

Part I – Rulings and Decisions Under the Internal Revenue Code of 1986

Abusive Foreign Tax Credit Intermediary Transaction

Notice 2004-20

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which, pursuant to a prearranged plan, a domestic corporation purports to acquire stock in a foreign target corporation and make an election under section 338 of the Internal Revenue Code before selling all or substantially all of the target corporation's assets in a transaction that is subject to foreign income tax. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of §1.6011-4(b)(2) of the Income Tax Regulations and §§301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations. This notice also alerts parties involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

The transaction generally involves four parties: a person or persons (X) that plans to sell the stock or assets of a foreign corporation or group of foreign corporations (Target) that is not engaged in a U.S. trade or business, a domestic corporation that acts as an intermediary (Midco), and a person or persons (Y) that plans to purchase the assets of Target. Pursuant to a prearranged plan, the parties undertake the following steps. X purports to sell the stock of Target to Midco. Midco then makes an election under section 338 to treat the stock purchase as resulting in a deemed sale by Target (Old Target) of its assets and an acquisition of those assets by a deemed new corporation, New Target, providing New Target with a stepped-up basis in the assets. Midco then may cause New Target to liquidate, either in a liquidation under local law or by making an election under §301.7701-3 to treat New Target as a disregarded entity. As a result of the liquidation (or deemed liquidation), Midco inherits New Target's assets with a stepped-up basis. Shortly thereafter, pursuant to the prearranged plan, Y purchases all or substantially all of New Target's assets. Alternatively, if Midco does not liquidate New Target (or elect to treat New Target as a disregarded entity), New Target pays a dividend to Midco after the asset sale.

The asset sale generates a taxable gain for foreign tax purposes (but not for U.S. tax purposes), and Midco claims a credit under section 901 with respect to the foreign income tax imposed on the asset sale. If Midco does not liquidate New Target (or elect to treat New Target as a disregarded entity), Midco claims a credit under section 902 for the foreign income tax imposed on the asset sale when New Target pays a dividend.

DISCUSSION

The transaction described above does not produce the tax benefits claimed by Midco. The transaction is intended to shift the foreign tax credits to Midco through the purported acquisition of assets that, when sold pursuant to a prearranged plan, triggers a foreign tax on built-in gain that is not subject to U.S. tax. The tax benefits purportedly derived from the transaction by Midco are inconsistent with the purposes of the foreign tax credit provisions, including the foreign tax credit limitation of section 904, which are intended to reduce or eliminate double taxation of income.

The Service will challenge the purported tax results to Midco of the transaction described in this notice by applying principles of existing law. See Notice 2001-16, 2001-1 C.B. 730 (announcing that the Service may challenge the purported tax consequences of a purported sale of stock to a tax-indifferent intermediary corporation that then purports to sell the target's assets). For example, the Service may challenge the purported tax results to Midco under the step transaction doctrine or the substance over form doctrine. "A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945) (citations omitted). Cf. *Aiken Industries, Inc. v. Commissioner*, 56 T.C. 925 (1971) (treating interest payments to a conduit entity as paid directly to the beneficial owner). Accordingly, Midco would not be treated for U.S. tax purposes as having purchased the stock of Target. The Service also may challenge the purported tax results to Midco of this transaction under the provisions of section 269 applicable to acquisitions made with the principal purpose of evading or avoiding income tax, or by applying agency principles to disregard Midco's ownership of Target.

Transactions that are the same as, or substantially similar to, the transaction described in this notice are identified as "listed transactions" for purposes of §1.6011-4(b)(2), §301.6111-2(b)(2), and §301.6112-1(b)(2) effective February 17, 2004, the date this notice was released to the public. In addition, independent of their classification as "listed transactions" for purposes of §§1.6011-4(b)(2), 301.6111-2(b)(2), and 301.6112-1(b)(2), transactions that are the same as, or substantially similar to, the transaction described in this notice may already be subject to the disclosure requirements of section 6011 (§1.6011-4), the tax shelter registration requirements of section 6111 (§301.6111-1T and §301.6111-2), or the list maintenance requirements of section 6112 (§301.6112-1). For purposes of the disclosure requirements of section 6011, only a taxpayer that acted as an intermediary (*i.e.*, Midco) in the listed transaction described in this notice will be considered to have participated in the transaction within the meaning of §1.6011-4(c)(3). No inference is intended, however, as to whether the other parties to such a transaction have participated in a transaction that is the same as

or substantially similar to the transactions described in Notice 2001-16. Persons who are required to register these tax shelters under section 6111 but have failed to do so may be subject to the penalty under section 6707(a). Persons who are required to maintain lists of investors under section 6112 but have failed to do so (or who fail to provide those lists when requested by the Service) may be subject to the penalty under section 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including the accuracy-related penalty under section 6662.

DRAFTING INFORMATION

The principal author of this notice is Ginny Chung of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Ms. Chung on (202) 622-3850 (not a toll-free call).