SLIDES ILLUSTRATING (1) A PROTOTYPICAL INVERSION TRANSACTION, AND (2) THE IMPACT OF TREASURY AND IRS NOTICE 2014-52
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PROTOTYPICAL INVERSION TRANSACTION

SLIDE #1 PRE-TRANSACTION STRUCTURE

Entity Key
Corporations =
Shareholders =

New Foreign Holding Company

Public Shareholders

U.S. Acquirer Aka: "Domestic Inverter"
(Its shareholders end up with more than 50% of the stock of
New Foreign Holding Company)

Public Shareholders

U.S. Merger Sub

Foreign Amalgamation Sub

Foreign Inversion Target
(Its shareholders end up with less than 50% of
the stock of New Foreign Holding Company)

↑ §956: Indirect Repatriations from CFCs results in income inclusion for U.S. Acquirer of Trapped Foreign Earnings.

Controlled Foreign Corporation #1 = CFC₁ Aka:
"DI's CFC #1" (Deferred "Trapped" Foreign Earnings)*

Controlled Foreign Corporation #2 = CFC₂ Aka:
"DI's CFC #2" (Deferred "Trapped" Foreign Earnings)*

*Total Deferred "Trapped" Foreign Earnings of all CFCs = $2 trillion ($1 trillion in cash)
PROTOTYPICAL INVERSION TRANSACTION

SLIDE #2 SUMMARY OF THE PRE-TRANSACTION STRUCTURE

New Foreign Holding Company

Public Shareholders

Domestic Inverter

U.S. Merger Sub

Foreign Amalgamation Sub

Foreign Inversion Target

§956: Indirect Repatriations from CFCs results in income inclusion for U.S. Acquirer of Trapped Foreign Earnings.

DI's CFC #1

DI's CFC #2
Step 1. Amalgamation Sub and Foreign Inversion Target consolidate pursuant to a Plan of Arrangement or Scheme of Arrangement. Consideration:
*Stock of Foreign Holding Company amounting to more than 20% but less than 50% of the Stock of Foreign Holding Co.
*Possibly some cash to satisfy the more than 20% but less than 50% requirement.

Step 2. Merger Sub merges into Domestic Inverter in a Reverse Subsidiary Merger (RSM). Consideration: Stock of New Foreign Holding Co amounting to more than 50% but less than 80% of the Stock of Foreign Holding Co. Note: If 80% or more, then under § 7874, New Foreign Holding Company is treated as a U.S. Corporation.

[2b] Debt Instrument of Domestic Inverter issued for Stock of New Foreign Holding Co to set up Interest Stripping

[2c] Stock of New Foreign Holding Co issued to Pub Shareholders

[2a] RSM

Di's CFC #1

Di's CFC #2
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SLIDE #4 POST TRANSACTION STRUCTURE

Old Public Shareholders of Domestic Inverter

Old Public Shareholders of Foreign Inversion Target

51% - 79%  21% - 49%

New Foreign Holding Company

Debt Instrument of U.S. Acquirer: Interest Stripping

Domestic Inverter

Foreign Inversion Target

"Out-From-Under", "Hopscotch" Loans from CFCs to New Foreign Holding Company. Query: Do the loans avoid §956 Constructive Dividend?
§ 2.01 of Notice will disregard certain stock of Foreign Inversion Target (FIT) attributable to passive assets, effectively ensuring that FIT's net active assets must have a value of at least 21% of the stock of FHC. A similar rule applies for the § 887 substantiality test.
SLIDE #6 THE NO-SLIMMING DOWN RULE. § 2.02

§ 2.02 of Notice will disregard certain “slimming down” distributions by Domestic Inverter that are designed to ensure that the fair market value of its stock is such that its shareholders receive no more than 79% of the stock of FHC.
TREASURY NOTICE: POST-INVERSION TAX AVOIDANCE
SLIDE #7 ANTI-HOPSCOTCH LOAN RULE, § 3.01

Old Public Shareholders of Domestic Inverter

51% - 79%

Old Public Shareholders of Foreign Inversion Target

21% - 49%

New Foreign Holding Company (FHC)

Domestic Inverter (DI)

DI’s CFC #1

DI’s CFC #2

Foreign Inversion Target

§ 3.01 of Notice treats “Out-Front-Under,” “Hopscotch”
Loans from CFCs to FHC as a dividend (see dotted line) to
DI under Section 956.
TREASURY NOTICE: POST-INVERSION TAX AVOIDANCE
SLIDE #8 ANTI-DECONTROL OF CFC RULE, § 3.02 (e) (i)

Old Public Shareholders of Domestic Inverter

51% - 79%

Old Public Shareholders of Foreign Inversion Target

21% - 49%

New Foreign Holding Company (FHC)

[1] Cash or Property

Domestic Inverter (DI)


DI's CFC #1

DI's CFC #2

Foreign Inversion Target

Under § 3.02 (e) (i) of Notice, this de-controlling transaction ([1] and [2]) is recharacterized as a contribution (see dotted lines [3a] and [3b]) from FHC to DI then followed by a matching contribution by DI to DI's CFC #2. DI's CFC #2 is the paying agent for DI.
TREASURY NOTICE: POST-INVERSION TAX AVOIDANCE
SLIDE #9 ANTI-DILUTION OF INTEREST IN CFC RULE, § 3.02 (e) (ii)

Old Public Shareholders of Domestic Inverter

51% - 79%

New Foreign Holding Company (FHC)

21% - 49%

Old Public Shareholders of Foreign Inversion Target

Domestic Inverter (DI)

[1a] 100% of Stock of DI's CFC #2

[1b] 60% of Stock of FIT

Foreign Inversion Target (FIT)

DI's CFC #1

DI's CFC #2

Under § 3.02 (e) (ii) of Notice, even though FIT becomes a CFC of DI, DI has gain recognition for the § 1248 deferred income amount attributable to DI's CFC #2 on the transfer, thus overriding §1.367(b)-4.
TREASURY NOTICE: POST-INVERSION TAX AVOIDANCE
SLIDE #10 ANTI-SECTION 304 AVOIDANCE RULE, § 3.03

Old Public Shareholders
of Domestic Inverter

51% - 79%

21% - 49%

Old Public Shareholders
of Foreign Inversion
Target

New Foreign Holding Company
(FHC)

[1a] Stock of DI $100K

[1b] $100K Cash

Domestic Inverter
(DI) E & P = $51K

DI's CFC #1

DI's CFC #2
E & P = $49K

Foreign Inversion Target

After this transaction, DI's CFC #2 owns stock in its parent DI. § 3.03 of Notice says no portion of the distribution [1b] is a dividend from the E & P of DI's CFC #2. $100K of cash is a dividend from DI to FHC. Thus, the deferred earning of DI's CFC #2 is not reduced.
§ 5 of Notice asks for comments "regarding the approaches" to "address strategies that avoid U.S. tax on U.S. operations by shifting or "stripping" U.S.-source earnings to lower-tax jurisdictions, including through inter company debt." This will, no doubt, involve the potential for regulations under §385. Any such regulations would apply to inversions occurring after the date of the Notice.