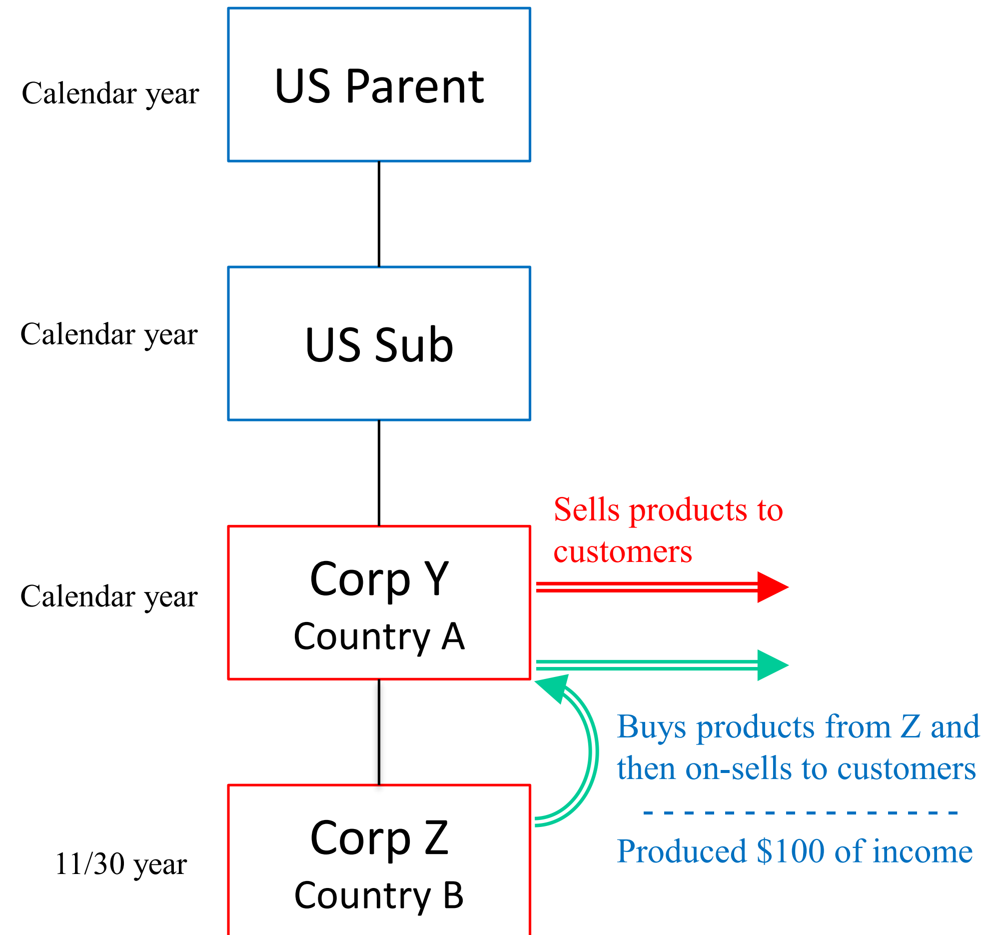
<u>Resulting Structure</u>

	Entity
Calendar year	US Parent
Calendar year	US Sub
Calendar year	Corp Y Country A
11/30 year	Corp Z Country B

Corp Y: Sells products to customers

Buys products from Z and then on-sells to customers

CCA 202501008 – Application of Section 269



Section 269 – Disallowing Tax Benefits

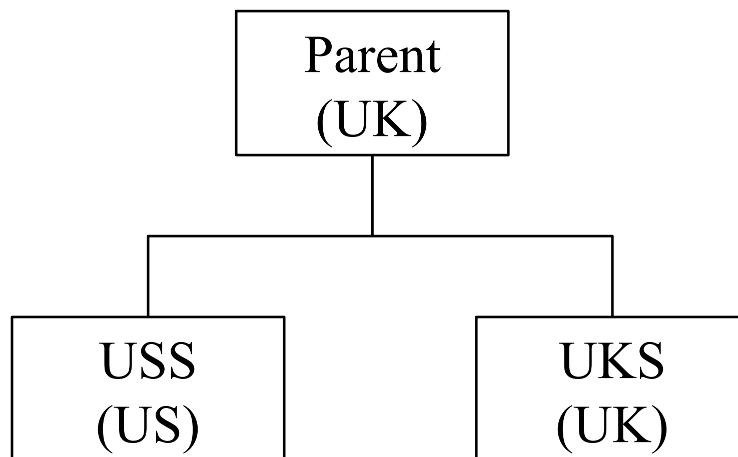
- CCA concludes that the section 898(c) election is disallowed under Section 269, or that income from the gap period can be allocated to Corp Y
    - *Section 269(a) In general If—**(1) any person or persons acquire, directly or indirectly, control of a corporation**, or . . .*
    - *and **the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax** by securing the **benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy**, then the Secretary may disallow such deduction, credit, or other allowance.*
- Accordingly, section 269 requires:
    - Acquisition of control of a corporation
    - ***The principal purpose*** of the acquisition is evasion or avoidance
    - By securing a deduction, credit or allowance
    - That was not otherwise available
- CCA also concludes that Treas. Reg. § 1.245-5T applied to disallow the section 954(c)(6) exception for 50% of extraordinary disposition amounts
- CCA does not discuss (as one would imagine), any of the regulatory authority issue presented by those regulations

Application to the Taxpayer

- CTB Election is treated like an actual incorporation and thus constitutes acquisition of control of a corporation
  - Cites *Dover v. Commissioner*
- The ***principal purpose*** of the transaction was tax avoidance
    - "In response to an [IDR], US Parent did not provide a business purpose for making the CTB Election and making that election effective December 30, 2017, rather than January 1, 2018."
    - "Furthermore, the CTB Election and subsequent section 898(c)(2) election had no effect on the taxpayer's operations described in this section."
    - Election revoked in 2020

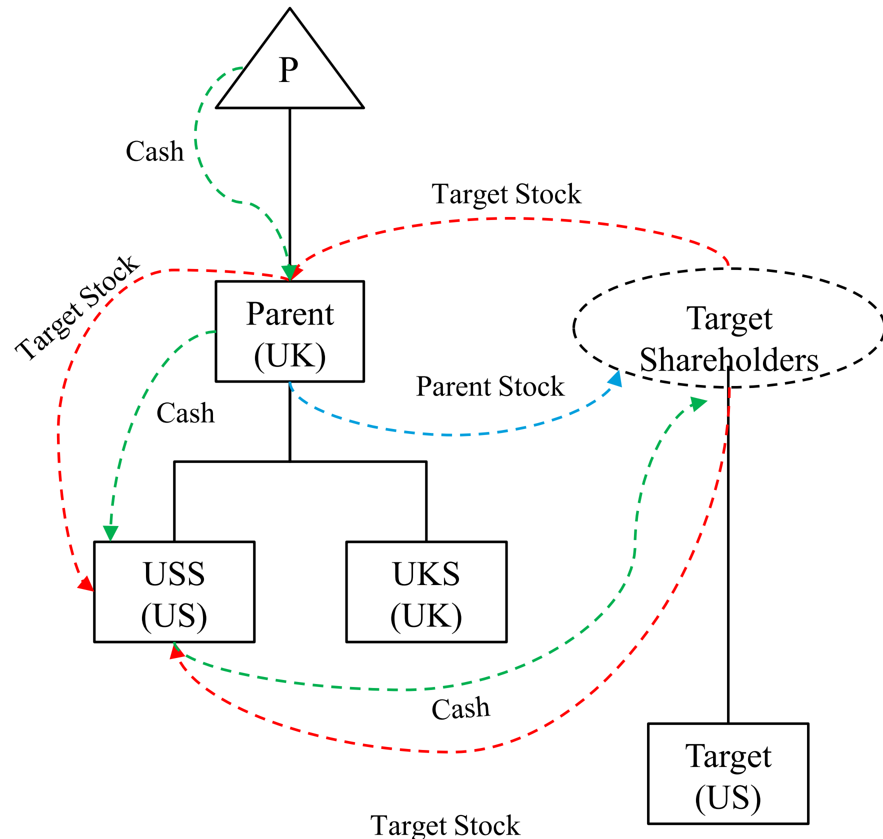
ADD-ON ACQUISITIONS

Portfolio Company Pre-Add-On Structure



- Parent UK entity with US and UK subsidiaries (USS and UKS).
- Assume each of Parent and USS are classified as corporations for US federal income tax purposes.
- Assume U.S. target add-on acquisition where the consideration consists of 80% cash and 20% UK parent stock.
- Assume target SHs are US persons that would like nonrecognition treatment on stock consideration if possible.
  - 40% continuity of interest threshold not met. Limits avenues for nonrecognition treatment on the stock consideration.

Scenario 1A: Target is a US C Corporation



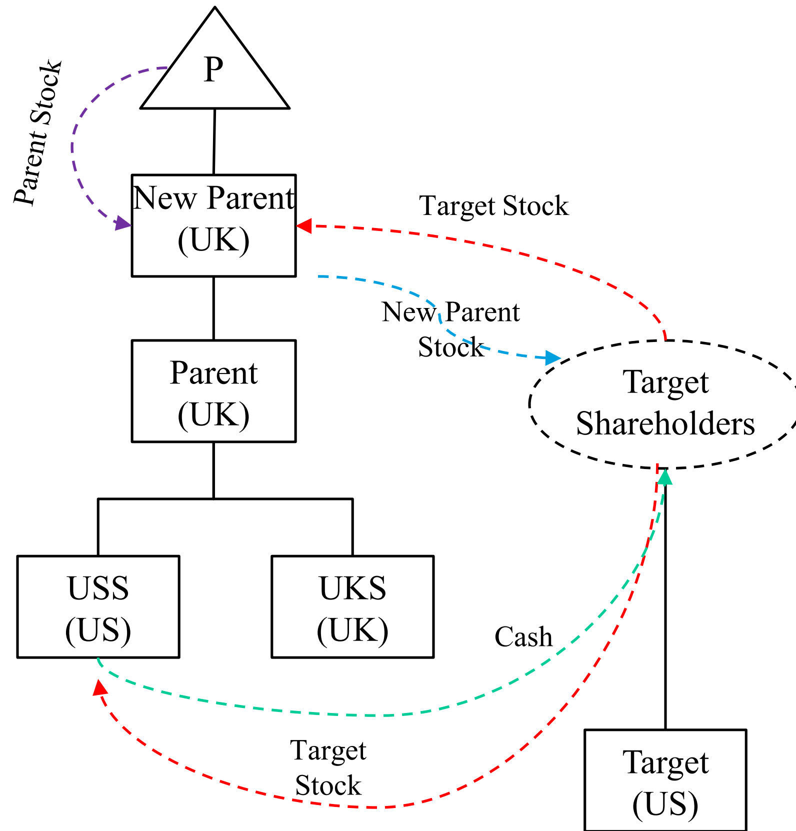
Cash will be contributed to UK Parent by the Fund (e.g., new capital call) to fund the acquisition:

- Contribute portion of target shares to Parent for Parent stock?
  - Could it qualify for section 351 treatment? Accommodation transferor rules.
  - Boot within gain rules – may be addressed through bifurcated structure (cash coming from USS instead of Parent).
- Outbound transfer subject to section 367.
  - Exception for outbound transfer of US stock to foreign corporation generally requires, among other requirements, that foreign corporation group (1) be engaged in active T/B outside the US for at least 3 prior years and (2) have greater FMV than the US target.
  - GRA requirement for any 5% holders.
- Inversion/FIRPTA considerations.

Gain Recognition Agreements (GRA)

- US target SHs that own at least 5% (vote or value) of the transferee foreign corporation immediately after the transfer must enter into GRA in order to avoid gain recognition under section 367.
- By entering into a GRA, the U.S. transferor agrees to recognize the gain if certain triggering events occur within a specified period, typically five years.
- Triggering events include the (i) disposition of the transferred property by the foreign corporation, (ii) a significant change in the ownership of the foreign corporation, or (iii) the failure to comply with the terms of the GRA.
- If a disposition of the property occurs, gain may still be deferred if the property is transferred to a corporation or partnership pursuant to an exchange to which section 351, 354 (but only in a section 368(a)(1)(B) reorganization), or section 721 applies, provided that a "new" GRA is entered into.

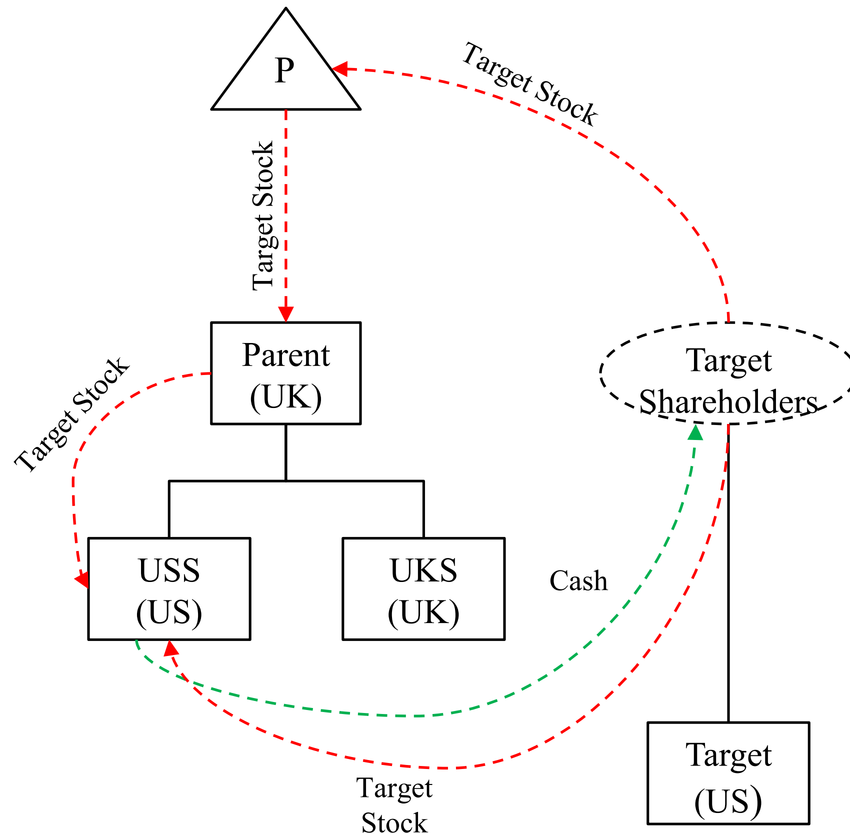
Scenario 1B: Target is a US C Corporation



No Cash into UK Parent (or otherwise concerns with section 351 qualification into UK Parent):

- Form new Parent UKco (for section 351 treatment?) – P contribute Parent to new Parent Ukco and Target Shareholder also contribute target shares to new Parent Ukco.
  - 367 foreign to foreign transfers still raise 5% holder GRA issue (tested at partner level).
  - Same 367 analysis for target SHs.
  - Business purpose requirement?
  - Section 269.

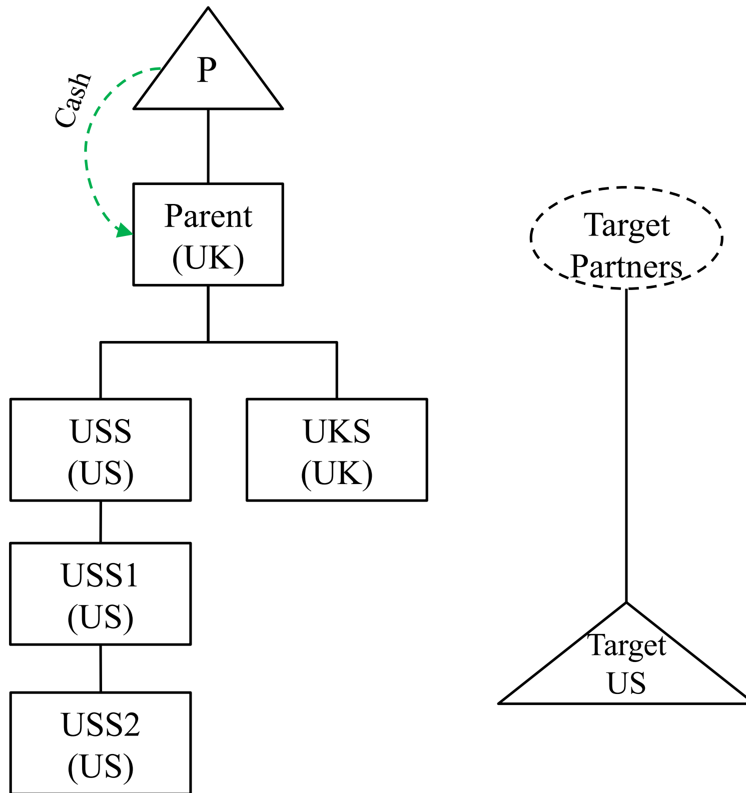
Scenario 1C: Target is a US C Corporation



No Cash into UK Parent (or otherwise concerns with section 351 qualification into UK Parent):

- T SHs instead contribute portion of target shares to a partnership above UK Parent for partnership interest (section 721).
- All previous consideration still applicable on transfers of target stock down the chain (section 367, FIRPTA, inversion).
  - 5% status for GRA determined at partner level.
- Post-closing cash payments with respect to contributed target stock.
  - Deemed dividend from Parent? Tax allocation?
  - Other solutions?

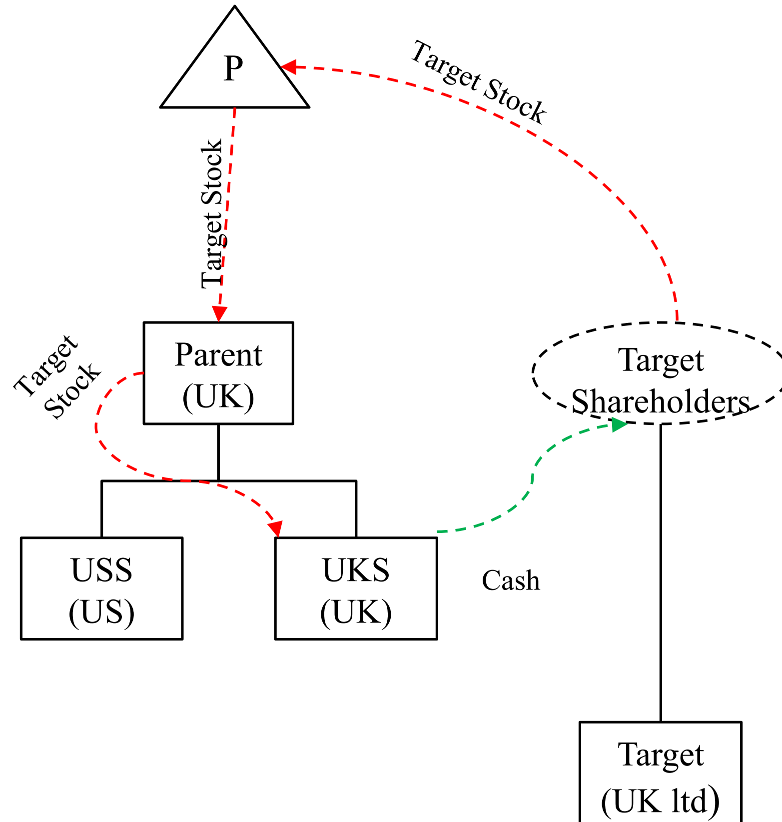
Scenario 2A: Target is a US Partnership



Cash will be contributed to UK Parent by the Fund (e.g., new capital call) to fund the acquisition:

- Transfer of property to UK Parent directly for Parent stock may be subject to adverse tax consequences under section 367(a) and section 367(d).
- Target SHs contribute 20% of target to USS for USS stock (or newly formed US sub for stock of such US sub), then contribute the stock received to Parent for Parent stock.
  - Rev. Rul. 2003-51 on successive 351.
  - See earlier discussion re accommodation transferors.
  - Same section 367 considerations when contributing to Parent.
  - Step transaction/269.

Scenario 3A: Target is a UK ltd.



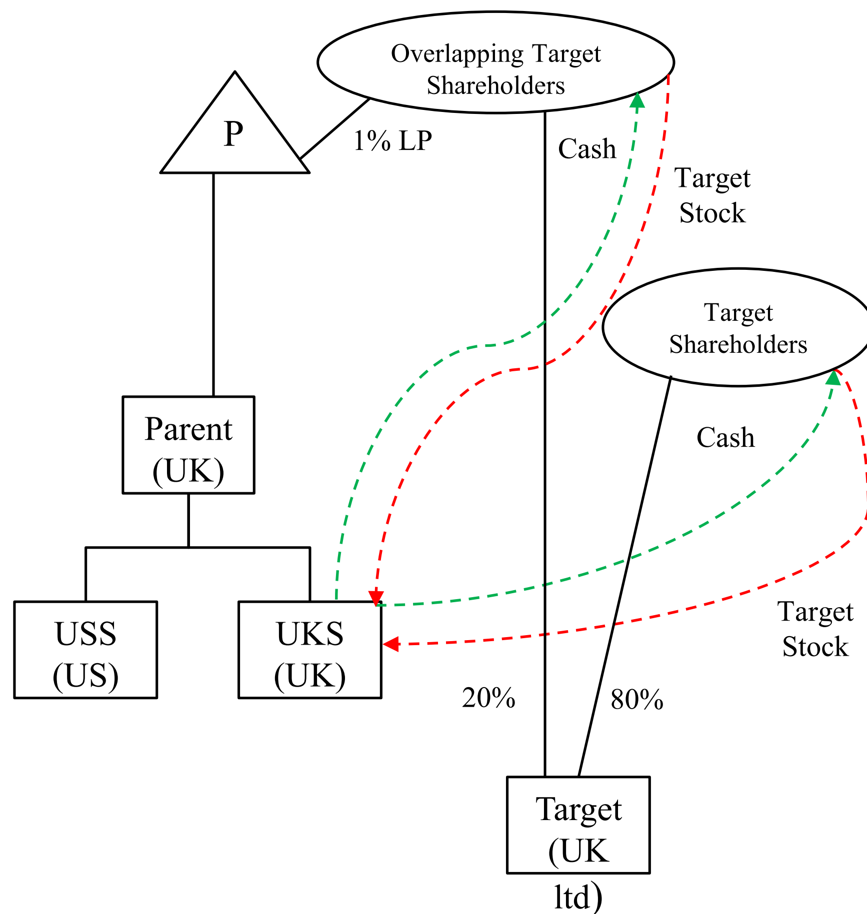
It is often advantageous for a section 338(g) election to be made. Among other reasons, the election can:

- Minimize e&p, increase QBAI (if relevant), facilitate tax efficient post closing restructurings, provide a clean slate for US tax reporting.

A Qualified Stock Purchase is required to make the election.

- Very generally, a corporation must purchase (in a taxable transaction) at least 80 percent of the vote/value of the target corporation within a 1 year period. (section 338(d)(3).
- Target Shareholders in no case can roll 20 percent or more of Target Shares into P or UK Parent.
  - Redemptions of Target Stock are excluded from the denominator (including deemed redemptions in an LBO where consideration is financed by a target borrowing).

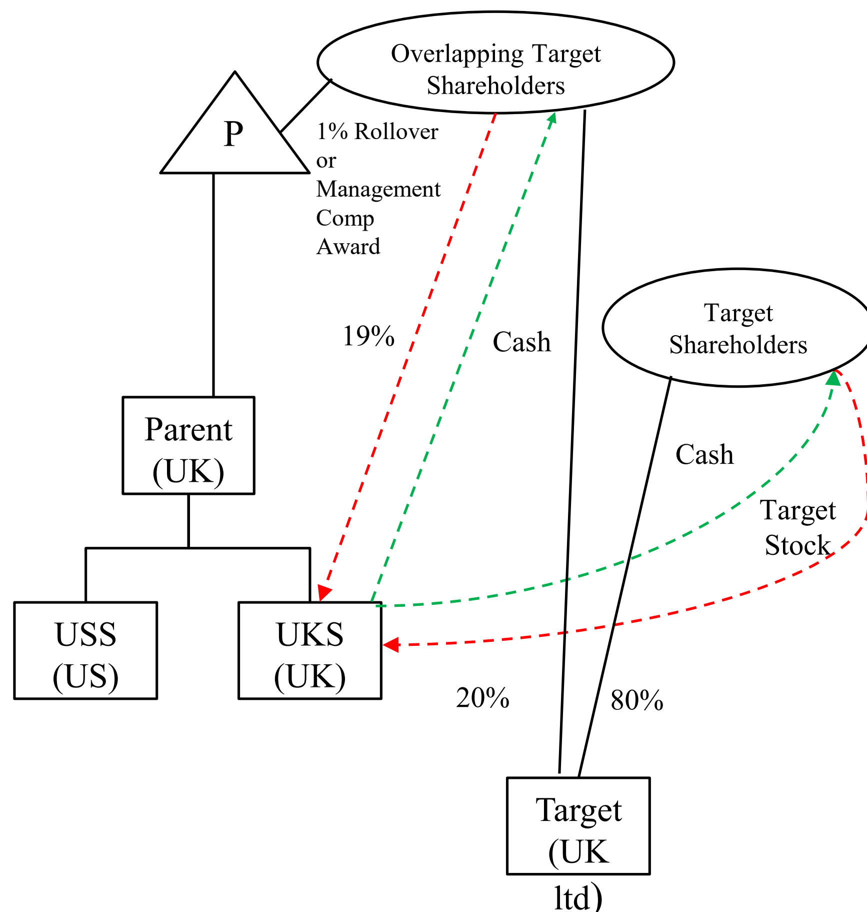
Scenario 3B: Target is a UK ltd. portfolio company where a target shareholder is a limited partner acquiring UK target



Among other requirements for a QSP, the stock cannot be acquired from a person whose stock in target can be attributed (under section 318) to the person acquiring such stock.

- Target stock owned by a Shareholder, who is a Partner in P (the acquiring investment fund) can be attributed to P.
- Any Target shares deemed owned by P in turn would be attributed to Parent and then to UKS because UK Parent owns more than 50% of UKS.
- If Target Shareholders that are Partners in P own 20 percent or more of Target, there can be no QSP because the Target Shares acquired even for cash will be treated as acquired from a related person (even where Target Shareholders owning 20% of Target Shares only own a di minimis LP interest in P).

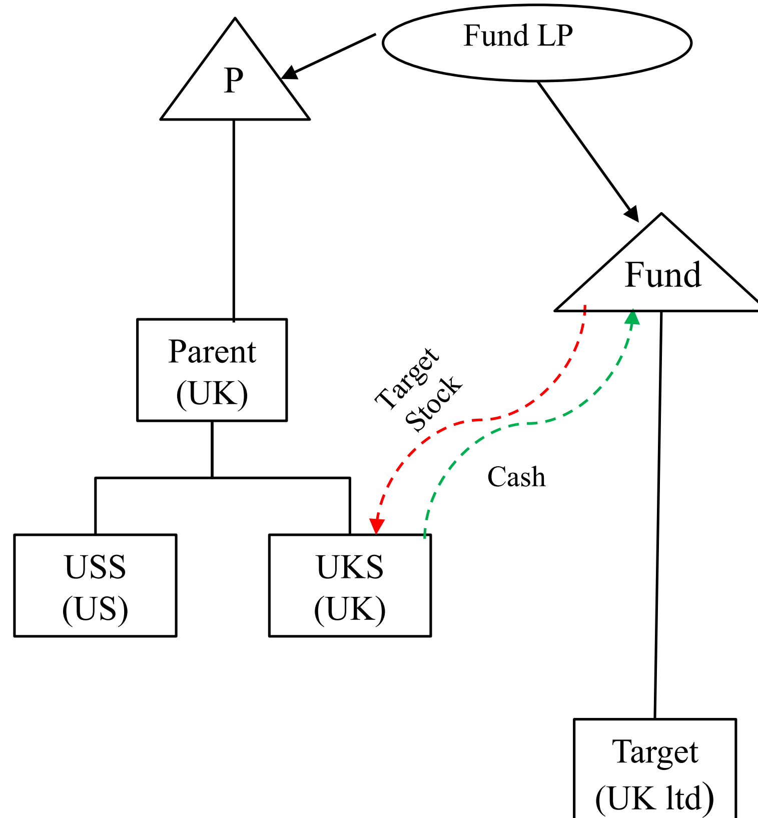
Scenario 3C: Target is a UK ltd. portfolio company where a target shareholder rolls over into the fund vehicle that owns UK Parent



The attribution test also takes into account target shareholders that receive partnership interests in P (the holding partnership of the UK acquisition group) in the transaction (whether by rollover or as part of management compensation arrangement).

- The downward attribution rule, as noted previously, applies to shares deemed owned by the partnership (P), without regard to P's percent ownership of UK Parent.
- By contrast, no downward attribution of Target Shares owned by an individual to UK Parent (unless the individual owns 50 percent in UK Parent).
- Can a direct UK Parent shareholder later become a partner in P?

Scenario 3D: Target is a UK ltd. portfolio company (of a fund vehicle that is transparent for US tax purposes).



- The related party attribution rule can be more problematic as a diligence matter where an investment fund owns target.
- Partnership to Partner attribution and then Partner to Partnership attribution may not be knowable.
- In some cases a preclosing CTB election on UK Target could achieve objectives identical to a section 338(g) election.
- “Flash” Commercial Activities Income (under section 892)?

Thank you

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