Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Outbound	–	–
Volume	1	Income Shifting	**Level 1 UIL**	9411
Part	1.8	Gain Exportation (through contribution or reorg)	**Level 2 UIL**	9411.08
Chapter	1.8.2	Outbound Transfers of Stock	**Level 3 UIL**	N/A
Sub-Chapter	N/A	N/A	–	–

Unit Name	Outbound Transfer of Foreign Stock

Document Control Number (DCN)	ISO/9411.08_04(2014)
Date of Last Update	01/08/16

Note: This document is not an official pronouncement of law, and cannot be used, cited or relied upon as such. Further, this document may not contain a comprehensive discussion of all pertinent issues or law or the IRS's interpretation of current law.

Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

General Overview

Issue and Transaction Overview

Outbound Transfer of Foreign Stock

A U.S. corporation can transfer foreign stock to another corporation in a wide variety of nonrecognition transactions. For example, a U.S. corporation can transfer foreign stock to another U.S. corporation in a nonrecognition transaction that qualifies as a tax free reorganization under IRC 368(a)(1)(B). However, when such normal nonrecognition transactions result in a transfer of property to a Foreign Corporation (FC), U.S. tax law imposes restrictions on the tax free transfer of certain types of property by overriding normal nonrecognition rules. IRC 367(a)(1) is the Code section that overrides the normal nonrecognition rules. Without an override of the nonrecognition provisions, the gain on the appreciated property may permanently escape U.S. tax upon the outbound (O/B) transfer of the property to a FC.

This Practice Unit focuses on the O/B stock exception in Treas. Reg. 1.367(a)-3(b) to the general rule of IRC 367(a)(1) relating to O/B transfers of foreign stock.

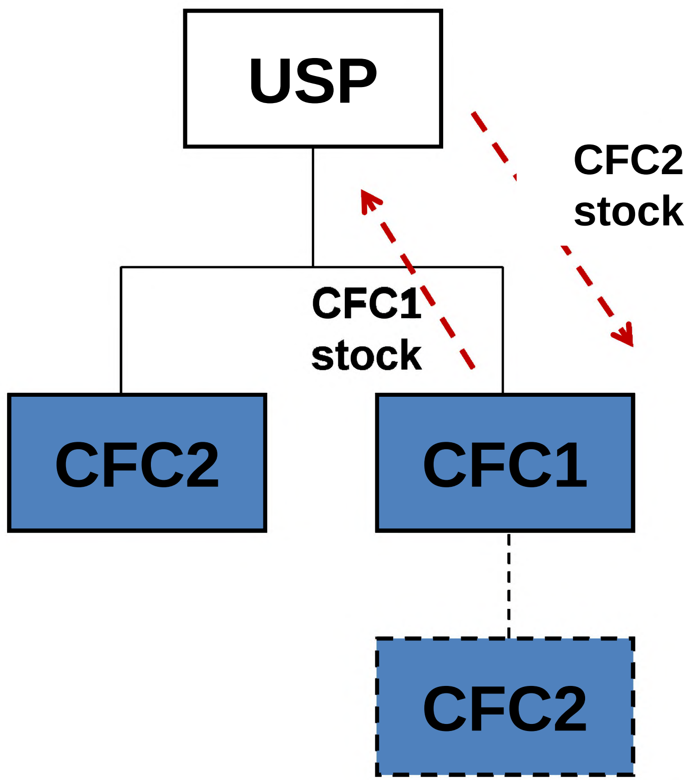
If certain criteria and reporting requirements are met, a U.S. person may be allowed to avoid gain recognition on the O/B transfer of foreign stock in the year of transfer. This Practice Unit provides general information on the reporting requirements in order to meet the stock exception. In certain circumstances, a U.S. person may enter into a Gain Recognition Agreement (GRA) to avoid immediate recognition of the gain on an O/B transfer of foreign stock to a FC. A GRA is subject to an annual certification requirement for each of the five full taxable years following the taxable year of the initial transfer. The annual certification essentially must state whether any subsequent event, commonly known as a "triggering event", would require recognition of the GRA's gain.

!

CAUTION: Other O/B transfers of property from a U.S. person to a FC that may be subject to IRC 367 will <u>not</u> be covered in this Practice Unit. If the O/B transfer by a U.S. person to a FC involves property other than foreign stock or securities, see the following related Practice Units: "Outbound Transfers of Property to Foreign Corporation – IRC 367 Overview", DCN: ISO/9411.08_01(2013); "Outbound Transfer of Domestic Stock", DCN: ISO/9411.08_06(2014); and "Outbound Transfer of Foreign Stock Followed by CTB Election", DCN: ISO/9411.08_05(2014). For O/B transfers of intangible property, see related Practice Unit, "Deemed Annual Royalty Income Under IRC 367(d)", DCN: ISO/9411.02_01(2013).

Transaction and Fact Pattern

Outbound Transfer of Foreign Stock

Diagram of Transaction	Facts
	<u>Facts:</u> ▪ USP, the U.S. Parent, owns 100% of CFC1 and CFC2. ▪ CFC2 has a fair market value (FMV) of $10M. ▪ USP has a basis of $5M in CFC2 stock resulting in a potential built-in gain of $5M. ▪ CFC2 has $3M of IRC 1248 Earnings and Profits (E&P). <u>Transaction:</u> ▪ USP transfers 100% of CFC2 to CFC1 in exchange for additional CFC1 stock. <u>Results After Transaction:</u> ▪ Since CFC2 is a foreign corporation, IRC 367(a) must be considered on the O/B transfer of any appreciated property by USP to CFC1. ▪ CFC2 remains a separate CFC and becomes a lower-tier CFC of CFC1.

Effective Tax Rate Overview

Outbound Transfer of Foreign Stock

ETR of Company

- The effective tax rate (ETR) of the company may show an increase in the year of the O/B foreign stock transfer either due to current taxation of the transaction or due to a tax accrual created for an uncertain tax position(s) related to the transfer of the stock. In the subsequent years, there may be a decline in the ETR as the beneficial tax effects of the transaction result in a shift of income (gain on disposition of the stock) to a lower tax jurisdiction.

ETR Impact of Adjustment

- An O/B transfer of foreign stock that fails to meet the stock exception to IRC 367(a)(1) will result in the recognition of gain and will be subject to immediate U.S. taxation. Thus, this gain may increase ETR, which could be reduced or eliminated as a result of any related foreign tax credits (FTC). Any reported gain treated as an IRC 1248 dividend may also bring FTC that may be sufficient to offset any U.S. tax. Alternatively, the U.S. parent may have not elected permanent offshore investment for U.S. GAAP purposes, and any additional U.S. tax would have been accrued . Therefore, the reported gain would have a minimal impact to ETR.
- An O/B transfer of foreign stock that is covered by a GRA under the stock exception will not cause an increase to ETR; however, if the GRA is triggered by a subsequent event, the U.S. person will be required to include the gain in income, thus increasing ETR.
- If an O/B transfer of foreign stock is covered by a GRA and no subsequent triggering events requiring gain recognition occur within the 5-year certification period and absent the application of the Subpart F rules, any transfer of appreciated stock to a FC located in a low-tax foreign country will successfully reduce any potential taxation on a subsequent disposition of such stock by the FC, thereby resulting in a reduction to the ETR.

Back to Table Of Contents

Summary of Potential Issues

Outbound Transfer of Foreign Stock	
Issue 1	Does USP’s transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?
Issue 2	Is USP’s transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?
Issue 3	Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?
Issue 4	Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

All Issues, Step 1: Initial Factual Development

Outbound Transfer of Foreign Stock

The general purpose of IRC 367(a)(1) is to tax the built-in gain on CFC2 stock that is transferred in an O/B transaction. Specifically, IRC 367(a)(1) imposes taxation on the O/B transfer of CFC2 stock by USP to CFC1 in what would otherwise be a nontaxable exchange. If the stock exception to IRC 367(a)(1) is applicable, including the timely filing of a GRA, when warranted, then the built-in gain on the appreciated CFC2 stock that is transferred in an O/B transaction will not be taxable in the year of transfer.

Fact Element	Resources	6103 Protected Resources
▪ Review global organization tax organizational charts for ownership of CFC2. − Compare org chart at the beginning and end of the tax year that includes CFC2. − Does CFC2 disappear from the org chart? − Does CFC2 have a change in how it is depicted on the org chart? ▪ Square – Foreign corporate status? ▪ Circle within a square – Disregarded Entity (DE) status? ▪ Other? NOTE: If after the O/B transfer of CFC2 stock to CFC1, CFC2 checked the box (CTB) to be a DE of CFC1 and is no longer a FC for U.S. tax purposes, see related Practice Unit, “Outbound Transfer of Foreign Stock followed by CTB Election,” DCN: ISO/9411.08_05(2014) for guidance.	▪ Tax Organizational Charts – Beginning of Year and Ending of Year for each year under examination.	

All Issues, Step 1: Initial Factual Development (cont'd)

Outbound Transfer of Foreign Stock

The general purpose of IRC 367(a)(1) is to tax the built-in gain on CFC2 stock that is transferred in an O/B transaction. Specifically, IRC 367(a)(1) imposes taxation on the O/B transfer of CFC2 stock by USP to CFC1 in what would otherwise be a nontaxable exchange. If the stock exception to IRC 367(a)(1) is applicable, including the timely filing of a GRA, when warranted, then the built-in gain on the appreciated CFC2 stock that is transferred in an O/B transaction will not be taxable in the year of transfer.

Fact Element	Resources	6103 Protected Resources
▪ Review disclosures or forms on U.S. tax return for any statement related to the transfer of CFC2 stock.	▪ IRC 351 or 368 Disclosures ▪ Statement on Plan for Liquidation (per Treas. Reg. 1.332-6) ▪ Form 926, Part III and IV ▪ IRC 6038B Disclosure ▪ GRA, if applicable - Related Form 8838 ▪ Form 5471 of CFC1 ▪ Form 5471, Sch O of CFC1 and CFC2 ▪ Form 8832, if any	
▪ Did USP report any gains or losses resulting from the O/B transfer of CFC2 stock? − Capital Gain? − Dividend Income – "IRC 1248 – Dividend Income"? − Any losses claimed?		

Issue 1, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock
Issue 1
Does USP's transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Issue	Resources
Reorganization - Nonrecognition Provisions: ▪ There are two types of reorganizations (reorg) defined in IRC 368(a)(1) – stock reorg (B reorg) and asset reorgs (A, C, D, F or G). When there is a valid reorganization as defined in IRC 368(a)(1), certain non-recognition provisions may apply at the S/H level (IRC 354/356) or at the corporate transferor's level (IRC 361). ▪ To qualify as a valid "B" stock reorganization, USP must exchange CFC2 stock (target corporation) solely for voting stock of CFC1 (acquiring corporation) under IRC 354. In addition, immediately after the exchange, CFC1 must control CFC2 (80% of vote and shares). ▪ Note: An IRC 356 exchange exists at USP's level if USP receives property (boot) in addition to CFC1 stock in exchange for the stock of CFC2. However, boot is not permitted in a B reorg. ▪ If USP sold CFC2 stock to CFC1 for property, such transaction would be treated as a sale, i.e., not as a "B" reorganization.	▪ IRC 354 - Exchanges of stock and securities in certain reorganizations ▪ IRC 356 - Receipt of additional consideration ▪ IRC 361 – Nonrecognition of gain or loss to corporations; treatment of distributions ▪ IRC 368 - Definitions relating to corporate reorganizations ▪ IRC 367 – Foreign Corporations

Issue 1, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock
Issue 1
Does USP’s transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Fact Element	Resources	6103 Protected Resources
▪ Did USP transfer 80% or more of CFC2 stock to CFC1 in exchange solely for CFC1 voting stock (no boot received)? ▪ Did CFC1 control CFC2, immediately after the transfer? (80% or more of vote and shares)	▪ Organizational Chart ▪ Step Plan, if any ▪ Tax Opinion, if any ▪ IRC 368 Disclosure ▪ Form 926, Part III and IV ▪ IRC 351 Disclosure or IRC 368 Reorg Disclosure ▪ IRC 6038B Disclosure ▪ GRA, if applicable ▪ Form 8838 – *Consent to Extend the Time to Assess Tax Under Section 367 – Gain Recognition Agreement* ▪ Form 5471 for CFC1 and CFC2 ▪ Form 5471, Sch O for CFC1 and CFC2	

Issue 1, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock
Issue 1
Does USP's transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
▪ Exam must determine whether the transaction in question is similar to the Fact Pattern illustrated in this Unit and, thus, qualifies as a tax-free reorganization.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person	

Back to Table Of Contents

Issue 1, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 1
Does USP's transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
▪ In our Fact Pattern, USP transferred 100% of CFC2 stock to CFC1 in an IRC 354 exchange. USP has exchanged CFC2 stock for additional voting stock in CFC1, and immediately after the transfer CFC1 controls CFC2. Therefore, the transaction in our Fact Pattern qualifies as an O/B "B" reorganization. Issue 2 must now be considered to see if IRC 367(a)(1) is applicable to override tax-free reorganization status. **DECISION POINT:** If the transfer is not described in IRC 351, 354, 356 or 361, then IRC 367(a)(1) is not applicable. The international examiner should consider other code sections in the analysis.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person	

Back to Table Of Contents

Issue 1, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 1
Does USP’s transfer of CFC2 stock to CFC1 qualify as a tax-free reorganization or as an IRC 351 transaction (prior to a possible override by IRC 367(a)(1) in Issue 2)?

Explanation of Adjustment	Resources	6103 Protected Resources
Overlap of IRC 351 and “B” Reorganization: When a S/H (USP) transfers only a controlling stock interest in a corporation (CFC2 – transferred corporation) to another controlled corporation (CFC1) and immediately after the transfer the controlled corporation (CFC1) controls the transferred corporation (CFC2), the exchange may qualify as an IRC 351 exchange or a “B” reorganization, commonly referred to as an “IRC 351/IRC 368(a)(1)(B) Overlap” transaction. Under either IRC section, the S/H (USP) receives nonrecognition treatment, regardless if additional stock of the controlled corporation (CFC1) is received in the exchange. This overlap transaction would still be subject to override by IRC 367(a)(1) in Issue 2 because IRC 351 applies in this case. NOTE: If the exchange included boot, the transaction would not qualify as a “B” reorganization due to the solely for stock requirement; however, the transaction still might qualify under IRC 351.	▪ IRC 351 – *Transfer to Corporation Controlled by Transferor* ▪ IRC 354 - *Exchanges of stock and securities in certain reorganizations* ▪ IRC 356 - *Receipt of additional consideration* ▪ IRC 361 – *Nonrecognition of gain or loss to corporations; treatment of distributions* ▪ IRC 368 - *Definitions relating to corporate reorganizations* ▪ IRC 367 – *Foreign Corporations*	

Issue 2, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Explanation of Issue	Resources
Generally, when USP transfers appreciated property (CFC2 stock) O/B to CFC1 in an otherwise nontaxable exchange (e.g., IRC 351, 354, 356, or 361), IRC 367(a)(1) trumps the nonrecognition provision and requires immediate taxation on the gain realized in the exchange by NOT recognizing CFC1 as a "corporation". This prevents the application of these nonrecognition provisions that require CFC1 to be a "corporation". In order for the O/B transfer of CFC2 stock to be subject to IRC 367, three elements must exist: ▪ USP must be a U.S. person (the transferor); ▪ a transfer of CFC2 stock to CFC1, a FC; and ▪ an exchange described in one of the following nonrecognition code sections: IRC 351, 354, 356 or 361.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person ▪ IRC 351, 354, 356 and/or 361 – Corporate Nonrecognition Provisions

Issue 2, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Explanation of Issue	Resources
▪ IRC 367(a) is applicable to an O/B transfer of CFC2 stock to CFC1 in an otherwise nonrecognition exchange (e.g., IRC 351, 354, 356, or 361) if CFC2 stock has appreciated in value prior to the transfer. ▪ Thus, if the O/B transfer of CFC2 stock does not have a built-in gain, IRC 367 does not apply to the transaction, and no further analysis is required on the transaction. ▪ IRC 367(a) does not operate to permit the recognition of a built-in loss on a transfer of CFC2 stock.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person ▪ IRC 332, 351, 354, 356 and/or 361 - Corporate Nonrecognition Provisions

Issue 2, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Fact Element	Resources	6103 Protected Resources
▪ Is USP (the transferor), the person/entity that is transferring CFC2 stock, a U.S. person? ▪ Is USP (the transferor) a U.S. Corporation?	▪ IRC 7701(a)(30) – *U.S. person* ▪ IRC 7701(a)(3) – *Corporation* ▪ IRC 7701(a)(4) – *Domestic* ▪ Articles of Incorporation of USP under relevant state law. ▪ Form 8832 – *Entity Classification Election (*if a domestic partnership or certain trust that has elected to be treated as a domestic corporation)	

Issue 2, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Fact Element	Resources	6103 Protected Resources
▪ Determine the type of transaction that occurred that involved a transfer of CFC2 stock to CFC1. ▪ A review of the disclosures (e.g., GRAs and Form 926 and Form 5471, Schedule O (for CFC1)) should show that USP has transferred CFC2 stock O/B to CFC1 in a transaction that is possibly subject to IRC 367(a). – A review of such documents will provide a basic understanding of the transactions that have occurred. Several transactions may be part of a much larger restructuring transaction. ▪ Organizing the disclosures in a chronological order will assist in the analysis of the transaction.	▪ GRAs ▪ Form 926 ▪ Form 5471, Schedule O ▪ IRC 368 or IRC 351 Disclosures	

Issue 2, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Fact Element	Resources	6103 Protected Resources
▪ A clear understanding of the type of transaction is key in determining the tax consequences. ▪ Request supporting documentation on the transaction from the taxpayer, such as: – Organizational Charts (preferably step by step); – Step Plan or any internal documentation, if any, that details the individual steps taken by the taxpayer in the transaction; and – Tax Opinions, if any, authored internally by the taxpayer's employees or outside advisors. ▪ When warranted, request that the taxpayer provide a step-by-step presentation of the transaction to the audit team.	▪ Organizational Charts (preferably step by step) ▪ Step Plan, if any ▪ Tax Opinion, if any ▪ Taxpayer Presentation of the Transaction	

Issue 2, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Fact Element	Resources	6103 Protected Resources
▪ Is CFC1, which receives CFC2 stock in the O/B transfer, treated as a FC for U.S. tax purposes? − A FC or − An eligible foreign business entity classified as a corporation for U.S. tax purposes, pursuant to a CTB election.	▪ IRC 7701(a)(5) – Definition of foreign ▪ Treas. Reg. 301.7701-2 – *Business entities definitions* ▪ Treas. Reg. 301.7701-3 – CTB regulations ▪ Form 8832, if any	
▪ Does the transferred stock have a potential built-in gain? (Gain = FMV over stock basis) ▪ Request documentation related to the CFC2 stock transferred, such as: − Listing of CFC2 stock transferred − FMV and basis computations − Valuation of CFC2 stock ▪ Review documentation provided in the tax return relating to the O/B transfer of CFC2 stock.	▪ Listing of CFC2 shares of stock transferred (FMV and basis) ▪ Valuation study on the O/B transfer of CFC2 stock ▪ Form 926, Part III ▪ GRA ▪ Form 8838 ▪ IRC 351 or 368 Disclosure	

Issue 2, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock
Issue 2
Is USP’s transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Explanation of Adjustment	Resources	6103 Protected Resources
The three Factors of IRC 367(a)(1) are satisfied in our Fact Pattern: ▪ USP is a person and, thus, is a U.S. transferor. ▪ USP transferred CFC2 stock to CFC1, a FC. ▪ The transfer qualifies under IRC 354 and IRC 351. **DECISION POINT:** Under Issue 2, if it has been determined that the gain on the O/B transfer of CFC2 stock to CFC1 is subject to taxation under the general rule of IRC 367(a)(1), then the next step is to determine if an exception under Issue 3 may apply to restore the nonrecognition treatment of the gain for the year of the transfer	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person ▪ IRC 351, 354, 356 and/or 361 – Corporate Nonrecognition Provisions	

Back to Table Of Contents

Issue 2, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Explanation of Adjustment	Resources	6103 Protected Resources
▪ CFC2 stock has a built-in gain at the time of the O/B transfer. **DECISION POINT:** Taxation under IRC 367(a) is based upon a property-by-property determination and is only relevant if CFC2 stock has a built-in gain. If CFC2 stock has a built-in loss, IRC 367(a) does not apply to the transfer. No loss is allowed, and the nonrecognition provision continues to apply.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person ▪ IRC 351, 354, 356 and/or 361 – Corporate Nonrecognition Provisions	

Issue 2, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 2
Is USP's transfer of CFC2 stock to CFC1 subject to IRC 367(a)(1), potentially resulting in a taxable exchange?

Explanation of Adjustment	Resources	6103 Protected Resources
! **CAUTION:** If other assets were transferred in addition to CFC2 stock, the international examiner must consider IRC 367 for the transfer of the other property. This Practice Unit only addresses the O/B transfer of CFC2 stock. See related Practice Unit, "Outbound Transfer of Property to Foreign Corporation – IRC 367 Overview," DCN: ISO/9411.08_01(2013), for further analysis of IRC 367 on the O/B transfer of other assets.	▪ IRC 367(a) – O/B Transfer of Property ▪ Treas. Reg. 1.367(a)-1T – O/B Transfer of Property – IRC 367(a) General Rules ▪ Treas. Reg. 1.367(a)-3 – O/B Stock Exception Rules ▪ IRC 7701(a)(30) – Definition of U.S. Person ▪ IRC 351, 354, 356 and/or 361- Corporate Nonrecognition Provisions	

Issue 3, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
Based upon the analysis of the Fact Pattern, it has been determined that: ▪ USP transferred CFC2 stock to CFC1 in an IRC 354 exchange, pursuant to an O/B “B” reorganization, and in an IRC 351 transaction, thus subjecting the transaction to potential taxation under IRC 367(a) (i.e., because IRC 351 is applicable). ▪ USP received additional CFC1 voting stock in the exchange. ▪ USP has a built-in gain of $5M in its CFC2 stock. The next step is to determine if USP’s O/B transfer of CFC2 stock may qualify for the stock exception in Treas. Reg. 1.367(a)-3(b) to avoid immediate gain recognition pursuant to the general rule of IRC 367(a)(1).	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock

Issue 3, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
Under the general rule of IRC 367(a)(1), when USP ("Transferor") transfers CFC2 stock ("Transferee"), then USP will recognize gain on the CFC2 stock transferred to CFC1 in the excess of FMV over its basis. However, an O/B transfer of CFC2 stock may avoid gain recognition at the time of the transfer if either: ▪ The U.S. transferor (USP) owns less than 5% (vote and value) of CFC1 (transferee) stock immediately after the transfer – OR – ▪ The U.S. transferor (USP) owns 5% or more (vote and value) of the CFC1 (transferee) stock immediately after the transfer and enters into a five-year Gain Recognition Agreement (GRA) with respect to the transferred CFC2 stock.	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8(c)(2) – Contents of a GRA ▪ IRC 318 – *Constructive ownership of stock* ▪ IRC 958(b) – *Constructive ownership*

Issue 3, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
In a GRA, USP (U.S. transferor) agrees to recognize the unrecognized gain from the O/B transfer of CFC2 stock to CFC1 if certain triggering events occur during the next five full tax years following the close of the tax year in which the stock transfer occurs. If USP was required to file a GRA, such GRA would be subject to an annual certification requirement for the next 5 years to certify that no triggering event has occurred that would require gain recognition. Assuming that the 5-year certification period expires with no triggering events, the GRA terminates, and no gain recognition is required under IRC 367(a). Upon a triggering event, the built-in gain on CFC2 stock at the time of the original transfer will be required to be recognized by USP. In addition, USP will be required to pay an interest charge. The gain is recognized in the year of the original transfer by filing an amended return, unless USP elects to report the gain, plus interest charge, in the year of the triggering event.	▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)–3(b)(1)(ii) - GRA agreement for nonrecognition of gain on the stock transfer. ▪ Treas. Reg. 1.367(a)-8 – *GRA requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of a GRA* ▪ Treas. Reg. 1.367(a)-8(g) – *Annual certification*

Issue 3, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
Outbound Transfer of CFC Stock – Concurrent Application of IRC 367(a) and IRC 367(b): If USP transfers CFC2 stock O/B to CFC1 in a transaction that would otherwise be a nonrecognition transfer, then IRC 367(a) must be considered on the O/B stock transfer as well as IRC 367(b) on the acquisition of CFC2 stock by CFC1. Thus, both IRC 367(a) and IRC 367(b) must be considered. IRC 367(b) and Treas. Reg. 1.367(b)-4 require certain ownership continuity in order to avoid gain recognition under IRC 367(b) in the form of an IRC 1248 dividend in an O/B transfer of CFC stock, regardless of the filing of a GRA under IRC 367(a). The general rule under IRC 367(b) is that the transaction (i.e., the O/B transfer of CFC stock to a FC) is nontaxable, provided that the E&P of the transferred FC (CFC2) remains in a CFC solution after the transaction, either at the CFC2 level or the acquiring FC's (CFC1) level and the U.S. S/H (USP) maintains its 1248 S/H status.	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-3(b)(2) – *Certain transfers subject to IRC 367(a) and (b)* ▪ Treas. Reg. 1.367(b)-4 – IRC 367(b) application to O/B transfer of FC stock.

Issue 3, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
Outbound Transfer of CFC Stock – Concurrent Application of IRC 367(a) and IRC 367(b) (cont'd): For example, under IRC 367(b), if USP exchanges CFC2 stock for non-CFC stock (or for stock in which USP receives less than 10% of the stock in a CFC), then USP (the exchanging S/H) must report a deemed dividend equal to the lesser of: (1) the realized gain ($5M) on the CFC2 stock; or (2) the IRC 1248 E&P ($3M) of CFC2 (the transferred CFC). Any excess gain ($5M - $3M) over the taxable deemed dividend required to be reported under IRC 367(b) may continue to be nontaxable in the year of the O/B transfer if a GRA is timely filed pursuant to IRC 367(a). The GRA may only defer the IRC 367(a) ($2M) gain and has no impact on the requirement of income inclusion under IRC 367(b). If the required income inclusion under IRC 367(b) equals the full amount of the realized gain on the O/B transfer, there is no need for a GRA under IRC 367(a) since the full gain was taxable under IRC 367(b). If, instead, USP (U.S. transferor) chooses not to file a GRA, then the $5M gain on the transfer is taxable under IRC 367(a), and the gain will be treated as a dividend up to the amount of IRC 1248 E&P ($3M) . Any excess gain over this amount ($2M) would be capital gain.	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-3(b)(2) – *Certain stock transfers subject to IRC 367(a) and (b)* ▪ Treas. Reg. 1.367(b)-4 – IRC 367(b) application to O/B transfer of FC stock.

Issue 3, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Issue	Resources
If the stock exception in Treas. Reg. 1.367(a)-3(b) does not apply (e.g., a GRA, if required to avoid gain recognition, is not timely filed), then USP, the U.S. transferor, must recognize any gain (not loss) on the O/B transfer of CFC2 to CFC1 in the year of transfer. Note: Under IRC 1248, the 1248 E&P amount includes any lower-tier CFC's IRC 1248 E&P that was owned by the transferred CFC (CFC2) that is attributable to the stock transferred.	▪ IRC 367(a)(1) – *General rule* ▪ IRC 1248 – *Gain from certain sales or exchanges of stock in certain foreign corporations* ▪ Treas. Reg. 1.367(a)-3(b)(1) – Stock exception for O/B transfer of foreign stock

Issue 3, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Fact Element	Resources	6103 Protected Resources
▪ Confirm USP's ownership percentage (vote and value) of the outstanding stock of the transferee FC (CFC1) immediately after the transfer. − Confirm if USP transferred all of its stock in CFC2 and, in turn, USP received stock (actual stock or deemed stock) in CFC1.	▪ Ownership charts ▪ Stock register ▪ Form 5471, Sch O of CFC1 and CFC2 ▪ IRC 368 Disclosure	

Issue 3, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Fact Element	Resources	6103 Protected Resources
▪ Confirm if CFC1 (the transferee foreign corporation) is a CFC immediately after the transfer. − Confirm if USP owns 10% or more of the total combined voting power of all classes of stock entitled to vote in the transferee corporation (i.e., confirm that CFC1 is a CFC in order to maintain USP's IRC 1248 S/H status).	▪ Ownership charts ▪ Stock register ▪ Form 5471, Sch O of CFC1 ▪ IRC 368 Disclosure	

Back to Table Of Contents

Issue 3, Step 3: Additional Factual Development (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Fact Element	Resources	6103 Protected Resources
DECISION POINT: If CFC1, the transferee, is not a CFC or USP does not maintain its IRC 1248 S/H status immediately after the transfer, additional factual development is required. ▪ Request and review USP's calculation of deemed dividend income inclusion pursuant to IRC 367(b). ▪ If CFC2 (the transferred FC) owned lower-tier CFCs, you must take into consideration in the computation of IRC 1248 E&P any IRC 1248 E&P from such subsidiaries.	▪ USP's calculation of deemed income inclusion ▪ Form 1120 ▪ Form 1118 ▪ E&P and FTC tax pool calculations for CFC ▪ Lower-tier CFC's E&P and FTC tax pools, if any	

Issue 3, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
IRC 367(a)(1) requires gain recognition on an O/B transfer of CFC2 stock by USP to CFC1, unless the stock exception in Treas. Reg. 1.367(a)-3(b) applies and certain requirements are met. The stock exception may allow nonrecognition if, immediately after the transfer, USP (the transferor): ▪ owns less than 5% of CFC1 (the transferee) immediately after the transfer, or ▪ owns 5% or more of CFC1 and timely files a GRA. In addition, because an O/B transfer of CFC stock (CFC2) has occurred, IRC 367(b) must also be considered. IRC 367(b) may require gain recognition, in the form of a deemed dividend, if certain criteria are met, regardless of the filing of a GRA under IRC 367(a).	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)-3(b)(1) – O/B transfer of FC stock exception to general rule ▪ Treas. Reg. 1.367(a)-3(b)(2) – *Certain transfers subject to IRC 367(a) and (b)* ▪ Treas. Reg. 1.367(b)-4(b)(1) – IRC 367(b) application to O/B transfer of FC stock – Loss of IRC 1248 S/H or CFC status	

Back to Table Of Contents

Issue 3, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
Based upon your analysis for the Fact Pattern, you have already determined that USP's O/B transfer of CFC2 stock to CFC1 qualified as an IRC 354 exchange in a "B" reorganization and as an IRC 351 transaction subject to IRC 367(a)(1) in Issue 2 (i.e., because IRC 351 applies). The next step is to determine if USP meets the requirements of Treas. Reg. 1.367(a)-3(b) in order to secure nonrecognition treatment under IRC 367(a) on the O/B transfer of CFC2 stock to CFC1 in the year of transfer. Since there was an O/B transfer of CFC stock (CFC2) to a FC (CFC1), you must also consider possible tax consequences under IRC 367(b).	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)-3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(b)-4(b)(1) – IRC 367(b) application to O/B transfer of FC stock – Loss of IRC 1248 S/H or CFC status	

Issue 3, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
Based on your analysis of the additional facts, you have determined that: ▪ USP was an IRC 1248 S/H of CFC2 since USP owned 100% of CFC2, immediately before the transfer. ▪ USP received stock of a CFC (CFC1) in the exchange and continues to own 100% of CFC1 and is an IRC 1248 S/H of CFC1 immediately after the transfer. ▪ USP has a built-in gain of $5M in CFC2 stock ($10M FMV - $5M basis). ▪ CFC2 has no lower-tier CFCs. Under the general rule, IRC 367(a)(1) requires gain recognition on the O/B transfer of CFC2 stock, unless an exception is met. Under Treas. Reg. 1.367(b)-3(b)(1)(ii), USP may qualify for the stock exception to IRC 367(a)(1) if USP enters into and timely files a GRA.	▪ IRC 367(a)(1) – *General Rule* ▪ IRC 1248 – *Gain from certain sales or exchanges of stock in certain foreign corporations* ▪ Treas. Reg. 1.367(b)-2(b) – *Section 1248 shareholder* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements*	

Issue 3, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
In addition, IRC 367(b) must be considered for possible gain recognition since CFC1, a FC, acquired CFC2 stock. See Treas. Reg. 1.367(b)-4. Since USP remains the sole S/H of CFC1, there is no loss of IRC Section 1248 S/H status with respect to the transfer of CFC2 shares. Thus, CFC2 remains a CFC, and there is no deemed dividend income inclusion required under IRC 367(b).	▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(b)-4(b)(1) – IRC 367(b) application to O/B transfer of FC stock – Loss of IRC 1248 S/H or CFC status	

Issue 3, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
DECISION POINT: You have determined that the stock exception in Treas. Reg. 1.367(a)-3(b) is available to USP to avoid gain recognition on the O/B transfer of CFC2 stock in the year of the transfer. The next step is to determine if USP properly filed the required GRA as prescribed in the regulations. Was a GRA timely filed on the return for the year of transfer? ▪ If a GRA was filed, continue with Issue 4 for the analysis of the compliance requirements. ▪ If a GRA was not filed, the O/B transfer of CFC2 stock is subject to taxation under IRC 367(a)(1) (i.e., the Treas. Reg. 1.367(a)-3(b) stock exception does not apply).	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA*	

Issue 3, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
If a GRA was not filed (cont'd): You need to verify that the proper amount of gain has been included on the return. If not, an adjustment should be proposed. The gain will be treated as a deemed dividend (with related FTC) equal to the lesser of the gain realized or the IRC 1248 E&P of CFC2 as a result of the application of IRC 367(a)(1). Any excess gain over the deemed dividend amount is treated as capital gain.	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ TD 9704 – GRA Regs ▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.6038B-1T(f)(3) – Request for relief for failure to comply under IRC 6038B – Reasonable cause	

Issue 3, Step 4: Develop Arguments (cont'd)

Outbound Transfer of Foreign Stock
Issue 3
Does the stock exception in Treas. Reg. 1.367(a)-3(b) prevent immediate gain recognition in this transaction despite the general taxability rule of IRC 367(a)(1) in Issue 2?

Explanation of Adjustment	Resources	6103 Protected Resources
If a GRA was not filed (cont'd): If a GRA was not timely filed, USP may attempt to request relief for the failure to timely file the GRA by submitting a formal request for relief under Treas. Reg. 1.367(a)-8(p). If a request for relief is filed, you will make a recommendation to the DFO International for the final determination on whether to grant or deny the request for relief.	▪ IRC 367(a)(1) – *General rule* ▪ Treas. Reg. 1.367(a)–3(b)(1) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ TD 9704 – GRA Regs ▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.6038B-1T(f)(3) – Request for relief for failure to comply under IRC 6038B – Reasonable cause	

Back to Table Of Contents

Issue 4, Step 2: Review Potential Issues

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
Because the stock exception in Treas. Reg. 1.367(a)-3(b) applies to the O/B transfer of CFC2 stock, USP must meet certain filing requirements. As described in Issue #3, USP must timely file a complete GRA if it is a 5% or more S/H in CFC1 (the transferee FC). Requirements of a GRA: ▪ In order to meet the stock exception, USP (the U.S. transferor) may be required to timely file a complete and valid GRA that contains the required information listed in Treas. Reg. 1.367(a)-8(c)(2). The failure to materially comply with the content requirements of a GRA may cause the GRA to be invalid. ▪ The GRA is an agreement in which USP agrees to report the realized gain, but not recognized, that is subject to the GRA in the case of a subsequent triggering event within the next 5 taxable years (the certification period). ▪ In addition, USP must also file annual certifications for the next five years certifying that no triggering event has occurred. The failure to file the annual certification is a triggering event requiring gain recognition.	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA*

Issue 4, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
Contents of a timely filed valid GRA: Some of the key items required in a valid GRA include, but are not limited to: ▪ Agreement to recognize gain if a triggering event occurs within the certification period ▪ Description of the CFC2 transferred stock – Calculation of the amount of the built-in gain – FMV and tax basis of the transferred stock ▪ Agreement to comply with all the conditions and requirements under Treas. Reg. 1.367(a)-8 (including the filing of annual certifications)	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA*

Issue 4, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
Filing of Form 8838: ▪ In addition to the GRA, USP must also timely file a Form 8838, "Consent to Extend the Time to Assess Tax Under Section 367 – Gain Recognition Agreement", that extends the statute of limitation for the assessment of tax *with respect to the gain realized but not recognized* on the initial transfer through the close of the eighth full taxable year following the taxable year of the initial transfer. ▪ The Form 8838 is required to be timely filed with USP's tax return for the year of transfer along with the required GRA for O/B transfers of CFC2 stock. ▪ Form 8838 extends the statute of limitation for only the tax associated with the gain on the GRA under IRC 367(a) and does not extend the statute of limitation for the entire tax return filed for the year of transfer.	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8(f) – Form 8838 Filing Requirement ▪ Treas. Reg. 1.367(a)-8(g) – *Annual Certification*

Issue 4, Step 2: Review Potential Issues (cont’d)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
Failure to timely file a GRA or failure to materially comply: If USP is eligible to file a GRA, but fails to timely file the GRA or fails to comply in any material respect with the GRA regulations or the terms of a GRA, USP may request relief for such failure promptly after it becomes aware of such failure. USP may request relief under Treas. Reg. 1.367(a)-8(p) by filing an amended return with the Service Center that includes a statement explaining the reasons for the failure to properly file the GRA. USP must also provide a copy of the amended return to the audit team (if USP is under audit for any tax year) or to the Director of Field Operations (DFO), International, LB&I (if not under examination). The audit team will work from the copy of the amended return to make a recommendation to the DFO International for the final determination on whether to grant or deny the request for relief. If USP files its formal request for relief, the IRS (the DFO International) must make a separate determination on whether relief should be granted or denied based upon all the facts and circumstances. The issues relating to a request for relief for failure to timely file a GRA or other related documents (i.e., annual certification or “new” GRA) is beyond the scope of this Practice Unit.	▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.367(a)-3(b) –Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements* ▪ Treas. Reg. 1.367(a)-8(c)(2) – *Content of GRA* ▪ Treas. Reg. 1.367(a)-8(f) – Form 8838 Filing Requirement ▪ Treas. Reg. 1.367(a)-8(g) – *Annual Certification*

Issue 4, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
IRC 6038B Reporting Requirements: ▪ Upon an O/B transfer of property by a U.S. transferor (USP) to a FC (CFC1), certain filing requirements under IRC 6038B must be met. This requirement is for any O/B transferred property, including the transferred CFC2 stock. ▪ The general rule of Treas. Reg. 1.6038B-1(b) requires USP to timely file a Form 926 with its return for each transfer of property to a FC. The Form 926 will include the date of transfer, type of transfer, description of the property transferred (including FMV, basis) and any gain recognized. ▪ The failure to comply with the reporting requirements under IRC 6038B is subject to a penalty equal to 10% of the FMV of transferred property (maximum $100,000, unless the failure was due to intentional disregard).	▪ IRC 6038B – *Notice of certain transfers to foreign persons* ▪ Treas. Reg. 1.6038B-1 – *Reporting of certain transfers to foreign corporations* ▪ Treas. Reg. 1.6038B-1(f) – IRC 6038B penalty for failure to comply

Issue 4, Step 2: Review Potential Issues (cont'd)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Issue	Resources
IRC 6038B Reporting Requirements (cont'd): ▪ Treas. Reg. 1.6038B-1(b)(2) provides special rules and exceptions for O/B transfers of stock. Under this section, USP was not required to file a Form 926 with respect to the transferred CFC2 stock before November 19, 2014. ▪ Under recently issued final regulations, a Form 926 must be filed in all cases in which a GRA is filed. The new GRA and IRC 6038B regulations are effective for transfers on or after November 19, 2014. ▪ Note: USP's failure to properly file a Form 926 has no impact upon whether USP qualifies for the Treas. Reg. 1.367(a)-3(b) stock exception. ▪ Note: The transfer of built-in loss foreign stock is not subject to IRC 367(a) (and thus no GRA is required). Nevertheless, the transfer is described in IRC 6038B(a)(1) and, consequently, a U.S. transferor must file a Form 926 if the U.S. transferor owns 5% or more of the transferee FC immediately after the transfer.	▪ IRC 6038B – *Notice of certain transfers to foreign persons* ▪ TD 9704 – GRA Regs ▪ Treas. Reg. 1.6038B-1 – *Reporting of certain transfers to foreign corporations* ▪ Treas. Reg. 1.6038B-1(b)(2) – Exceptions and Special Rules for O/B Transfer of Stock under IRC 367(a) ▪ Treas. Reg. 1.6038B-1(f) – IRC 6038B penalty for failure to comply

Issue 4, Step 3: Additional Factual Development

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Fact Element	Resources	6103 Protected Resources
▪ Determine if USP timely filed a GRA, Form 8838, and/or Form 926	▪ GRA ▪ Form 8838 ▪ Form 926, if the O/B transfer of CFC2 stock occurred on or after 11/19/2014	

Issue 4, Step 4: Develop Arguments

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Adjustment	Resources	6103 Protected Resources
If USP has properly filed the required GRA and Form 8838 with its U.S. return for the year of the initial transfer to meet all the requirements for the O/B stock exception, no immediate gain recognition is required in the year of the transfer. Effective November 19, 2014, a Form 926 must be filed in all cases in which a GRA is filed. If USP fails to properly file a Form 926, then USP will be subject to a monetary penalty under IRC 6038B. Also, the failure to properly file a Form 926 extends the period of limitations for assessment of tax upon the transfer of the property to the date that is 3 years after the date on which the information required to be reported is provided.	▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements*; -8(c)(2) – *Content of GRA*; -8(f) – Form 8838 Filing Requirement – Extension of period of limitation;-8(g) – *Annual Certification* ▪ Treas. Reg. 1.6038B-1 – *Reporting of certain transfers to foreign corporations* ▪ Treas. Reg. 1.6038B-1(b)(2) – Exceptions and Special Rules for O/B Transfer of Stock under IRC 367(a) ▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.6038B-1(f)(3) – Request for relief for failure to comply under IRC 6038B – Reasonable Cause	

Issue 4, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Adjustment	Resources	6103 Protected Resources
Going forward, the international examiner needs to track the GRA over the next 5 years to determine whether ▪ Annual certifications are timely filed for each of the next 5 years. Failure to file the annual certification is a triggering event requiring gain recognition. ▪ A subsequent event has occurred that constitutes a triggering event that would require gain recognition. ▪ A subsequent event has occurred that meets an exception to a triggering event that would require a new GRA to be filed to continue nonrecognition treatment of the original GRA.	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements*; -8(c)(2) – *Content of GRA*; -8(f) – Form 8838 Filing Requirement – Extension of period of limitation;-8(g) – *Annual Certification* ▪ Treas. Reg. 1.6038B-1 – *Reporting of certain transfers to foreign corporations* ▪ Treas. Reg. 1.6038B-1(b)(2) – Exceptions and Special Rules for O/B Transfer of Stock under IRC 367(a) ▪ TD 9704 – GRA Regs	

Issue 4, Step 4: Develop Arguments (cont’d)

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Adjustment	Resources	6103 Protected Resources
If USP has failed to timely file any of the required documents (GRA, Form 8838) with its U.S. return for the year of the initial transfer in order to meet all the requirements for the O/B stock exception, immediate gain recognition is required in the year of the transfer under the general rule of IRC 367(a)(1). All of the requirements to meet the Treas. Reg. 1.367(a)-3(b) stock exception have not been met if USP failed to timely file such documents. If USP has not reported the full gain on the O/B transfer as income, then an adjustment is required. In addition, a penalty under IRC 6038B should be considered.	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements*; -8(c)(2) – *Content of GRA*; -8(f) – Form 8838 Filing Requirement – Extension of period of limitation;-8(g) – Annual Certification ▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.6038B-1T(f)(3) – Request for relief for failure to comply under IRC 6038B – Reasonable Cause	

Outbound Transfer of Foreign Stock
Issue 4
Has USP properly complied with the regulatory reporting requirements to secure non-recognition treatment under the stock exception in Issue 3?

Explanation of Adjustment	Resources	6103 Protected Resources
NOTE: If USP has failed to timely file the documents, USP may elect to file for relief under the "not willful" provision of Treas. Reg. 1.367(a)-8(p) and under the "reasonable cause" for failure to comply provision of IRC 6038B pursuant to Treas. Reg. 1.6038B-1T(f)(3). At such time, the audit team will make a recommendation to the DFO International for a final determination on whether to grant or deny the relief request. Based upon the IRS's determination, adjustments may be required to include the gain in taxable income and a possible IRC 6038B penalty.	▪ Treas. Reg. 1.367(a)-3(b) – Stock exception for O/B transfer of foreign stock ▪ Treas. Reg. 1.367(a)-8 – *GRA Requirements*; -8(c)(2) – *Content of GRA*; -8(f) – Form 8838 Filing Requirement – Extension of period of limitation;-8(g) – *Annual Certification* ▪ TD 9704 GRA Regs ▪ Treas. Reg. 1.367(a)-8(p) – Request for relief for failure to file or comply – Not Willful ▪ Treas. Reg. 1.6038B-1T(f)(3) – Request for relief for failure to comply under IRC 6038B – Reasonable Cause	

Back to Table Of Contents

Training and Additional Resources

Chapter 1.8.2 Outbound Transfer of Stock		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
CENTRA sessions	▪ 2013 (TPO) & (IBC) CPE CENTRA - Hot Topics of IRC 367 ▪ 2014 (TPO) CPE CENTRA - Outbound Transfer of Property to Foreign Corporation - IRC 367 Overview	
Reference Materials – Treaties	▪ *BNA Tax Management Int'l Portfolio* 919-3rd – Sec. II – *Scope and General Operation of IRC 367(a)(1)* – Sec. IV – Para. B - *O/B Transfers of Stock* – Sec. IV – Para. E - *Interaction with Section 367(b)* – Sec. IV – Para. F – *Gain Recognition Agreements* – Sec. VI – Reporting of IRC 367(a) transfers under IRC 6038B ▪ Dolan - *U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures* Para. 9 – *O/B Transfer of Stock* – Para. 9.03 & 9.04 – *O/B Transfer of Non-CFC and CFC Stock* ▪ Dolan - *U.S. Tax. Int'l Mergers, Acquis. & Jt. Ventures* Treatises Para 10.02 – *General IRC 367(a) Rules*	

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
CFC1	Foreign Acquiring Corporation (Transferee)
CFC2	Foreign Target Corporation (Transferred Corporation)
CTB	Check-the-Box
DCN	Document Control Number
DE	Disregarded Entity
E&P	Earnings and Profits
ETR	Effective Tax Rate
FC	Foreign Corporation
FMV	Fair Market Value
GRA	Gain Recognition Agreement
O/B	Outbound
Reorg.	Reorganization described in IRC 368(a)(1)
S/H	Shareholder
U.S.	United States
USP	U.S. Parent

Index of Related Issues

Issue	Associated UIL(s)	References
Outbound Transfer of Property to Foreign Corporation – IRC 367 Overview	9411.08	Practice Unit, “Outbound Transfers of Property to Foreign Corporation – IRC 367 Overview,” DCN: ISO/9411.08_01(2013)
Outbound Transfer of Intangible Property to Foreign Corporation – IRC 367(d) Overview	9411.02; 9411.08	Practice Unit, “Deemed Annual Royalty Income Under IRC 367(d),” DCN: ISO/9411.02_01(2013)
Outbound Transfer of Foreign Stock Followed by CTB Election	9411.08	Practice Unit, “Outbound Transfer of Foreign Stock Followed by CTB Election,” DCN: ISO/9411.08_05(2014)
Outbound Transfer of Domestic Stock	9411.08	Practice Unit, “Outbound Transfer of Domestic Stock,” DCN: ISO/9411.08_06(2014)

Back to Table Of Contents