Failing to Talk to Yourself – A FIRPTA Tax Trigger
by John B. Magee and F. Scott Farmer

John B. Magee and F. Scott Farmer are partners with McKee Nelson LLP in Washington. They gratefully acknowledge the assistance of Cornelia J. Schnyder, counsel to the firm, for her assistance in the preparation of this article. This article was originally presented as a paper to the Washington International Tax Study Group.

“Facts do not cease to exist because they are ignored.”
— Aldous Huxley, Proper Studies (1927)

Introduction

The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) added to the Internal Revenue Code a substantive liability for dispositions of U.S. real property interest under section 897 of the code.1 In 1984 a complementary withholding tax regime was added in section 1445.2 Both the statutes and their underlying regulations are extremely complex and cover a wide range of circumstances. This article is concerned only with the limited circumstances in which foreign-owned U.S. corporate groups may run afoul of these rules for failure to provide timely information between members of the group when certain events occur and to notify the Internal Revenue Service. In particular, it is our view that the remedial reporting rules adopted in Rev. Proc. 2008-273 as a preliminary substitute for the increased number of taxpayer requests for relief under Treas. reg. section 301.9100-1 and Treas. reg. section 301.9100-34 regarding the FIRPTA regime are inadequate as applied to the circumstances discussed in this article. The limited foreign controlled U.S. corporate group circumstances we consider would be more effectively dealt with by regulations that created a presumption of FIRPTA liability in these circumstances that could be rebutted on audit of the domestic corporate group.

The simplest paradigm for our foreign controlled U.S. corporate group is the circumstance in which a foreign corporation (FP or FS) owns 100 percent5 of a domestic corporation (US), and US either owns no real property interests in the United States, or plainly falls below the 50 percent fair market value threshold for a U.S. real property holding corporation (USRPHC) set forth in section 897(c)(2).6 Our simplified potential tax

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1FIRPTA was part of the Omnibus Reconciliation Act of 1980. Section 1122(a) of that public law added section 897 to the Internal Revenue Code. Unless otherwise indicated, all references to “section” or “sections” herein are to the Internal Revenue Code of 1986, as amended as of the relevant date; all references to “Treas. reg.,” “Temp. Treas. reg.,” or “regulations” are to regulations of the U.S. Department of Treasury, as most recently adopted, proposed, or amended as of the relevant date.

2Tax Reform Act of 1984, section 129(a)(1) (adding section 1445 effective for any disposition on or after January 1, 1985). In 1980 the Senate version of the bill contained a withholding provision, but it was dropped in conference to carefully structure the withholding provision. Enactment of a withholding provision was further delayed in part by a delay in reporting regulations under sections 897 and 6039C.


4Treas. reg. section 301.9100 provides a mechanism under which the commissioner may grant extensions for some filing failures upon demonstration of reasonable action and good faith.

5Our analysis should apply equally to an 80 percent controlled group as defined in section 1504(a), but without regard to section 1504(b)(3). As discussed herein, this is the definition adopted in the section 7874 regulations, and we believe it would adequately address most circumstances that we are aware of when these issues arise.

6Section 897(c)(2) defines USRPHC as any corporation if (A) the FMV of its U.S. real property interest equals or exceeds 50%.
triggers include FP (or FS) reorganizing the US holdings outside the United States, receiving a distribution from US in excess of its earnings and profits, or making a distribution regarding its interest in US. The statutes and regulations create a binding presumption of tax liability in these circumstances unless US provides a timely written statement to the foreign transferee that it is not a USRPHC under section 897(c)(2) and notifies the IRS within a specified period of time (the statement/notification procedural requirements).\(^7\)

Failure to timely comply with these procedural requirements could trigger U.S. tax on the entire gain realized on the transfer, as well as interest and penalties. The amounts at issue can be large, and even though the prospects are high for correcting the failure under Rev. Proc. 2008-27 or through the Treas. reg. section 301.9100 relief process, there is some risk that a request for more time could be denied, resulting in the imposition of tax.\(^8\) And because the taxpayer subject to U.S. tax on the gain under section 897 is a foreign corporation that typically has not filed U.S. returns because it is not otherwise subject to U.S. tax, the statute of limitations remains open. Similarly, assuming that no withholding return has been filed reflecting the transaction, the statute of limitations on withholding tax liability also remains open.\(^9\)

Although taxpayers and practitioners are generally aware of the FIRPTA provisions, in our experience there has been frequent inattention to the procedural requirements, creating exposure to gain recognition when the disposition transactions relate to stock ownership of U.S. corporations that clearly fell below the 50 percent FMV threshold in section 897(c)(2) (the substantive rules). Although practitioners frequently check the FMV of real estate,\(^10\) they often overlook the procedural requirements necessary to avoid a FIRPTA tax on gains. These omissions created a flood of Treas. reg. section 301.9100 relief requests, starting in 2005 with a request for which the authors were responsible,\(^11\) and reaching a peak in 2007 and 2008.

Rev. Proc. 2008-27 is a response to these increasing requests and reflects them to Ogden, Utah, under a simplified procedure. Under the revenue procedure, the taxpayer’s submission is deemed to have established reasonable cause for late compliance if the taxpayer has not been notified within 120 days that the IRS has determined that its noncompliance was not supported by reasonable cause or that additional time is needed for the determination.\(^12\) Only if denied relief under the revenue procedure is the taxpayer required to file a private letter ruling application under Treas. reg. section 301.9100. It is too early to gauge how this process will be administered in practice, but, as discussed below, we believe more changes should be made to the regulations to address foreign controlled group situations more appropriately.\(^13\)

**Illustrative Transactions**

The following are four relatively common situations that will trigger FIRPTA substantive and withholding tax liabilities if the statement/notice reporting provisions described here are not followed. They are presented here for purposes of illustration. Under section 897(c)(1)(A), dispositions of any interest in a domestic corporation other than as a creditor will trigger these rules. Simple additional examples would include changes in ownership of preferred stock or options held by foreign parties.

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\(^7\)Although in situations 2, 3, and 4 (illustrated below) it may be difficult for the IRS as a practical matter to collect any such tax (both the taxpayer and the withholding agent are foreign corporations, and their only U.S. asset is stock of US), few foreign-owned U.S. groups are willing to rely on uncollectibility to resolve the issue.

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\(^8\)The tax liability and procedural requirements are discussed in more detail below.

\(^9\)See recommendations below.

\(^10\)Treas. reg. section 1.897-2(b)(2) contains a presumption that the real property interests are less than 50 percent of the FMV if the book value of those interests is 25 percent or less of book value.

\(^11\)The authors were reviewing the FIRPTA implications of a proposed distribution in excess of E&P by a U.S. corporation to its foreign shareholder. Our FIRPTA inquiry revealed a series of previous restructurings involving the U.S. stock, which required relief under Treas. reg. section 301.9100.


\(^13\)See also Kenneth J. Krupsky, “New Relief for Failure to File No-Withholding FIRPTA Certificates: Secret Law?” 37 Tax Mgt’n Int’l J. 685 (Nov. 14, 2008), raising the issue of private law developing at the service center level.
**Situation 1**
US makes a distribution to FP in excess of its E&P.

**Situation 2**
FS distributes its US stock to FP.

**Situation 3**
FP checks the box to treat FS as a disregarded entity.\(^\text{14}\)

\(^{14}\)A similar issue arises when FP sells the stock of FS and the buyer makes a section 338 election, which treats a stock purchase as an asset acquisition. That scenario presents additional issues regarding the proper application of the procedural requirements, given that the election likely postdates the date of disposition of the stock. See section 338(g)(1), providing that the election must be made no later than the 15th day of the ninth month beginning after the month in which the acquisition occurred. For instance, does old FS need to request a statement from US to give to itself (as new FS) when the deemed sale of the stock of US occurs?

**Situation 4**
FP contributes stock of US to FS.

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**A Brief Review of FIRPTA Rules**

**Substantive FIRPTA Liability**

Under section 897(a)(1), a foreign corporation is taxed on gain from the disposition of a United States real property interest under section 882(a)(1)\(^\text{15}\) as if it were engaged in a trade or business within the United States and the gain were effectively connected with that trade or business.\(^\text{16}\) Most of the problems we focus on are attributable to section 897(c)(1)(A)(ii), which defines a U.S. real property interest to include any interest in any domestic corporation (other than solely as a creditor), unless the taxpayer establishes in the time and manner directed by the Treasury regulations that at no time during the five-year period ending on the date of the disposition was it a USRPHC. As discussed in more detail below, the general rule for withholding

\(^{15}\)Net based taxation.

\(^{16}\)FIRPTA has equal application to nonresident alien individuals. See section 897(a)(1)(A); section 897(a)(2).
under section 1445(a) is 10 percent of the amount realized on the disposition of a United States real property interest. A 10 percent rate applies specifically to section 301 distributions from a domestic corporation that is a USRPHC to a foreign person to the extent that the distribution exceeds E&P and to section 302 distributions of property to a foreign person.\footnote{Section 1445(e)(3).}

The term “disposition” is broadly defined in Treas. reg. section 1.897-1(g) as “any transfer that would constitute a disposition by the transferor for any purpose of the Internal Revenue Code and regulations thereunder.” Treas. reg. section 1.897-1(h) provides that gain or loss from a disposition of the United States real property interest is “the amount determined as provided in section 1001(a) and (b).” Also, that gain or loss is subject to section 897(a), unless a nonrecognition provision in section 897(d)(2) or (e) applies.\footnote{Treas. reg. section 1.897-1(h).}

Section 897(d)(1) states that except as otherwise provided in regulations, a foreign corporation recognizes gain for section 897(a) purposes upon its distribution (including a distribution in liquidation or redemption) of a U.S. real property interest in an amount equal to the excess of FMV of that interest over its adjusted basis.\footnote{Temp. Treas. reg. section 1.897-5T(c) has similar provisions.} A 35 percent withholding rate applies to gain on these dispositions.\footnote{Section 1445(e)(2).}

**Binding Presumption of USRPHC Status**

Pursuant to the regulatory authority in section 897(c)(1)(A)(ii), Treas. reg. section 1.897-2 sets forth the required proof of a domestic corporation’s exclusion from classification as a USRPHC. Treas. reg. section 1.897-2(g)(1)(i) provides that the foreign corporation must establish that the domestic corporation is not a U.S. real property holding corporation as of the date of disposition, either by obtaining a statement from the domestic corporation in accordance with Treas. reg. section 1.897-2(g)(1)(i), or by obtaining a determination by the commissioner under Treas. reg. section 1.897-2(g)(1)(ii). If the foreign person fails to implement either proof mechanism, the interest in the domestic corporation is presumed to have been a U.S. real property interest and the statutory liability is triggered. Although presumptions in tax law are frequently rebuttable, this presumption appears to be binding, based on the structure and operation of the regulation. The private letter rulings regarding relief under Treas. reg. section 301.9100 confirm that this is the IRS’s interpretation of the rules. Treas. reg. section 1.897-2(a) describes the structure of the regulation and states: Paragraph (g) explains the manner in which an interest-holder can establish that a corporation is not a U.S. real property holding corporation, and paragraph (h) provides rules regarding certain notification requirements applicable to corporations.

The statement/notification mechanics for avoiding tax by establishing non-FIRPTA status are as follows. The foreign corporation requests and obtains from the domestic corporation a statement under penalties of perjury that an interest in the corporation was not a U.S. real property interest.\footnote{Treas. reg. section 1.897-2(g)(1)(i)(A).} To rely on a statement from the domestic corporation, the foreign person “must obtain the [domestic] corporation’s statement no later than the due date, including any extensions, on which a tax return would otherwise be due regarding the disposition.”\footnote{Treas. reg. section 1.897-2(g)(1)(ii)(A).} However, this statement is valid only if the domestic corporation complies with the notice requirements of Treas. reg. section 1.897-2(h)(2) or (h)(4). Treas. reg. section 1.897-2(h)(2) requires that notice with certain information must be provided to the IRS at the FIRPTA unit in Philadelphia on or before the 30th day after the statement was mailed to the interest holder that requested it. Failure to provide the notice to the IRS within that time period will invalidate the statement provided to the interest holder under Treas. reg. section 1.897-2(h)(1).\footnote{Treas. reg. section 1.897-2(h)(4).} Under Treas. reg. section 1.897-2(h)(4), if the domestic corporation has provided a voluntary notice to the IRS with its last tax return and has not had an event described in Treas. reg. section 1.897-2(c)(1)(i)(ii)- (iv) (acquisitions of realty or dispositions of trade or business assets), the notice does not need to be sent to the IRS. This rule does not eliminate the need for (1) the foreign corporation to request a statement of non-FIRPTA status from the domestic corporation, or (2) the domestic corporation’s statement of non-FIRPTA status to be given to the foreign corporation.

Treas. reg. section 1.897-2(g)(1)(ii)(B) provides a coordination rule with section 1445 eliminating withholding liability for the transferee if it receives the corporation’s statement. As discussed below, the section 1445 rules generally require that the statement be received by the transferee before the transfer at issue, so that the statement requirements for section 1445 purposes typically must be satisfied earlier than may be required under section 897.

The taxpayer may also satisfy the proof requirements by obtaining a commissioner’s determination under Treas. reg. section 1.897-2(g)(1)(iii)(B), (C), or (D), but these rules are not typically applicable to the foreign controlled U.S. corporate group transactions we
are focusing on here. The mechanics in (B) and (C) also require that the taxpayer make timely filings. For example, both (B) and (C) appear to contemplate situations in which the taxpayer has sought a statement from the U.S. corporation and has received no response from the U.S. corporation or has adequate information in its possession that would allow the commissioner to make the determination. Curiously, (D) appears to allow the commissioner upon his own motion to determine, at any time, that a U.S. corporation is not a USRPHC. Given that the commissioner previously has allowed taxpayers relief only through a reasonable cause showing under Treas. reg. section 301.9100-3 or Rev. Proc. 2008-27, it seems unlikely that the commissioner would unilaterally make that determination on a basis different from reasonable cause. We are unaware of any situation in which the commissioner has independently exercised this authority.

Accordingly, even where the controlled group knows that US is not a USRPHC because its real estate is too small a fraction of its business assets to be anywhere near the 50 percent threshold or the 25 percent or less book value test, FP (or FS) must timely request from its controlled US subsidiary a statement of a known fact, and the subsidiary must file an additional notice with the IRS to avoid the binding presumption of taxable gain.

The USRPHC Determination

Determining whether a domestic corporation is a USRPHC at any time within the five years preceding the disposition is not as simple as just asserting that the domestic corporation cannot be a USRPHC because it holds insignificant real property in the United States or the U.S. Virgin Islands. The statement must be signed under penalties of perjury, which requires care in the determination process.

Under section 897(c)(2) and Treas. reg. section 1.897-2(b)(1), establishing non-USRPHC status by satisfying the less than 50 percent test requires the domestic corporation to determine the FMV of its United States real property interests, its interests in real property located outside the United States (that is, foreign real property), and any other of its assets that are used or held for use in a trade or business.

For purposes of the FIRPTA rules, real property includes the following three categories of property:

- Land and unsevered natural products of the land, improvements, and personal property associated with the use of real property.

The term “interest in real property” includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

An interest in real property other than an interest solely as a creditor includes a fee ownership, co-ownership, or leasehold interest in real property, a time-sharing interest in real property, and a life estate, remainder, or reversionary interest in such property.

The term also includes any direct or indirect right to share in the appreciation in the value of, or in the gross or net proceeds or profits generated by, the real property.

The term “asset used or held in a trade or business” includes:

- Property, other than a U.S. real property interest, that is: “[s]tock in trade of an entity or other property of a kind which would properly be included in the inventory of the entity if on hand at the close of the taxable year, or property held by the entity primarily for sale to customers in the ordinary course of its trade or business,” or “depreciable property used or held for use in the trade or business, as described in section 1231(b)(1) but without regard to the holding period limitations of section 1231(b).”

- “Goodwill and going concern value, patents, inventions, formulas, copyrights, ... trademarks, trade names, franchises, licenses, customer lists, and similar intangible property, but only to the extent that such property is used or held for use in the entity's trade or business and subject to the valuation rules of section 1.897-1(o)(4).”

- “Cash, stock, securities, receivables of all kinds, options or contracts to acquire any of the foregoing, and options or contracts to acquire commodities, but only to the extent that such assets are...

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24 The alternative book value test referred to above is found in Treas. reg. section 1.897-2(b)(2). Although this simple alternative is typically the preferred method, it is still difficult to comply with and often may not be available. It requires that the books be computed according to U.S. generally accepted accounting principles, rather than the international accounting standards more generally used by foreign-owned U.S. corporate groups. Also, the presumption as to the FMV of a corporation’s U.S. real property interests provided by the alternative test may be denied in some circumstances, under Treas. reg. section 1.897-2(b)(2)(iii).

25 Treas. reg. section 1.897-1(b)(1). Local law definitions will not be controlling for purposes of determining the meaning of the term “real property” as it is used in sections 897, 1445, and 6093C and the regulations thereunder. Id.

26 Section 897(c)(6)(A).

27 Treas. reg. section 1.897-1(d)(2)(i).

28 Id; see also supra note 6.


31 Treas. reg. section 1.897-1(f)(1)(ii).
used or held for use in the corporation’s trade or business and do not constitute U.S. real property interests.32 33

- A proportionate share of the property, other than a United States real property interest, described in the above three categories that is owned by a partnership, trust, estate in which a person holds an interest, or that is owned by a corporation in which a person holds a controlling interest.33

The domestic corporation also must consider when to make its determination of status as a USRPHC. Once again, the determination date rules are far from simple. It can be as simple as at the end of each tax year.34 Or there may be multiple determination dates, such as the date of acquisition of any U.S. real property interest, the date on which the corporation disposes of foreign real property, or the date of disposition of certain trade or business assets.35

Withholding Under Section 1445

Section 1445(a) provides as a general rule that in the case of any disposition of a U.S. real property interest, as defined in section 897(c), by a foreign person (which includes foreign corporations and foreign partnerships),36 the transferee must deduct and withhold a tax equal to 10 percent of the amount realized37 on the disposition.38

Section 1445(b) provides several exemptions to the general withholding rule of section 1445(a) that generally parallel the rules in section 897. Section 1445(b)(6) exempts the disposition of a U.S. real property interest if “the disposition is of a share of a class of stock that is regularly traded on an established securities market.”39 The regulations explain the scope of other exemptions by providing that in general, a transferee has a duty to withhold under section 1445(a) only if both of the following are true:

- the transferor is a foreign person; and
- the transferee is acquiring a U.S. real property interest.40

However, the transferee must comply with the procedures in the regulations to ascertain whether liability is relieved because one or the other of these two elements is missing.41 The procedures depend on the transaction at issue.42

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32 For purposes of section 1445, the term “foreign person” means any person other than a United States person. Section 1445(f)(3). The term “United States person” is not defined in section 1445 or the regulations thereto. Section 7701(a)(3) defines a United States person as a citizen or resident of the United States, a domestic partnership, a domestic corporation, and some trusts and estates. Section 7701(a)(1) defines person as an individual, trust, estate, partnership, association, company, or corporation.

33 Treas. reg. section 1.1445-1(f)(1)(ii). “Assets described in paragraph (f)(1)(iii) of this section shall be presumed to be used or held for use in a trade or business, in an amount up to 5 percent of the fair market value of other assets used or held for use in the trade or business. However, the rule of this paragraph (f)(3)(i) shall not apply with respect to any assets described in paragraph (f)(1)(iii) of this section that are held or acquired for the principal purpose of avoiding the provisions of section 897 or 1445.” Treas. reg. section 1.897-1(f)(3)(i).

34 Treas. reg. section 1.897-1(e)(1). This applies only to a corporation in which a person holds a controlling interest. In such a case, the actual interest in the controlled corporation is not itself taken into account. Treas. reg. section 1.897-2(e)(3)(iii). However, if a person holds less than a controlling interest in the stock of a domestic or foreign corporation, that interest in the corporation is itself considered a U.S. real property interest unless it can be shown that the corporation in which the person owns stock is not a U.S. real property holding corporation. There is no look-through to the assets of the corporation in which the person does not own a controlling interest. Section 897(c)(1)(A)(ii); Treas. reg. section 1.897-2(e)(1).

35 Treas. reg. section 1.897-2(c)(1)(i) and (ii). These are additional determination dates because it is more likely that after such transactions the domestic corporation has become a USRPHC.

36 For example, section 1445 has a parallel exception from withholding for some nonrecognition transactions. Under Treas. reg. section 1.1445-2(d)(2), a transferee is not required to withhold if the transferor provides notice to the transferee that, by reason of the operation of a nonrecognition provision of the code or the provisions of any U.S. treaty, the transferor is not required to recognize any gain or loss regarding the transfer. The notice must include the information described in Treas. reg. section 1.1445-2(d)(2)(i). The transferee must provide a copy of the notice to the IRS within 20 days of the transfer. Treas. reg. section 1.1445-2(d)(2)(i)(B). Similarly, in transfers described in section 1445(c), an entity or fiduciary otherwise required to withhold is not required to withhold if, by reason of the operation of a nonrecognition provision of the code or the provisions of any U.S. treaty, no gain or loss is required to be recognized by the foreign person with respect to which withholding would otherwise be required. Treas. reg. section 1.1445-5(b)(2)(i)(A). Withholding is not required if, within 20 days of the transfer, the entity or fiduciary delivers a notice to the IRS that includes the information described in Treas. reg. section 1.1445-5(b)(2)(i). See Treas. reg. section 1.1445-5(b)(2)(i)(B).
For purposes of this article, the procedure that parallels the section 897 statement process in the context of a foreign controlled group is section 1445(b)(3), which relieves the transferee’s withholding duty if the nonpublicly traded domestic corporation provides an affidavit stating, under penalty of perjury, that:

- the domestic corporation is not and has not been a U.S. real property holding corporation during the applicable period; or
- as of the date of the disposition, interests in such corporation are not U.S. real property interests by reason of section 897(c)(1)(B) (the so-called cleansing rule in which the corporation disposed of all of its U.S. real property interests in transactions in which all gain was recognized).

Under Treas. reg. section 1.1445-2(c)(3), section 1445(b)(3)(A) is satisfied if the transferor provides the transferee with the statement issued by the domestic corporation under penalties of perjury in accordance with Treas. reg. section 1.897-2(h). At the request of the transferor, the domestic corporation can provide the statement directly to the transferee. The transferor must request the statement before the transfer, and at the time of the transfer, the transferor or the transferee must have the statement in hand.

Section 1445(e) provides special rules for certain dispositions and distributions, including distributions by foreign corporations. Section 1445(e)(2) and Treas. reg. section 1.1445-5(d) provide that in the case of any distribution by a foreign corporation on which gain is recognized by the foreign corporation under section 897(d) or (e), the foreign corporation is required under section 1445(e) to withhold a tax equal to 35 percent of the amount of gain recognized. Withholding is not required if no gain is required to be recognized by reason of the operation of a nonrecognition provision or provision of any treaty of the United States, but only if notice requirements are complied with.

Withholding is also not required in two other circumstances. First, it is not required if the foreign corporation determines that the property distributed is not a U.S. real property interest. The foreign corporation must make that determination in compliance with the procedures in the regulations. Treas. reg. section 1.1445-5(b)(4)(iii) provides one method involving the transferee’s receipt of the statement from the domestic corporation issued under Treas. reg. section 1.897-2(h), and Treas. reg. section 1.1445-5(b)(4)(ii) provides another method for interests in publicly traded entities. Second, withholding is not required regarding a foreign corporation’s distribution of a U.S. real property interest if the distributing corporation obtains a withholding certificate from the IRS under Treas. reg. section 1.1445-6.

### Does Absence of Gain Avoid the Rules?

Unfortunately, the absence of gain does not clearly remove the transaction from the scope of the rules. Although there would be no substantive tax liability and no related withholding tax liability in the absence of gain from the disposition, there is still potential exposure for interest under Treas. reg. section 1.1445-1(c)(3)(ii) from the date the withholding was required to the date the IRS issues a withholding certificate establishing that the transferor’s maximum tax liability is zero. The relief originally announced in Notice 2006-99 for potential exposure for interest and penalties, under Treas. reg. section 1.1441-1(b)(7) before amendment, for failure to withhold under section 1441 or 1442 when there was no substantive tax liability, was not extended to withholding under section 1445, and the regulations under section 1445 have not been amended.

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45Treas. reg. section 1.897-2(g)(1)(ii)(B) provides a coordination rule with section 1445, such that the statement for section 897 satisfies the affidavit requirement of section 1445. Also, the domestic corporation could get such a determination from the IRS. Treas. reg. section 1.897-2(g)(1)(iii).

46Treas. reg. section 1.1445-2(c)(3)(i).

47Treas. reg. section 1.1445-2(c)(3)(i).

48Treas. reg. section 1.1445-2(g)(1)(ii)(B) provides a coordination rule with section 1445, such that the statement for section 897 satisfies the affidavit requirement of section 1445. Also, the domestic corporation could get such a determination from the IRS. Treas. reg. section 1.897-2(g)(1)(iii).

49Id. The regulation’s cross-reference to (b)(3) should be to (b)(4).

50Treas. reg. section 1.1445-5(b)(4)(ii)(A) refers only to the domestic corporation’s statement that the interest is not a U.S. real property interest. The regulation does not address a determination by the commissioner.

51Treas. reg. section 1.1445-5(d)(2)(ii).

522006-2 C.B. 907.

53See T.D. 9323, 72 Fed. Reg. 18,386 (Apr. 12, 2007), retroactively incorporating Notice 2006-99 into the regulations under section 1441 (and thus section 1442). Before T.D. 9323, Treas. reg. section 1.1441-1(b)(7)(iii) provided that a withholding agent that failed to withhold tax for reasons other than reliance on the appropriate presumptions is not relieved from liability for interest under section 6601. It further provided that such liability exists even when there is no underlying tax that is ultimately shown to be due.
The policy rationale for the changes to section 1441 appears to be based on the notion that withholding is simply a means of collecting what is otherwise the substantive tax and thus should not result in greater liability to the withholding agent than the substantive tax liability. Even though section 1445 withholding normally is applied at a 10 percent rate on the amount realized without regard to the ultimate tax liability of the taxpayer, it is difficult to discern why the policy rationale would not apply to section 1445 obligations. As noted above, however, nothing explicitly exempts section 1445 liability for interest or potential penalties in these circumstances.54

When a domestic corporation makes a distribution in excess of earnings and profits to a foreign shareholder, section 1445(e)(3) and Treas. reg. section 1.1445-5(e) require a withholding tax equal to 10 percent of the value of the amount distributed, without regard to any determination of whether the excess distribution exceeds the recipient’s basis in the stock of the domestic corporation. Although as illustrated in Situation 1, FP would not have a substantive tax liability under section 897, US’s failure to withhold potentially raises, again, the section 1445 interest and penalty exposures discussed above.

Surely There Are Some Exceptions

Despite the shared knowledge of non-USRPHC status that is apparent in our foreign controlled U.S. corporate group paradigm, under the current regulation structure there are no applicable exceptions or exclusion that would avoid the need for timely compliance with the procedural requirement to avoid application of both sections 897 and 1445.

Zero Current Real Property Holdings

Section 897(c)(1)(B) excludes from the term “United States real property interest” any interest in a corporation if, at the date of disposition, the corporation has zero U.S. real property interests and all of the U.S. real property interests held by it during the five-year period ending on the disposition date were disposed of in taxable transactions. This appears to be a complete override, without required regulations, of the USRPHC status conferred by section 897(c)(1)(A)(ii) on interests in domestic corporations generally. Nevertheless, the regulations implementing (A) seem to override the statutory structure. Treas. reg. section 1.897-2(a) makes paragraph (g) of that section the exclusive means of establishing an exemption. While Treas. reg. section 1.897-2(f) reiterates the statutory rule exempting domestic corporations with zero real property from the status conferred by (A), it seems reasonable to interpret the regulations as requiring compliance with the procedural rules of Treas. reg. section 1.897-2(g). Finally, the rule in (B) is referred to explicitly in the context of the statement requirement in Treas. reg. section 1.897-2(h)(1)(ii).

Publicly Traded Domestic Stock

Section 897(c)(3) excludes from the definition of U.S. real property interest any class of stock of a domestic corporation that is regularly traded on an established securities market, if held by a person holding less than 5 percent of that class of stock.55 Section 1445 eliminates any withholding requirement even if the transfer is of stock held by a 5 percent shareholder.56 Because US’s stock is not publicly traded, this exception does not apply in the foreign controlled U.S. group contexts in any of the situations set forth above.

Foreign Distributors

The gain rule for distributions by a foreign corporation under section 897(d)(1) is subject to an exception in section 897(d)(2) if the distributee would be subject to U.S. tax on the subsequent distribution or disposition of the property and has a carryover basis.57 Although one could argue in Situation 3 that this provision is satisfied because of the presumed status of US as a USRPHC, that argument could require that the taxpayer treat US as a USRPHC for the next five years. And even if the U.S. real property interest was subject to U.S. tax immediately after the exchange, there are timely filing requirements in temp. Treas. reg. section 1.897-5T(d)(1)(iii) that must be satisfied58 that makes this exception inapplicable in our assumed facts.

Nonrecognition Transactions

The exception in section 897(e)(1) for nonrecognition transactions59 also does not apply to our foreign controlled U.S. corporate group transactions. Section

54 See letter from American Institute of Certified Public Accountants to Treasury and the IRS (June 2, 2008), following Notice 2006-99 and the retroactive withdrawal of Treas. reg. section 1.1441-1(b)(7)(iii), recommending to add to the priority list guidance on liability of a withholding agent for interest regarding withholding under section 1445 or section 1446, if the withholding agent does not withhold for a foreign person that has no U.S. tax liability, or that has satisfied its U.S. tax liability.
897(e)(1) and temp. Treas. reg. section 1.897-6T\textsuperscript{60} require that the interest being exchanged is a U.S. real property interest and the exchange is for an interest the sale of which is subject to U.S. tax.\textsuperscript{61} This requirement raises the same issues as the foreign distributor situation described above.\textsuperscript{62} If a nonrecognition provision does not apply to a transaction because it fails to meet the requirements of section 897(e) and temp. Treas. reg. section 1.897-6T, the gain realized from the transfer of the U.S. real property interest will be subject to U.S. tax under section 897.\textsuperscript{63}

Finally, it is interesting to note that Situation 4 is the fact pattern that led to the issuance of recent regulations under section 7874 that exempt from the inversion rules restructurings within a foreign controlled group. No similar exception has been provided under FIRPTA. In general, under section 7874, if a foreign corporation acquires directly or indirectly substantially all of the assets of a domestic corporation and after the acquisition former shareholders of the domestic corporation own 80 percent or more (by vote or value) of the stock of the foreign corporation by reason of their ownership in the domestic corporation, then section 7874 treats the foreign corporation as a domestic corporation unless the foreign corporation has substantial business activities in the country in which it is incorporated compared with the substantial business activities of the expanded affiliated group (EAG), as defined in section 7874(c)(1), as a whole.

A special rule in section 7874(c)(2) provides that any stock owned by the EAG is excluded from both the numerator and denominator in determining the 80 percent ownership threshold. In our Situation 4, FP, US, and FS would all be part of the EAG. Accordingly, in determining the ownership threshold after the transfer by FP, the stock that FP owns in FS would be excluded from both the numerator and denominator, so that if there were any minority ownership in US that received stock in FS — no matter how small — the 80 percent ownership threshold would be triggered; moreover, even if there were no minority ownership as illustrated in Situation 4, the result would produce a fraction of 0/0, a result that is mathematically described as indeterminate or infinity, leading some to question even in a wholly owned fact pattern whether it was clear that the 80 percent ownership threshold had not been satisfied. Treas. reg. section 1.7874-1, finalized in May 2008, provides relief from these rules in such intercompany restructurings by providing that FP’s stock ownership in FS is excluded from the numerator but not the denominator of the ownership fraction, thereby resulting in a fraction of 0/100.\textsuperscript{64}

Requests for Relief

Given the FIRPTA status presumption regarding domestic corporations, a transferor or transferee may realize after a distribution/disposition date that they failed to comply with section 897 and/or section 1445. Because the statement/notice procedure described in Treas. reg. sections 1.897-2(g)(1)(ii)(A), 1.897-2(h), 1.1445-2(c)(3)(i), 1.1445-2(d)(2), 1.1445-5(b)(2), and 1.1445-5(b)(4) all fall within the definition of a regulatory election,\textsuperscript{65} the taxpayer (which may be the transferor or the transferee) may request under Treas. reg. section 301.9100-1 and -3 an extension of time to file the statements and notices. This relief may be granted by the IRS if the taxpayer provides evidence that it acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government.\textsuperscript{66}

Since the enactment of the FIRPTA rules, there have been over 30 ruling requests granted for relief under Treas. reg. section 301.9100. While there were a few submissions in the 1990s, there were 21 submissions beginning in 2005. Although a few related to real USRPHCs, most dealt with cases in which the failure to follow the procedural requirements exposed the transaction to tax and the transferee to withholding tax liability, even though the domestic corporation was not a USRPHC under the substantive test of section 897(c)(2). Some of these rulings are illustrated below in the appendix to illustrate how easy it is run afoul of the FIRPTA rules and the various situations in which the issue arises.

Finally, there is the practical problem of the scope of relief to request when the belated preparation of information regarding USRPHC status reveals there have been similar oversights in prior years, each of which could involve a preceding five-year period. The answer appears to lie in the general policy of the IRS not to enforce filing requirements for more than six years absent a history of noncompliance or other negative factors.\textsuperscript{67}

\textsuperscript{60}See temp. Treas. reg. section 1.897-6T(b)(1), providing exception to the general rule for some foreign-to-foreign exchanges.

\textsuperscript{61}See also temp. Treas. reg. section 1.897-5T(d)(1), providing rules for interests subject to taxation upon later disposition.

\textsuperscript{62}There are timely filing requirements for this exception set forth in temp. Treas. reg. section 1.897-5T(d)(1). Also, section 897(i) provides that gain inherent in contributions to capital is taxable unless exempted by regulations as well. Presumably this refers to contributions not otherwise covered by nonrecognition treatment.

\textsuperscript{63}Temp. Treas. reg. section 1.897-6T(a)(3).

\textsuperscript{64}See Treas. reg. section 1.7874-1(f), Example 3.

\textsuperscript{65}Treas. reg. section 301.9100-1(b).

\textsuperscript{66}Treas. reg. section 301.9100-3(a).

\textsuperscript{67}See P-5-133 Delinquent Returns, I.R.M. 1.2.1.5.19 (approved Nov. 24, 1980); Enforcement Determination, I.R.M. 5.1.11.6.1 (May 7, 2002).
Rev. Proc. 2008-27

After the numerous ruling requests for relief under Treas. reg. section 301.9100, the IRS responded on May 13, 2008, by issuing Rev. Proc. 2008-27, which provides a simplified method for taxpayers to request relief for late filings under Treas. reg. sections 1.897-2(g)(1)(ii)(A), 1.897-2(b), 1.1445-2(c)(3)(i), 1.1445-2(d)(2), 1.1445-5(b)(2)(i), and 1.1445-5(b)(4). This procedure is in lieu of the letter ruling procedure that otherwise would be used under Treas. reg. section 301.9100, and it is applicable to all requests for relief received after June 26, 2008.

Unlike a ruling request under Treas. reg. section 301.9100, user fees do not apply to corrective action under Rev. Proc. 2008-27. A taxpayer can request relief under Treas. reg. section 301.9100 only if the taxpayer is denied relief by the IRS under Rev. Proc. 2008-27.

A taxpayer is eligible for relief from late filing of the statement/notice procedural requirements under Rev. Proc. 2008-27 on the same reasonable cause basis that applied for purposes of Treas. reg. section 301.9100. Once the taxpayer becomes aware of the failure to file the statements or notices, the taxpayer must file the completed statement and/or notice with the appropriate person and include a statement at the top of the documents that they are “Filed pursuant to Rev. Proc. 2008-27.” With a completed statement or notice required to be filed with the IRS, the taxpayer must attach an explanation describing why the failure to timely file the statement or notice was due to reasonable cause. And in the explanation the taxpayer must state that it filed with, or obtained from, an appropriate person the appropriate statement or notice. The completed statement or notice attached to the explanation must be sent to the Ogden Service Center, P.O. Box 409101, Ogden, UT 84409.

Upon receipt of a completed application requesting relief, the IRS will determine whether the requirements for granting more time have been satisfied. The IRS will notify the taxpayer in writing within 120 days of the filing of the completed application only if it determines that the failure to comply was not due to reasonable cause, or if more time will be needed to make a determination. If, once that period commences, the taxpayer is not again notified within 120 days, the taxpayer will be deemed to have established reasonable cause.

The implication of Rev. Proc. 2008-27 is that the National Office no longer wants to deal with ruling requests for relief under Treas. reg. section 301.9100 (which depicts the foolishness of the FIRPTA rules). The same information that would have been included in the ruling request regarding the failure and the reasonable cause is now merely shipped off to Ogden. The only change is that there will no longer be any transparency through the ruling publication process.

Recommendations

The foreign controlled circumstances that we have focused on here, in which the domestic corporation is clearly not a USRPHC, deserve a simplified process that eliminates the current regulation statement/notification procedures and the frequent need for Rev. Proc. 2008-27 (or Treas. reg. section 301.9100) relief. We recommend the IRS change the regulations to eliminate these requirements in the case of foreign controlled U.S. corporate groups. The regulations should replace the current mechanism with a presumption of FIRPTA tax liability in the case of covered dispositions, subject to rebuttal on audit. If the issue is not raised in an audit, the presumption should expire with the statute of limitations of the domestic corporation for the year of the covered distribution/disposition.

This recommendation has several advantages over the current process, without any additional compliance exposure for the IRS. It may even enhance compliance. It seems clear that foreign controlled groups that have dispositions involving U.S. subsidiaries that are in fact USRPHCs either recognize and report their tax liabilities or are eligible for a nonrecognition exception. The current statement/notification process is of no benefit to them. It merely presents an easily overlooked administrative hurdle in circumstances when the U.S. entity is not a USRPHC. On the other hand, reliance on a regular audit mechanism could increase the likelihood of identifying taxable transactions while providing the means for a careful review of exempt status.

Thus, permitting the presumption of liability to expire with the statute of limitations is unlikely to reduce tax collections. Audit practices should incorporate an automatic, pattern information document request to a foreign-owned U.S. corporate group regarding the existence of any potential FIRPTA distributions/dispositions, followed by requests for information necessary to determine the USRPHC status of the U.S. company if dispositions exist. The regulations should provide that disposition transactions create a rebuttable presumption of tax liability and require the U.S. subsidiary of the foreign group to rebut the presumption by providing information similar to the current statement within a reasonable, fixed period following a request during an audit.

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682008-21 IRB 1014.
69Taxpayers that have ruling requests pending as of May 27, 2008, were not required to use the procedures of Rev. Proc. 2008-27. However, if taxpayers have not received a determination of their request as of May 27, 2008, they may withdraw their relief request under Treas. reg. section 301.9100, and the IRS will refund the taxpayer’s user fee.
These recommended changes for foreign controlled U.S. corporate groups would avoid many of the problems with the current compliance regime. The current statement/notice procedures are artificial in requiring controlled parties to report to one another, and these requirements are easily and understandably overlooked by foreign owners conducting internal group restructurings. They deserve relief similar to that granted to foreign controlled groups in the context of the inversion rules under section 7874. Our recommended procedures would acknowledge that the statement/notice process is artificial in this context and would leave the determinations to the audit. The existence of the rebuttable presumption would provide the IRS with all of the enforcement leverage it requires in these circumstances.

The recommendations also have the advantage of eliminating prospects for the body of private law that may arise under the silence-is-approval policy of the revenue procedure, while eliminating the administrative drain that is necessarily involved in these requests. Moreover, it is not clear under what circumstances a taxpayer would not have reasonable cause for failing to follow the statement/notification procedures. We assume that if there have been unsuccessful requests for relief under Treas. reg. section 301.9100 in this area, they were withdrawn before the public benefited from the publication of a negative private letter ruling. Nevertheless, the IRS’s discretion to find that reasonable cause for the compliance failure existed presents the potential for abuse. The authors are aware of at least one circumstance in which relief under Treas. reg. section 301.9100 was withheld until the taxpayer made additional concessions on issues related to the transaction that triggered the potential FIRPTA liability. This seems an improper exercise of discretion under Treas. reg. section 301.9100.

Reporting requirements do not appear to be a suitable alternative. Congress has already attempted two reporting regimes regarding the FIRPTA rules. The Omnibus Reconciliation Act of 1980 added section 6039C to the code in conjunction with section 897. That provision required domestic corporations to file a return if it was a USRPHC under section 897(c)(2) listing all of its foreign shareholders and any transfers of its stock. Congress introduced the section 1445 withholding regime in 1984 in part because the IRS had delayed the regulations under section 6039C, but at the same time Congress revised section 6039C.

As revised, to the extent provided in regulations, the reporting requirement now falls on any foreign person that owns “direct investments in United States real property interests.” While the use of the word “direct” might appear at first blush to exclude stock interests in domestic corporations, the definition in section 6039C(c) incorporates section 897(c) and thus the rule that any interest in domestic corporation stock is a U.S. real property interest. Fortunately, no regulations have been issued under this provision, so there is currently no reporting requirement.

**Appendix**

**Illustrations of Relief**

For presentation purposes, any shaded square represents a domestic corporation. Indirect ownership is noted by a slash mark on the connecting lines between the corporations. For simplicity, the defined terms for the parties used in our illustrations may not correspond with the terminology used in the private letter rulings.

Unless otherwise noted, the domestic corporations in the private letter rulings were not USRPHCs under the substantive test of section 897(c)(2), but the statement/notice procedural requirements discussed in this article were not followed.

**Redemption of Stock**

In LTR 200840014 (June 20, 2008), domestic parent (US), a nonpublicly traded corporation, owned all the stock of a foreign corporation (FS). FS owned shares in US, and US redeemed the shares held by FS for a note. The redemption of shares of a domestic corporation under section 302 is a disposition for purposes of section 897(a), as shown in Figure 5.

![Figure 5](image-url)

**Section 351 Transactions**

In LTR 200838007 (June 13, 2008), a foreign corporation (FP) wholly owned two domestic corporations (US 1 and US 2). In a section 351 transaction, FP contributed its shares of US 2 to US 1 in exchange for one share of US 1 and a note.

Even though section 351 is a nonrecognition provision, the contribution is subject to section 897(a), a

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70 The ruling request dealt only with the section 897 liability. The transaction would also have been subject to section 1445(e)(3) (distributions by domestic corporations to foreign shareholders) and the requirements under Treas. reg. section 1.1445-5(e)(3).
variation of Situation 4, because section 897(e) was inapplicable where FP received in the exchange stock in another domestic corporation (US 1), which was not a U.S. real property interest under the substantive test of section 897(c)(2).

Afterwards, at a time when US 1 had no current or accumulated E&P, US 1 distributed cash to FP in a section 301 transaction. Section 301 distributions in excess of E&P are subject to section 897(a) and section 1445(e)(3), similar to Situation 1. (See Figure 6.)

DE transferred all its interests in US 1 and FS 2 to FS 1. The contribution was intended to qualify under section 351, a variation of Situation 4. Section 897(a) was applicable to the contribution because a U.S. real property interest was not received in the exchange (that is, section 897(e) was inapplicable where DE received stock of a foreign corporation). Afterwards, FS 1 transferred its entire interest in US 1 to FS 2, similar to Situation 4. Although it was a section 351 transaction, section 897(a) was applicable to the contribution because stock in FS 2, a foreign corporation, is not a U.S. real property interest (that is, section 897(e) was inapplicable). Figure 8 depicts the structure after the contributions.

In LTR 200831007 (April 20, 2008), a foreign corporation (FP), through a disregarded entity (DE), owned all of a domestic corporation (US 1) and two foreign corporations (FS 1 and FS 2). US 1 in turn owned all of a domestic corporation (US 2). (See Figure 7.)

To effectuate an internal restructuring, LTR 200726028 (March 23, 2007) represents a case in which the FIRPTA rules were violated in consecutive section 351 transfers of the same domestic corporation stock (similar to Situation 4). Section 897(e) was inapplicable to the section 351 transactions because a U.S. real property interest was not received in the exchanges (either stock in another foreign corporation or a domestic corporation that was not a U.S. real property interest under the substantive test of section 897(c)(2) was received). (See Figure 9.)

71The ruling request dealt only with the section 897 liability.
LTR 200631020 (May 4, 2006) involved three types of transactions. First, a foreign subsidiary (FS 1) transferred all of the stock of a domestic corporation (US 1) to its parent (FP) in exchange for cancellation of debt by FP. Such a disposition is subject to section 897(a) and section 1445. Second, FP transferred all of the stock of US 1 to its foreign subsidiary (FS 2), and then FS 2 transferred that US 1 stock to another foreign corporation (FS 3) (similar to Situation 4). Although they were section 351 transactions, both transfers were subject to section 897(a) and section 1445. Lastly, FS 1 sold stock of a domestic corporation (US 2) to FS 3 in a taxable transaction, clearly subject to section 897(a) and section 1445. Figure 10 shows the structure before the transaction.

The final structure is shown in Figure 11.

Liquidations and Entity Classification

In LTR 200735004 (June 4, 2007), a foreign corporation (FP) owned all of the stock of a foreign corporation (FS), which in turn owned all of the stock of a domestic corporation (US). FS liquidated into FP, a variation of Situation 3, in a liquidation under section 332. Section 897(d) is applicable to liquidating distributions and provides that gain will be recognized for section 897(a) purposes. The exception in section 897(d)(2) was inapplicable where FP would not be subject to tax on the subsequent distribution of US (which under the substantive test is not a U.S. real property interest). (See Figure 12.)

LTR 200634014 (May 17, 2006) had the same fact pattern — the liquidation of a foreign subsidiary (FS), which owned all of the stock of a domestic corporation (US), into its foreign parent (FP). Again, section 897(d) was applicable and the exception in section 897(d)(2) was inapplicable.

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Figure 9

FP
FS 1
FS 2
FS 3
FS 4
FS 5
FS 6
FS 7
US 1
US 2

FP acquired Target, a domestic corporation followed by transfer of Target to FS 2.

Then:

FS 2 transferred Target to FS 3
FS 3 transferred Target to FS 4
FS 4 transferred Target to FS 5
FS 5 transferred Target to FS 6
FS 6 transferred Target to FS 7
FS 7 transferred Target to US 1
US 2 merged into Target, with Target surviving.

Figure 10

FP
FS 1
FS 2
US 1
US 2

Figure 11

FP
FS 1
FS 2
FS 3
US 1
US 2

Figure 12

FP
FS liquidated
FS
US

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In LTR 200609017 (Nov. 28, 2005), a foreign corporation (FP) owned all of a domestic corporation (US). Corp C, which was unrelated to FP or US before the transactions at issue, owned all of the stock of a foreign corporation (FS). (See Figure 13.)

Corp C transferred all of its stock in FS to US in exchange for US stock. FS then converted from an Italian S.p.A. (Società per azioni) to an S.r.l. (Società a responsabilità limitata), an eligible entity, and checked the box to be disregarded for federal income tax purposes, which is treated as a deemed liquidation of FS (similar to Situation 3). This was in the event that relief under Treas. reg. section 301.9100 was granted. While not specifically addressed in the ruling, it appears that the check-the-box election by FS (which was followed by the liquidation of Corp C) was treated as a reorganization under section 368(a)(1)(D). As a result, FS received stock of US in the reorganization and thus was a disposition subject to section 897.

Both LTR 200409013 (Nov. 17, 2003) and LTR 200304022 (Oct. 23, 2002) involved the same fact pattern: A foreign corporation (FP) owned all of a foreign subsidiary (FS), and FS owned all the stock of a domestic corporation (US). FS checked the box to be disregarded for federal income tax purposes, which is treated as a deemed liquidation of FS (similar to Situation 3). Section 897(d)(1) was applicable to the deemed liquidation. (See Figure 14.)

Intended Reorganizations

In LTR 200714014 (April 6, 2007), to simplify the U.S. ownership structure, a domestic corporation (US 1) merged into another domestic corporation (US 2). As a result, foreign corporation (FP), though a disregarded entity (DE), exchanged its US 1 stock for US 2 stock. This is a disposition for purposes of section 897, and section 897(e)(1) was inapplicable. US 2 was not a U.S. real property interest under the substantive test of section 897(c)(2). (See Figure 15.)

LTR 199942024 (July 27, 1999) involved a reorganization under section 368(a)(1)(F) of a domestic corporation (US) that was wholly owned by a foreign corporation (FP). In the reorganization, stock of US was exchanged for stock of New US. Even though section 354(a)(1) provides nonrecognition to the shareholder FP, section 897 was applicable because a subsequent disposition of New US would not be subject to taxation. (See Figure 16.)
Nine Restructuring Transactions

LTR 200742008 (July 5, 2007) involved nine separate transactions that crossed several tax years. All transactions were solely within the group of corporations owned by foreign parent (FP) and involved internal restructuring.

Transaction 1

A foreign corporation (FS Entity 1), which was a subsidiary of FP, sold its entire interest in a domestic corporation (US Entity 2) to an entity (DE Entity 3). For federal tax purposes, DE Entity 3 was classified as a disregarded entity of a foreign partnership (FP Partnership Entity 4). The partners of FP Partnership Entity 4 were two foreign corporations within FP’s then existing group. FS Entity 1’s sale of its interest in US Entity 2 was a disposition for purposes of section 897(a), and gain was realized under section 1001. (See Figure 17.)

When the ruling request was submitted, US Entity 2 was no longer in existence and through reorganizations is now part of US Entity 6, a domestic corporation. (See Transaction 5 discussed below.)

Transaction 2

A foreign corporation (FS Entity 7) converted under foreign law to an entity classified as a per se corporation for purposes of Treas. reg. section 301.7701-2(b)(8) in a transaction intended to qualify under section 368(a)(1)(F). At that time, FS Entity 8, through its disregarded entity (FS Entity 7), owned the stock of a domestic corporation (US Entity 6). For U.S. tax purposes, FS Entity 8 is treated as exchanging its assets, including its stock in US Entity 6, for stock of New FS Entity 8. This deemed asset transfer was a disposition for purposes of section 897, and in the disposition, FS Entity 8 realized gain under section 1001. (See Figure 19.)

Transaction 3

FS Entity 8 converted under foreign law to an entity classified as a per se corporation for purposes of Treas. reg. section 301.7701-2(b)(8) in a transaction intended to qualify under section 368(a)(1)(F). At that time, FS Entity 8, through its disregarded entity (FS Entity 7), owned the stock of a domestic corporation (US Entity 6). For U.S. tax purposes, FS Entity 8 is treated as exchanging its assets, including its stock in US Entity 6, for stock of New FS Entity 8. This deemed asset transfer was a disposition for purposes of section 897, and in the disposition, FS Entity 8 realized gain under section 1001. (See Figure 19.)

Transaction 4

DE Entity 3, which was a disregarded entity of a foreign partnership (FP Partnership Entity 4), contributed assets that included stock of a domestic corporation (US Entity 272) to a foreign corporation (FS Entity 8) in exchange for voting and nonvoting stock of FS Entity 8, which is not a U.S. real property interest, and cash. The partners of FP Partnership Entity 4 were two foreign corporations within FP’s then existing group.

Figure 17

Figure 18

72US Entity 2 no longer exists and through reorganizations is now part of US Entity 6. (See Transaction 5 discussed below.)
In the contribution, gain was realized under section 1001 and is therefore subject to section 897(a). (See Figure 20.)

**Transaction 5**

US Entity 2, a domestic corporation, statutorily merged into a domestic corporation (US Entity 11), which was the predecessor to US Entity 6. US Entity 11 later changed its name to US Entity 6. Before the merger, a foreign corporation (FS Entity 8) was the sole shareholder of US Entity 2 and US Entity 11. At that time, FS Entity 8 owned stock of other domestic corporations. For simplicity, only the domestic corporations at issue are shown in the diagrams. FS Entity 8 received US Entity 11 stock and the right to deferred cash payments in exchange for its US Entity 2 stock. This exchange was a realization event under section 1001.73 (See Figure 21.)

**Transaction 6**

A foreign corporation (FS Entity 8) made a distribution of the stock of two domestic corporations (US Entity 6 and US Entity 12) to its sole shareholder, a foreign corporation (FS Entity 13, a variation of Situation 2). FS Entity 13 is now known as FS Entity 14. (See Transaction 7 below.) The distribution of stock in a domestic corporation by a foreign corporation to another foreign corporation was subject to gain recognition under section 897(d). (See Figure 22.)

**Transaction 7**

A foreign corporation (FS Entity 13) changed its place of incorporation from one foreign country to another foreign country and changed its name to FS Entity 14. At the time of reincorporation and name change, FS Entity 13 owned all the stock of US Entity 6 and US Entity 12,74 both domestic corporations. This transaction was likely a reorganization under section 368(a)(1)(F), in which FS Entity 13 is treated as distributing all of its assets to New FS Entity 13 (FS Entity 14). This deemed asset transfer was a disposition, and in the disposition, FS Entity 13 realized gain under section 1001. (See Figure 23.)

73 The taxpayer did not request section 1445 relief for this transaction given that the transferee did not “acquire” a U.S. real property interest; section 1445 does not appear to be applicable to this transaction. See Treas. reg. section 1.1445-2(a); Treas. reg. section 1.1445-5(e).

74 US Entity 12 was liquidated into FS Entity 15 after the transaction.
**Transaction 8**

A foreign corporation (FS Entity 14) distributed all the stock of US Entity 6 and US Entity 12, both domestic corporations, to its sole shareholder, a foreign corporation (FS Entity 16, a variation of Situation 2). The distribution of stock in a domestic corporation by a foreign corporation to another foreign corporation was subject to gain recognition under section 897(d). (See Figure 24.)

**Transaction 9**

A foreign corporation (FS Entity 16) sold all the stock of US Entity 12, a domestic corporation, to a foreign corporation (FS Entity 15). At the time of the sale, FS Entity 16 was an indirect subsidiary of FS Entity 15. The sale was a disposition under section 897(a) and gain was realized under section 1001. (See Figure 25.)

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75US Entity 12 was liquidated into FS Entity 15 after the transaction.