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# WNTS Insight

## A Washington National Tax Services (WNTS) Publication

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### *Final regs on "Killer B," other triangular reorganizations involving foreign corporations*

The IRS recently issued final regulations that apply to certain cross-border triangular reorganizations. Businesses should consider the potential application of these regulations in any triangular reorganization involving at least one foreign corporation.

The regulations finalize, with modifications, temporary and proposed regulations issued in 2008 in response to certain repatriation transactions also known as "Killer B" transactions. In addition to triangular "B" reorganizations, the regulations apply to other triangular reorganizations, such as section 368(a)(2)(D) and (a)(2)(E) reorganizations, "C" reorganizations, and "G" reorganizations. In addition, this regulation package makes a few changes to the regulations under section 367(a), as discussed below. The regulations generally apply to transactions occurring on or after May 19, 2011.

### Background

Generally, in a triangular reorganization, the acquiring corporation (S) uses the stock of its parent (P) to acquire the stock or assets of a target corporation (T). The use of parent stock qualifies for tax-free reorganization treatment under Reg. sec. 1.1032-2. However, under those regulations, if either P or S (or both) is a foreign corporation, and S acquires P stock or securities in exchange for property (as defined by section 317(a) with some additions), then S will be deemed to have distributed a notional amount equal to the value of such property to P in a distribution described in section 301, and P will be deemed to contribute a notional amount equal to the value of such property to S. The distribution and contribution are deemed to occur immediately prior to the reorganization. The regulations apply whether S acquires the P stock or securities directly from P or from P's shareholders.



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## Key changes in the final regulations

Changes from the temporary regulations that are incorporated in the final regulations include the following:

- The scope of the final regulations has been modified so that they do not apply in certain situations in which a dividend from S to P would not be subject to U.S. tax, such as when P is foreign, S is domestic, and the dividend created by the deemed distribution qualifies for an exception under a treaty. However, such transactions still could be subject to other provisions, including other parts of section 367.
- The final regulations expand the scope of the temporary regulations to include certain P and T securities as well as stock.
- The final regulations modify the layout of the "priority rule" under section 367. Reg. sec. 1.367(a)-3(a) applies to transfers of stock to a foreign corporation (which may be subject to both sections 367(a) and (b)), and provides an ordering rule for the application of those sections. Under this ordering rule, the transferor generally must follow whichever provision results in the most taxable income. The final regulations set forth a new, separate priority rule in Reg. sec. 1.367(b)-10, providing that the final regulations do not apply if the amount of gain recognized by the T shareholders under section 367(a)(1) in the section 354 or 356 exchange is greater than the sum of deemed distribution that would be treated as income under sections 301(c)(1) and 301(c)(3). A corresponding rule addressing the application of section 367(a)(1) to the exchanging shareholders also is included in Reg. sec. 1.367(a)-3(a).
- The regulations clarify the interaction of the deemed distribution and contribution rules with other provisions. Specifically, they provide that S is deemed to distribute, and P is deemed to contribute, a notional amount equal to the value of the property used in the exchange. In other words, there is not a deemed distribution or contribution of the property itself. Therefore, if S exchanges appreciated property for P stock, S recognizes gain under section 1001, and not section 311(b). Other provisions, such as section 1032, the reorganization provisions, and section 304 are not affected by the deemed distribution and contribution.
- Reg. sec. 1.367(a)-3(a) was modified to provide that "gain is recognized" on exchanges of stock or securities subject to section 367(a)(1), whereas previously the regulation had provided that the exchange was "treated as a taxable exchange."

**Observation:** The preamble to the final regulations states that this is a "clarification." This change reflects the IRS's reasoning in TAM 200919032, which states that other parts of the section 367(a) regulations -- which provide that to determine the character and source of section 367(a) gain, the property is treated as if disposed in a taxable exchange -- do not turn the entire transaction into a taxable transaction. Consequently, the transaction still is otherwise treated as a nonrecognition transaction.

Link to WNTS Insight archive: <http://www.pwc.com/us/en/washington-national-tax/newsletters/washington-national-tax-services-insight-archives.jhtml>

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