Internal Revenue Service

Number: **200913008**
Release Date: 3/27/2009

Index Number: 367.00-00, 367.03-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:INTL:B04
PLR-147439-08
Date:
December 15, 2008

LEGEND

Target	=
Foreign Acquirer	=
Subsidiary	=
Country A	=
Industry X	=
Exchange 1	=
Exchange 2	=
Date 1	=
Date 2	=
xx	=
yy	=

Dear :

This is in reply to your letter dated November 3, 2008, in which you request a ruling under Treas. Reg. § 1.367(a)-3(c)(9) that the indirect transfer of stock by U.S. persons in a domestic corporation (Target) under Treas. Reg. § 1.367(a)-3(d) in connection with a statutory merger described in sections 368(a)(1)(A) and 368(a)(2)(D) (the Merger) will qualify for an exception to the general rule of section 367(a)(1) of the Internal Revenue Code of 1986 (the Code). Additional information was provided in a letter dated December 8, 2008.

The rulings are based on information and representations submitted by the taxpayers. The information and representations are accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified any of the material submitted in support of this request, it is subject to verification upon examination.

FACTS

Target is a domestic corporation. It is engaged in Industry X and is publicly traded on Exchange 1. Foreign Acquirer is a Country A entity that is represented to be a corporation for U.S. federal income tax purposes. Foreign Acquirer is also engaged in Industry X and is publicly traded on Exchange 2.

On Date 1, Foreign Acquirer and Target agreed on the Merger whereby Target will merge with and into Subsidiary, a wholly owned domestic subsidiary of Foreign Acquirer, with Subsidiary surviving in a transaction represented to be a reorganization described in sections 368(a)(1)(A) and 368(a)(2)(D) of the Code. Shareholders of Target will receive stock of Foreign Acquirer and/or cash in exchange for their interests in Target.

LAW AND ANALYSIS

When a U.S. person transfers appreciated property to a foreign corporation, and that transfer is in connection with an exchange described in section 354 or 356, the transfer will generally be treated as a taxable exchange under section 367(a)(1). If the appreciated property consists of stock, section 1.367(a)-3 applies. Under that section, a transfer of appreciated stock of a domestic corporation by a U.S. person to a foreign corporation constitutes a taxable exchange, unless one of the exceptions in section 1.367(a)-3(c) applies.

Certain reorganizations under sections 368(a)(1)(A) and 368(a)(2)(D) trigger the application of section 367(a)(1). Treas. Reg. § 1.367(a)-3(d)(1)(i). These types of mergers consist of a section 361(a) transfer of property followed by an exchange of stock under section 354 or 356. The exchange of stock takes place between the target

corporation and its shareholders. When, however, the target corporation is domestic, and the corporation that controls the acquiring corporation is foreign, the reorganization is recast for the purposes of applying section 367(a)(1). Treas. Reg. § 1.367(a)-3(d)(1). Instead of being treated as a section 361(a) transfer followed by a section 354 or 356 exchange, the reorganization falls under the indirect stock transfer rules of section 1.367(a)-3(d). Treas. Reg. § 1.367(a)-3(d)(1)(i). There, the U.S. persons that are shareholders in the domestic corporation are treated as having made an indirect transfer of the stock in the domestic corporation to a foreign corporation. As a result, unless the requirements of section 1.367(a)-3(c) are satisfied, the indirect transfer of appreciated stock constitutes a taxable exchange under section 367(a)(1) to the extent that the exchange would otherwise have qualified for non-recognition treatment under section 354 or 356.

Among the requirements of Treas. Reg. § 1.367(a)-3(c) is the requirement that the U.S. target company must satisfy the reporting requirements of Treas. Reg. § 1.367(a)-3(c)(6). Treas. Reg. § 1.367(a)-3(c)(1). Target represents that it will satisfy the reporting requirements of Treas. Reg. § 1.367(a)-3(c)(6).

The other requirements are as follows:

(a) U.S. persons transferring U.S. target stock must receive, in the aggregate, 50 percent or less of both the total voting power and total value of the stock in the transferee foreign corporation (taking into account the attribution rules of section 318 of the Code, as modified by the rules of section 958(b) of the Code). Treas. Reg. § 1.367(a)-3(c)(1)(i). For purposes of this test, options and interests similar to options are treated as exercised and thus counted as stock for purposes of determining whether the 50-percent threshold is exceeded if a principal purpose of the issuance or acquisition of the options or similar interests was the avoidance of the general rule under section 367(a)(1). Target and Foreign Acquirer represent that pursuant to the Merger, the U.S. shareholders of Target will receive 50 percent or less of the total voting power and value of Foreign Acquirer.

(b) U.S. persons who are officers or directors of the U.S. target corporation, or who are 5 percent shareholders (by vote or value) of the U.S. target corporation, must own in the aggregate immediately after the transfer, 50 percent or less of each of the total voting power and the total value of the stock in the transferee foreign corporation (taking into account the attribution rules of section 318, as modified by the rules of section 958(b)). Treas. Reg. § 1.367(a)-3(c)(1)(ii). Target and Foreign Acquirer represent that U.S. persons who are officers, directors, or 5 percent Target shareholders will own in the aggregate, actually or constructively, 50 percent or less of each of the total voting power and total value of all shares of Foreign Acquirer outstanding immediately after the Merger.

An additional requirement of Treas. Reg. § 1.367(a)-3(c) is that each U.S. transferor who is a 5 percent shareholder of the transferee foreign corporation immediately after the exchange must enter into a five- year gain recognition agreement as provided in Treas. Reg. § 1.367(a)-8. Treas. Reg. § 1.367(a)-3(c)(1)(iii)(A). Foreign Acquirer and Target expect that no U.S. transferor will be a 5 percent shareholder of Foreign Acquirer immediately after the exchange and thus believe that Treas. Reg. § 1.367(a)-3(c)(1)(iii) will be satisfied.

(c) Among the remaining requirements of Treas. Reg. § 1.367(a)-3(c) is that the active trade or business test of Treas. Reg. § 1.367(a)-3(c)(3) must be satisfied. The active trade or business test itself has three requirements. The first requirement is that the transferee foreign corporation (or any qualified subsidiary or qualified partnership as defined under Treas. Reg. § 1.367(a)-3(c)(5)(vii) and (viii)) must have been engaged in the active conduct of a trade or business outside the United States, within the meaning of Treas. Reg. § 1.367(a)-2T(b)(2) and (3), for the entire 36-month period immediately preceding the exchange of U.S. target stock. Treas. Reg. § 1.367(a)-3(c)(3)(i)(A). Foreign Acquirer represents that through its qualified subsidiaries it has been continuously engaged in the active conduct of a trade or business, within the meaning of Treas. Reg. § 1.367(a)-3(c)(3)(i)(A), for the entire 36-month period preceding the Merger.

The second requirement of the active trade or business test is that at the time of the exchange, neither the transferors nor the transferee foreign corporation (or any qualified subsidiary or qualified partnership engaged in the active trade or business) will have the intention to substantially dispose of or discontinue the active trade or business outside the U.S. Treas. Reg. § 1.367(a)-3(c)(3)(i)(B). Foreign Acquirer represents that neither Foreign Acquirer nor its operating subsidiaries will have an intention to substantially dispose or discontinue Foreign Acquirer's active trade or business outside of the U.S. carried on through its qualified subsidiaries.

The third requirement of the active trade or business test is that the substantiality test of Treas. Reg. § 1.367(a)-3(c)(3)(iii) be satisfied. Under the substantiality test, the fair market value of the transferee foreign corporation must equal or exceed the fair market value of the U.S. target corporation at the time of the transfer. Treas. Reg. § 1.367(a)-3(c)(3)(iii)(A). Foreign Acquirer and Target have submitted representations and information showing that Foreign Acquirer's market capitalization exceeded Target's at the time Foreign Acquirer and Target agreed on the Merger and had exceeded Target's for a significant amount of time prior thereto. On Date 1, Foreign Acquirer's market capitalization exceeded that of Target's by xx. By Date 2, Foreign Acquirer's market capitalization only exceeded Target's by yy. It is unclear whether the market capitalization of Foreign Acquirer will exceed that of Target on the date of transfer.

For purposes of the substantiality test, the fair market value of the transferee foreign corporation must be reduced by the value of certain prohibited assets. Treas. Reg. §

1.367(a)-3(c)(3)(iii)(B). Specifically, the fair market value of the transferee foreign corporation must be reduced by the amount of any asset that it acquired outside the ordinary course of business during the thirty-six month period preceding the exchange to the extent that: (1) the asset produces or is held for the production of passive income at the time of the exchange; or (2) the asset was acquired for the principal purpose of satisfying the substantiality test. Treas. Reg. § 1.367(a)-3(c)(3)(iii)(B)(1)(i). The value of the transferee foreign corporation is further reduced by the value of any assets that it received within the thirty-six month period preceding the exchange if those assets were owned by the U.S. target company or an affiliate. Treas. Reg. § 1.367(a)-3(c)(3)(iii)(B)(3). After these adjustments, if the fair market value of the transferee foreign corporation continues to equal or exceed the fair market value of the U.S. target, then generally the substantiality test will be satisfied. Treas. Reg. § 1.367(a)-3(c)(3)(iii)(A). Foreign Acquirer represents that it has not acquired any assets owned by Target during the 36-month period preceding the exchange and that it has not acquired any assets outside the ordinary course of Foreign Acquirer's business within the 36-month period preceding the exchange that are held for the production of passive income for the principal purpose of satisfying the substantiality test of Treas. Reg. § 1.367(a)-3(c)(3)(iii).

Under Treas. Reg. § 1.367(a)-3(c)(9), the Service may, in limited circumstances, issue a private letter ruling to permit a taxpayer to qualify for an exception to section 367(a)(1) if a taxpayer is unable to satisfy all of the requirements of the active trade or business test, but is in substantial compliance with such test and meets all of the other requirements of Treas. Reg. §1.367(a)-3(c)(1).

CONCLUSION

Based solely on the information submitted and on the representations set forth above, we rule as follows:

(1) The indirect transfer of Target shares by U.S. persons in exchange for cash and shares of Foreign Acquirer will qualify for an exception to the general rule of section 367(a)(1). Treas. Reg. §§ 1.367(a)-3(c)(1) and 1.367(a)-3(c)(9).

(2) Any U.S. person transferring Target shares who is a 5 percent transferee shareholder (as defined in Treas. Reg. § 1.367(a)-3(c)(5)(ii)) will qualify for the exception to section 367(a)(1) only upon entering into a five-year gain recognition agreement pursuant to Treas. Reg. § 1.367(a)-8.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether the Merger will qualify as a reorganization within the meaning of sections 368(a)(1)(A) and 368(a)(2)(D) of the Code. In addition, no opinion is expressed as to whether the parties have satisfied the

reporting requirements of U.S. persons exchanging stock under section 6038B and the regulations thereunder.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

_____

Charles P. Besecky
Branch Chief
Associate Chief Counsel
(International, Branch 4)

cc: