

The 30th Annual Institute on Current Issues in International Taxation

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Cross Border Spin-Offs, Issues and Planning

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International Issues in Spin-Offs

- “Packaging” a U.S. Spinco — Pre-spin international restructuring to set the stage for spin-off of U.S. Spinco
 - Common international tax issues (Subpart F, FTC, Section 1248, Section 367, Host Country Issues)
 - Unique section 355 issues with internal packaging spins
 - Impact of tax reform
- What if Spinco subsequently combined with another company? U.S. or Foreign.
- Inversion Issues
 - Spin by Foreign Parent of Foreign Subsidiary
 - Routine U.S. Spin by U.S. parent of U.S. Subsidiary
 - Spin by U.S. Parent of Foreign Subsidiary

Packaging a US Spinco; Typical Pre-Spin Steps

- Transfers of assets between CFCs
- Internal spin-off of one CFC by another CFC
- Internal spin-off of CFC by U.S. sub to another U.S. affiliate
- Section 351 contributions of CFC to another CFC or to a U.S. affiliate
- Transfer of CFC from USP Group (distributing group) to U.S. Spinco (spun off group)

Packaging a US Spinco; Typical International Issues

Code Section	Distributing	Controlled	Distributing Shareholders	Result
Section 367(e)	U.S.	Foreign	Foreign	Distributing recognizes gain on distributions to foreign shareholders
Section 1248(f)	U.S.	Controlled Foreign Corporation	Not relevant	Distributing may be required to recognize a deemed dividend
Section 367(b) – Rule 1 [Treas. Reg. § 1.367(b)-5(b)]	U.S.	Foreign	Individuals	Distributing recognizes gain to the extent of distributions to individuals
Section 367(b) – Rule 2 [Treas. Reg. § 1.367(b)-5(c), (d)]	Controlled Foreign Corporation	Not relevant	Not relevant	Potential basis adjustments or deemed dividend

Packaging a US Spinco; Typical International Issues

Issues

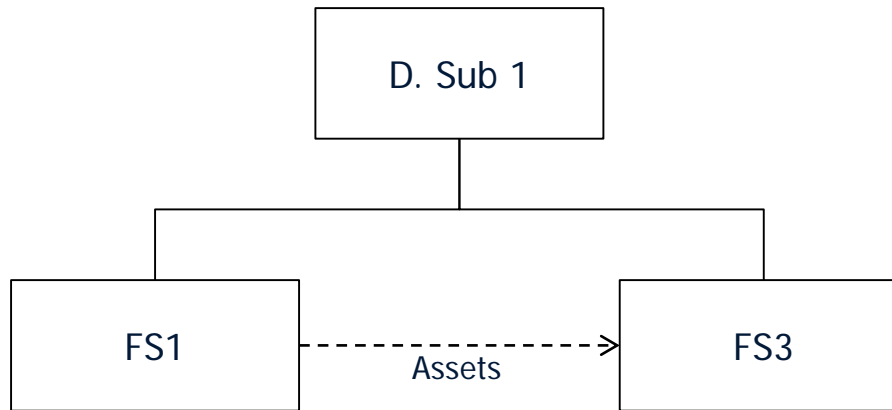
- Asset transfers from FS1 to FS3 to separate business line. Subpart F? Transfer taxable or tax free? Section 351 / 361 typically applies but could be issues. Host Country issues (de-merger)

See slides 5 - 9

- Internal spin of FS3 by FS1. Need to look at Section 1248 amounts embedded in FS1 and FS3. Does spin off cause a reduction in Section 1248 amount? See Reg Section 1.367(b)-5.
 - Basis D Sub 1 has in FS1 shares
 - Allocation of that basis between FS1 and FS3
 - E&P allocation between FS1 and FS3
 - Result may be basis reduction or income inclusion

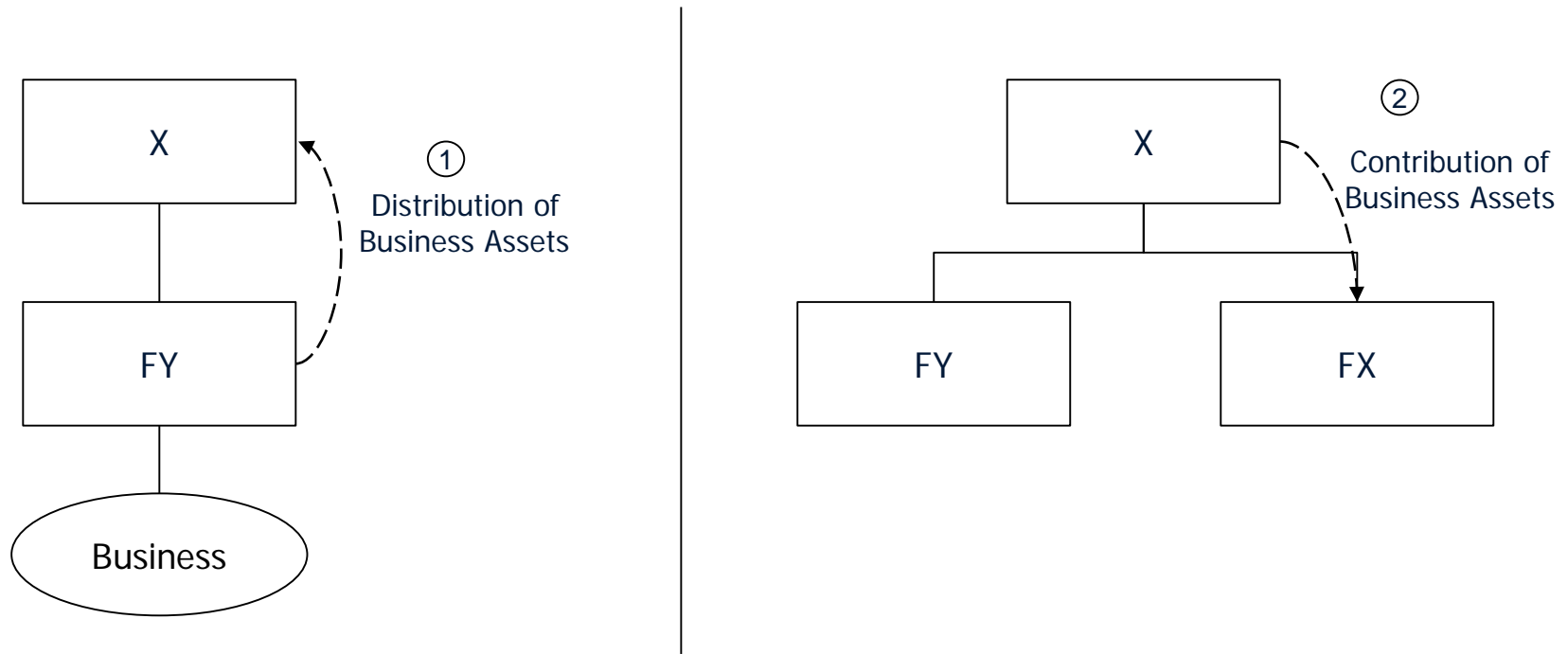
See slides 10 - 12

Packaging a US Spinco; Typical International Issues – Foreign Demerger



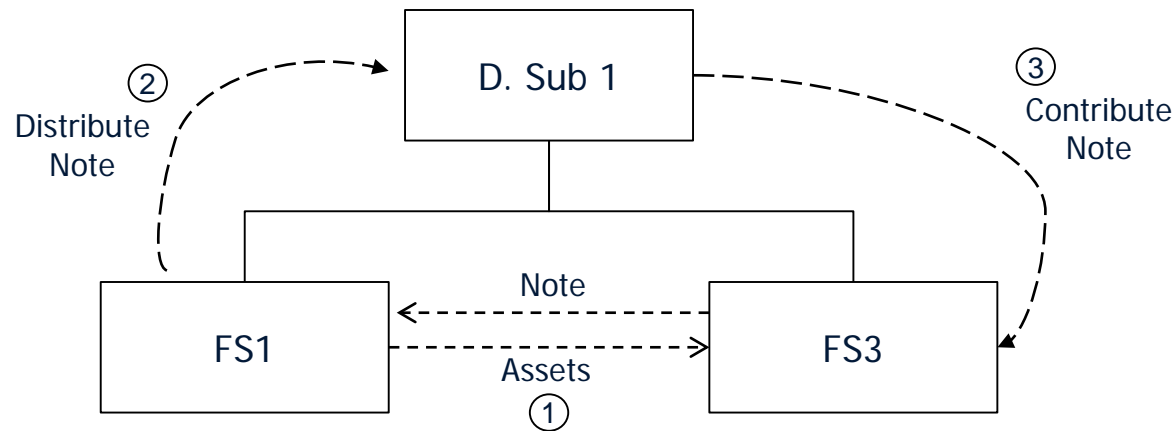
- Local steps via de-merger
- Section 355 qualification? Numerous PLRs rule that a demerger under foreign law is in substance a divisive D reorganization followed by a Section 355 distribution
- By operation of law, assets of distributing become the assets of controlled
- Pennsylvania and Texas have demerger statutes

Packaging a US Spinco; Typical International Issues – Asset Distribution/Contribution



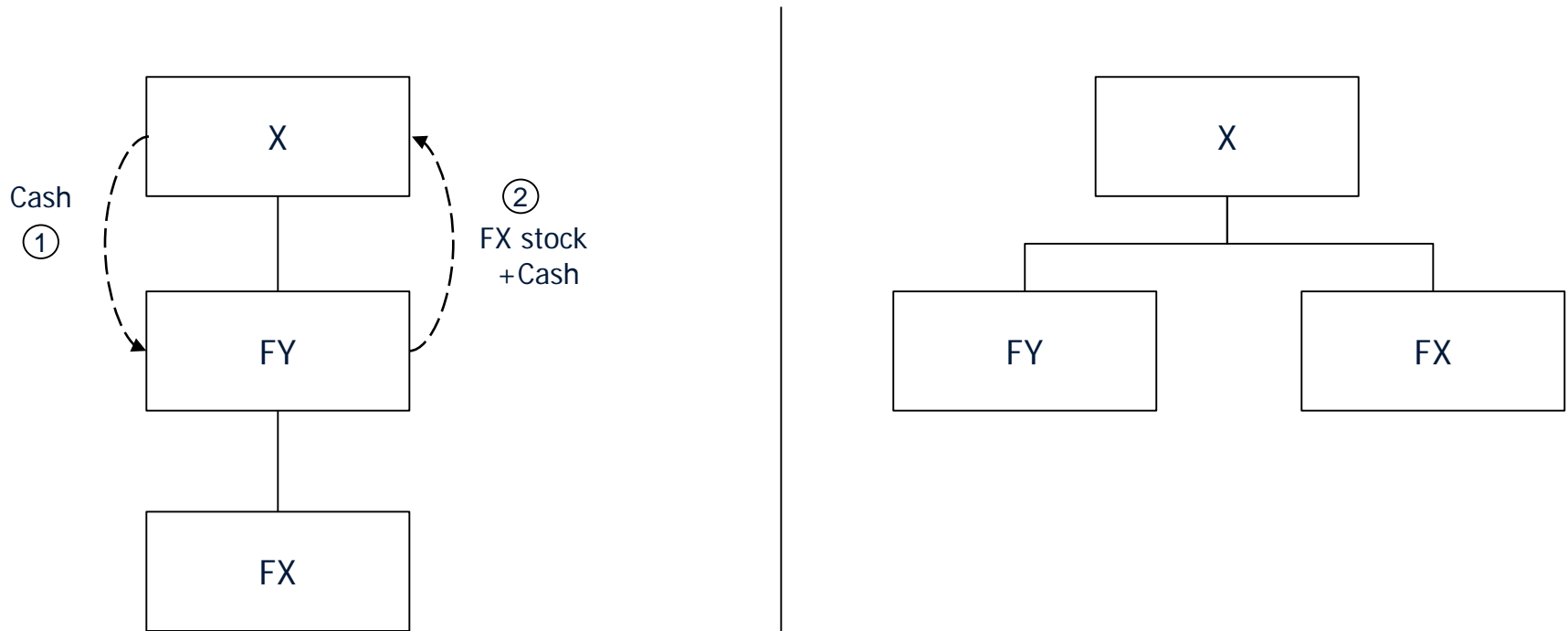
- FY is engaged in two businesses and distributes one business to X
- Immediately after as part of an integrated X contributes the business to newly formed FX
- See Revenue Ruling 77-191

Packaging a US Spinco; Typical International Issues – Circular Flow of Cash, Example 1



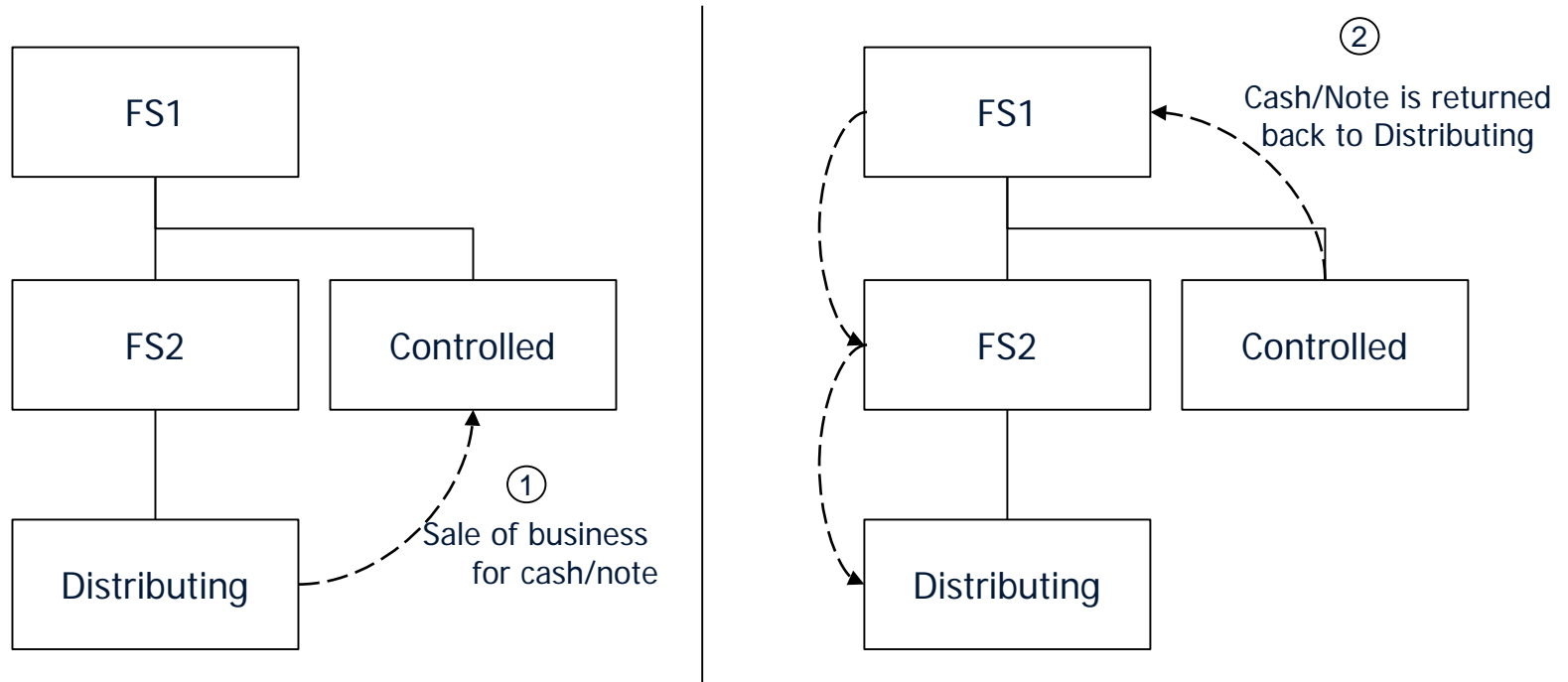
- “Round Tripped Cash”: IRS liberal view in rulings.
- Section 355 qualification? Rev. Rul. 77-191; Rev. Rul. 83-142

Packaging a US Spinco; Typical International Issues – Circular Flow of Cash, Example 2



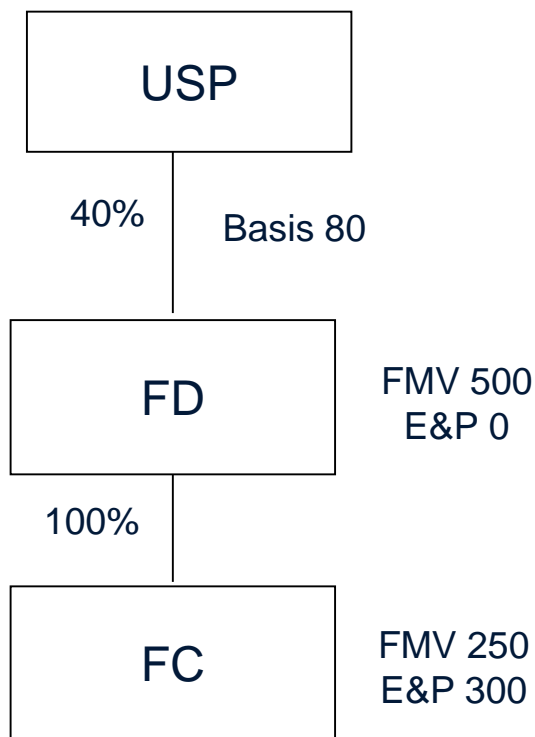
- X owns 100% of FY, with owns 100% or FX. FY sells the stock of FX to X in exchange for cash equal to the FMV of FX.
- As part of the plan, FY distributes the sales proceeds to X.
- Form was chosen to qualify for tax-free treatment under foreign law
- Distribution was treated as a dividend under foreign law and was grossed-up for withholding tax
- See Revenue Ruling 83-142

Packaging a US Spinco; Typical International Issues – Circular Flow of Cash, Example 3



- Does step transaction apply to treat this as a divisive D reorganization with two successive spins?
- Is there a limit to the number of tiers that can be skipped?

Internal Spin of CFC by another CFC



What would USP's Section 1248 amount be if it sold FD?

Assume FD distributes FC to USP.

Treas. Reg. § 1.367(b)-5 examples.

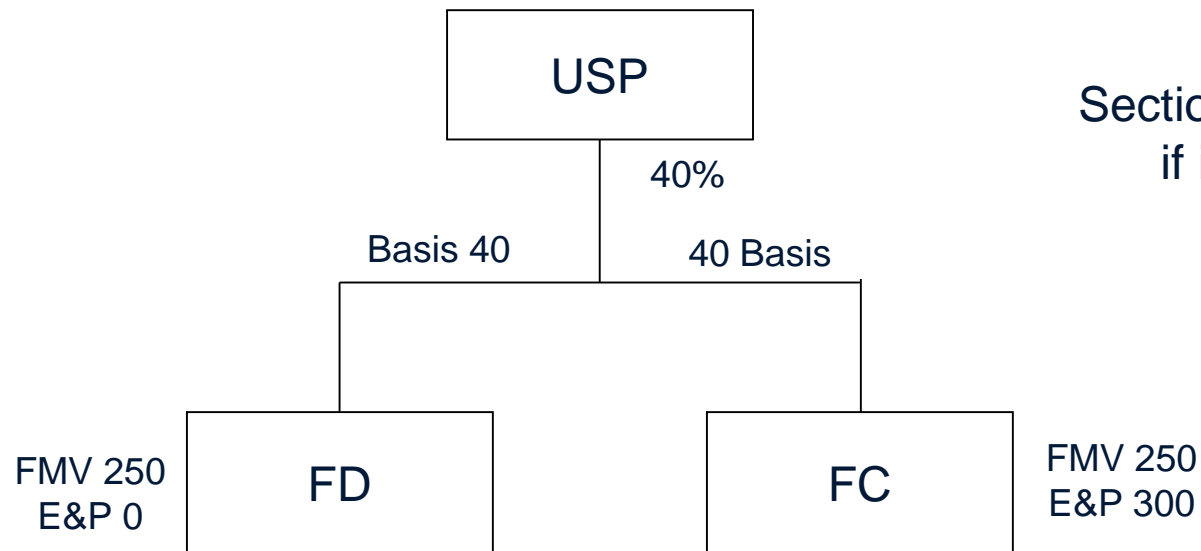
Sale of FD would have resulted in:

Amount realized	– 200	(40% X 500)
Basis	– 80	
Gain	120	(All § 1248)

Internal Spin of CFC by another CFC – Reg. 1.367(b)-5

- Reg. 1.367(b)-5 applies to spin-offs by CFCs, with an objective to preserve the section 1248 amount with respect to Distributing and Controlled
- As a result, the provision generally requires a comparison of the section 1248 amount for Distributing and Controlled before and after the spin-off and can result in a deemed dividend to Distributing's shareholders if the spin-off results in a diminution of the section 1248 amount
- For spin-offs not preceded by a reorganization under section 368(a)(1)(D), the pre-spin section 1248 amount is determined before Distributing's E&P is reduced under Reg. 1.312-10(b)
- For spin-offs preceded by a reorganization under section 368(a)(1)(D), the pre-spin section 1248 amount is determined *after* the allocation of E&P from Distributing to Controlled
- Current regulations do not automatically require a deemed dividend when there is a reduction in Distributing's section 1248 amount; rather Reg. 1.367(b)-5(c)(2) generally requires a downward basis adjustment in Distributing's stock basis in an attempt to make up for the reduction in E&P, and there is a deemed dividend only to the extent there is insufficient basis in the stock of Distributing to absorb the adjustment
- Proposed regulations would result in a deemed dividend in a greater variety of circumstances

Section 367(b): Internal Spin of CFC by another CFC



What would USP's
Section 1248 amount be
if it sold FD and FC?

Sale of FC would now result in:

Amount realized – 100 (40% X 250)	
Basis	– <u>40</u>
Gain	60 (All § 1248)

USP must reduce basis in FC to 0, and include 20 dividend. USP can increase basis in FD by $40 + 20$.

Preservation of Section 1248 Amount is goal.

E&P Allocation in Cross-Border Spins

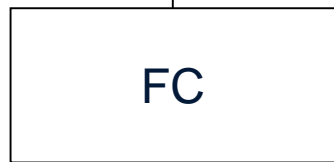
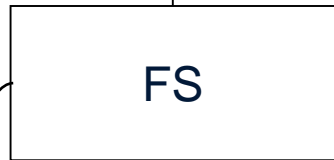
- E&P allocations between Distributing and Controlled
 - Current law consists of Reg. 1.312-10(a) and (b)
 - For D/355's, Reg. 1.312-10(a) provides that Distributing's E&P is generally allocated to Controlled in proportion to the relative FMV of assets transferred to Controlled vs. the assets Distributing retains, as determined using the below formula
 - Current regulations provide that in a "proper case," E&P is allocated in accordance with "net basis" instead of relative FMV; 2000 Proposed Regulations would mandate use of net basis, and preamble to final regulations in 2000 instructs taxpayers to use a "reasonable method" until the 2000 Proposed Regulations are finalized
- For straight 355's, there is a two-step process for determining whether and how much E&P is allocated from Distributing to Controlled:
 - First, Distributing's E&P is reduced in proportion to the FMV of the stock in Controlled compared to the FMV of Distributing's other assets, but the reduction cannot exceed the "net worth" of Controlled (sum of basis of property plus cash minus liabilities);
 - Second, the E&P reduction for Distributing is compared to Controlled's E&P, with Controlled's E&P increased only if it is less than the amount of the E&P reduction for Distributing

CFC Spin of CFC – Section 355(d) Trap for the Unwary

Prior Year (Within last five years)

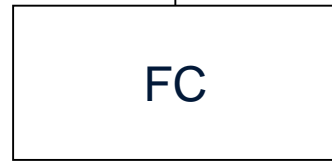
OR

Prior Year (Within last five years)



250 Cash

FMV 250



Stock worth
250

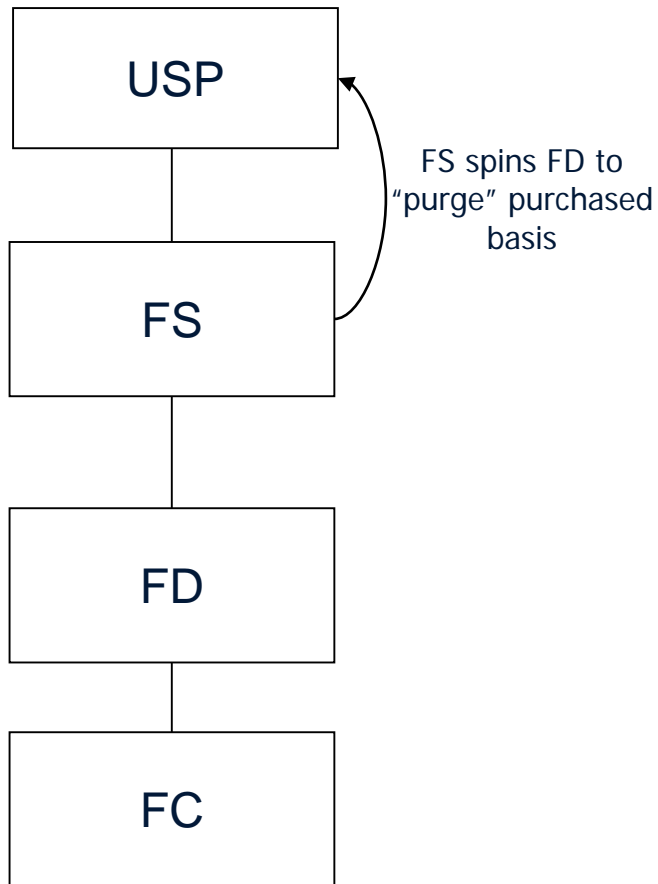
FMV 250

CFC Spin of CFC – Section 355(d) Trap for the Unwary

- Under section 355(d), Distributing recognizes gain on a distribution if, immediately after the distribution, any person holds “disqualified stock” in either Distributing or Controlled constituting a 50-percent or greater interest (by vote or value) in such corporation. Disqualified stock means any stock in Distributing or Controlled acquired by “purchase” during the five-year period ending on the spin date, or any stock in Controlled received in a distribution on Distributing stock or securities that were acquired by “purchase” during the five-year period
- “Purchase” generally means any acquisition if the basis of the property acquired is not a transferred basis or determined under section 1014(a), and generally excludes stock acquired in exchanges to which section 351, 354, 355, or 356 applies.
- Section 355(d)(5)(B) treats as purchased any shares of a transferee corporation issued in a section 351 transaction to the extent such shares were acquired in exchange for (i) any cash or cash item, (ii) any marketable stock or security, or (iii) any debt of the transferor
 - Regulatory exceptions for section 351 transfers of cash or cash items either (i) as part of an active trade or business as described in Reg. 1.355-6(d)(3)(iv) or (ii) between members of the same affiliated group (within the meaning of section 1504(a)) as described in Reg. 1.355-6(d)(3)(v)
 - Affiliated group exception *does not apply* to cross-border transfers or foreign-to-foreign transfers
- If a person acquires an interest in an entity (first interest) by purchase and the first interest is exchanged for an interest in the same or in another entity (second interest) and the adjusted basis of the second interest is determined in whole or in part by reference to the first interest, the second interest is treated as having been purchased on the date the first interest was purchased. This is referred to as the “exchanged basis rule.” Reg. 1.355-6(e)(3).
- Complicated aggregation, attribution, and deemed purchase rules – requires significant diligence of prior five years history to confirm section 355(d) non-application

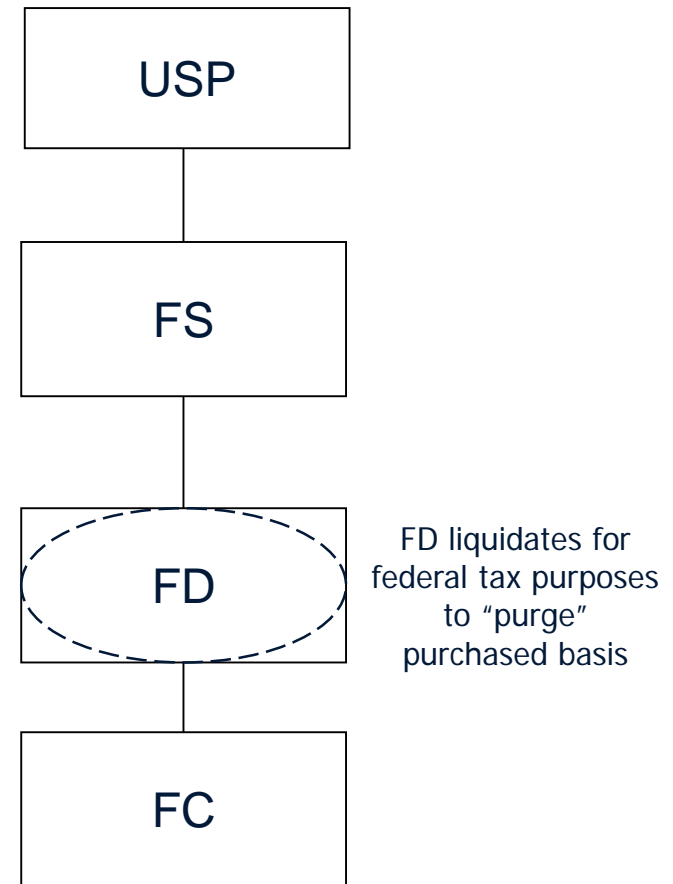
CFC Spin of CFC – Section 355(d) Trap for the Unwary

Potential Solution



OR

Potential Solution

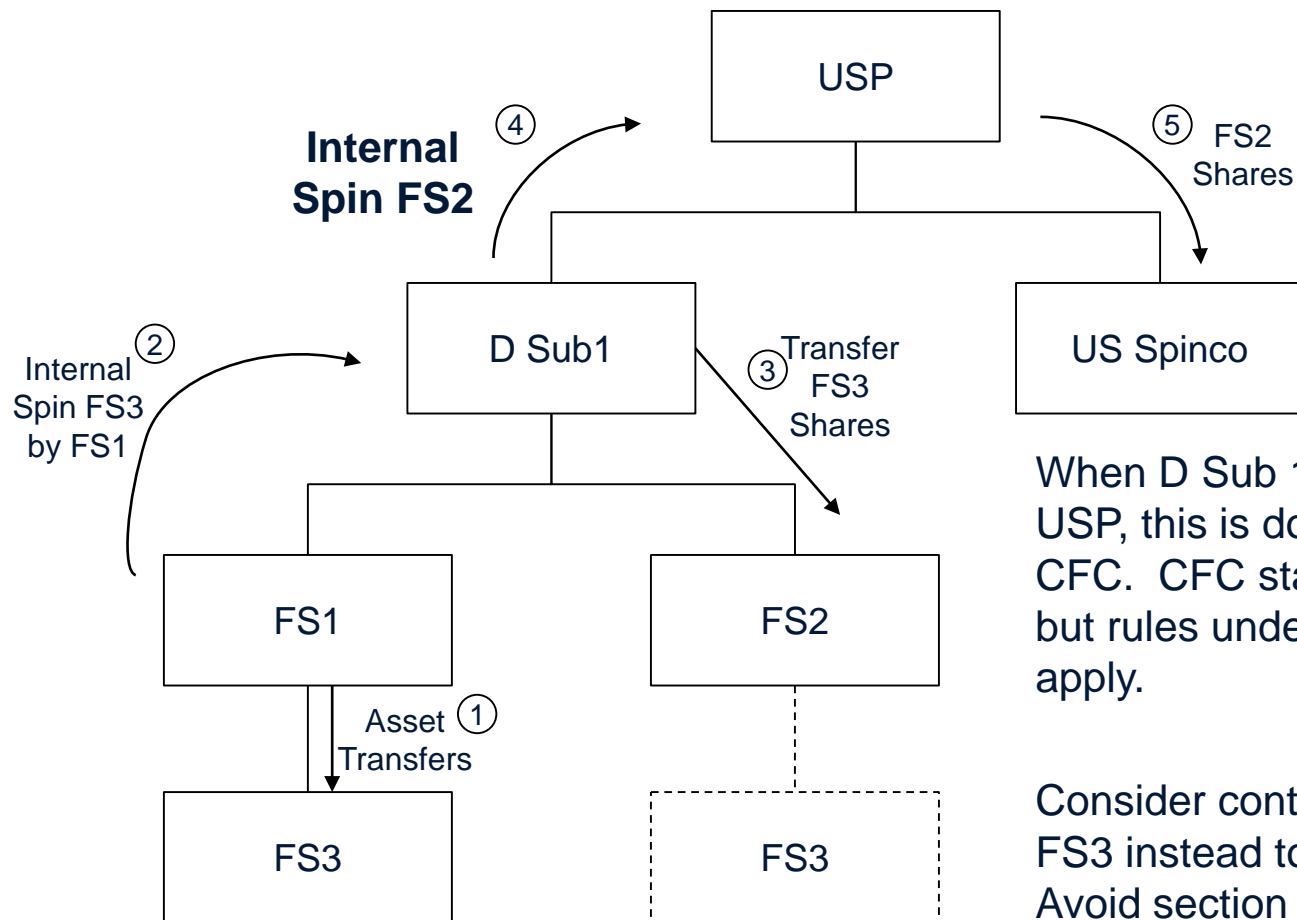


Packaging a US Spinco; Typical International Issues

- D Sub 1 transfers FS3 to FS2. This is outbound transfer of CFC to CFC.
 - Gain Recognition Issues, Reg. 1.367(a)-3. GRA required under Reg. 1.367(a)-8
 - Basis and Holding Period Rules under Section 358. See also Reg. 1.367(b)-13. Can arise in merger where results in higher basis in FS2 (due to BIL in FS3 shares).
- Internal spin of FS2 by D Sub 1 to USP. Distribution of CFC by one U.S. affiliate to another U.S. affiliate.
 - Section 1248. See Section 1248(f).
 - General rule is Section 1248 inclusion by D Sub 1. But see Reg. 1.1248(f)-2. No inclusion if certain basis, holding period and compliance met. Again – preservation of 1248 amount is key.
- Contribution of FS2 to U.S. Spinco.
 - Section 1248.
 - Note: U.S. Spinco to leave group; now owns the GRA shares

See slide 18

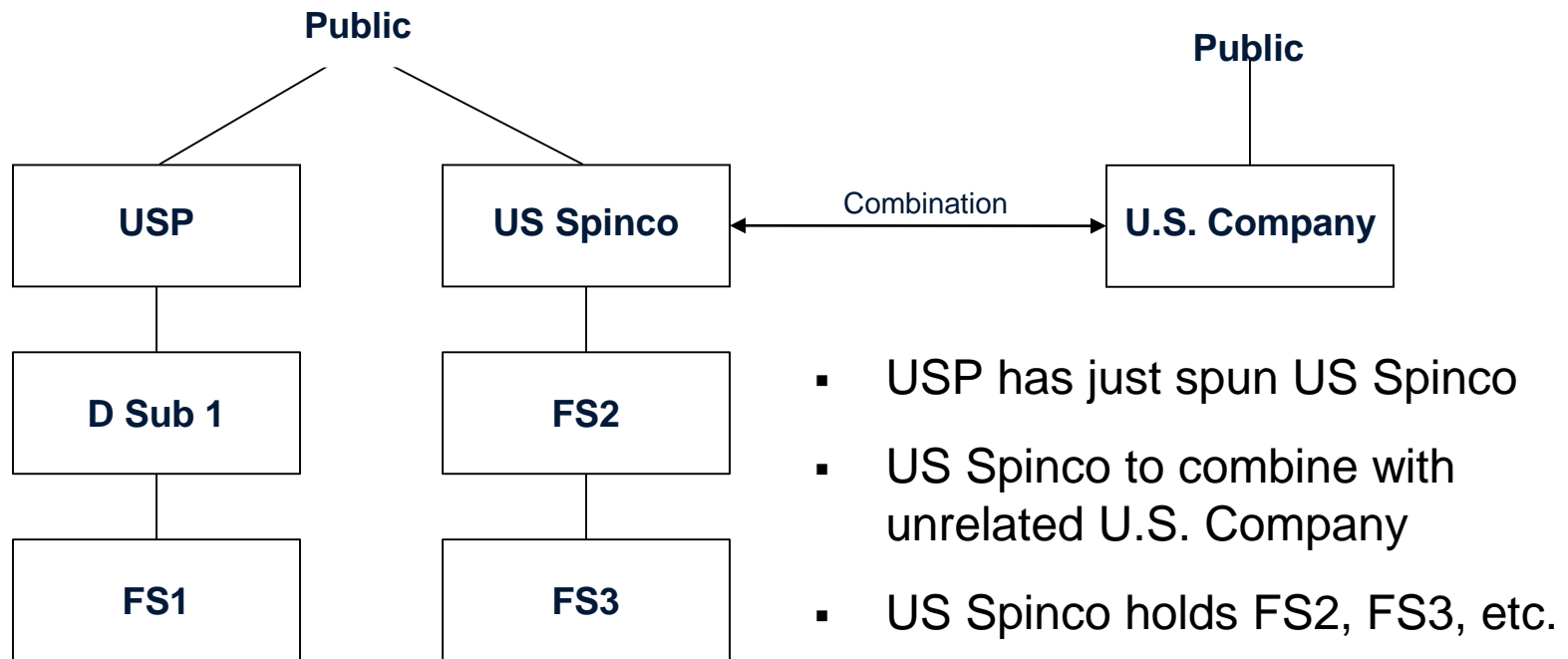
Packaging a US Spinco: Internal Domestic Spin of CFC



When D Sub 1 distributes FS2 to USP, this is domestic spin of CFC. CFC status is preserved, but rules under section 1248(f) apply.

Consider contributing FS2 and FS3 instead to a domestic spinco. Avoid section 1248(f) issues and GRA.

Post-Spin: Who owns the CFC on day 365?



Issue

Tax years of FS2, FS3 have not closed. Subpart F based on last day of CFC ownership. U.S. Company may be liable for pre-spin subpart F income. Tax Sharing Agreement may address allocation of liability.

Packaging a US Spinco; Summary

Summary on packaging up a U.S. Spinco where various lower tier international subsidiaries and steps:

- Do transfers within CFC group or by CFCs trigger Subpart F income? Consider local country issues in De-Merger or asset sales.
- Does internal spin of CFC by another CFC trigger basis reductions or income inclusion under Reg. 1.367(b)-5?
- When CFC is transferred to another CFC or a U.S. sub?
 - GRA Issues (outbound transfers only)
 - Section 1248
 - Basis adjustments
- Internal spin of CFC by U.S. sub to USP – Section 1248(f)
- Tax sharing agreement especially in post-spin combination

Potential Impact of Tax Reform on Packaging Transactions

- The Tax Cuts and Jobs Act takes a territorial approach under a participation exemption system, in which foreign-source earnings of subsidiaries of U.S. multinational companies are generally not subject to U.S. federal tax upon repatriation.
- Act is silent, but presumably Section 1248 gain will be exempt under the new participation exemption system.
- In general, capital gains recognized from the sale of foreign subsidiary stock would not qualify under the proposed participation exemption system.
 - Subpart F income if it is a sale of a lower-tier CFC
 - Capital gain if a sale of a first-tier CFC
- Act also introduces a “minimum tax” on foreign “high returns.”
- Sections 368 and 355 likely to remain relevant in order to avoid subpart F income, capital gain, and/or minimum tax on internal separation transactions.
- Section 367(b) and 1248(f) may be modified since Section 1248 amount can be repatriated tax-free.

Section 7874: Background

- Congress first enacted Section 7874 in 2004 to combat “self-inversions” where U.S. companies simply moved offshore by creating a new foreign parent company, rather than combining with a foreign company in an M&A transaction.
- Historic key benefits of an inversion (before Section 7874 and Section 385 regulations):
 - Reduction of U.S. tax costs to access to U.S. company’s historic and future offshore cash
 - Ability to introduce leverage into the U.S. company’s capital structure
 - Ability to use non-U.S. parent as a platform for future growth
 - Avoids placing operations of the non-U.S. company below a U.S. taxpayer
 - Can take the form of a stock or asset acquisition

Section 7874: Ownership Test

Section 7874 applies to an inversion transaction (or series of related transactions) if:

Substantially All the Assets Test

- Pursuant to a plan, a foreign acquiring corporation acquires directly or indirectly substantially all of the assets of a U.S. corporation (or partnership)

Ownership Test

- After the acquisition, at least 60% of the stock of the foreign acquiring corporation is owned by former shareholders of the U.S. company “by reason of” their ownership of the U.S. company (or partnership)

Substantial Business Activities Test

- After the acquisition, the foreign group does not have “substantial business activities” in the jurisdiction of incorporation of the foreign acquiring corporation

Section 7874 Consequences

80% Ownership

- Non-U.S. Acquiror is treated as a U.S. corporation for all U.S. tax purposes (i.e., subject to U.S. tax on worldwide income).
- No current tax to U.S. shareholders of U.S. Target, but effectively negates future tax planning opportunities.
- Causes existing non-U.S. subsidiaries of the Non-U.S. Acquiror to become CFCs.

60% ownership

- Non-U.S. Acquiror is respected as a non-U.S. corporation for all U.S. tax purposes.
- Transaction is generally taxable to U.S. shareholders of U.S. Target.
- For at least 10 years, U.S. Target's taxable income cannot be less than its inversion gain, i.e., the gain recognized on its transfer of stock or assets plus certain royalty income from non-U.S. affiliates. Further, U.S. Target cannot use its tax attributes to offset such income or gain.
- Excise tax on certain insiders' equity-based compensation to the extent such compensation would otherwise be deferred.

Section 7874: Impact on Spin-Offs

- Spin-offs of foreign spinco by a foreign parent group
- Spin-off of U.S. spinco by U.S. parent group
- Treatment of debt allocation transactions under the “NOCD” rules

The Expanded Affiliated Group

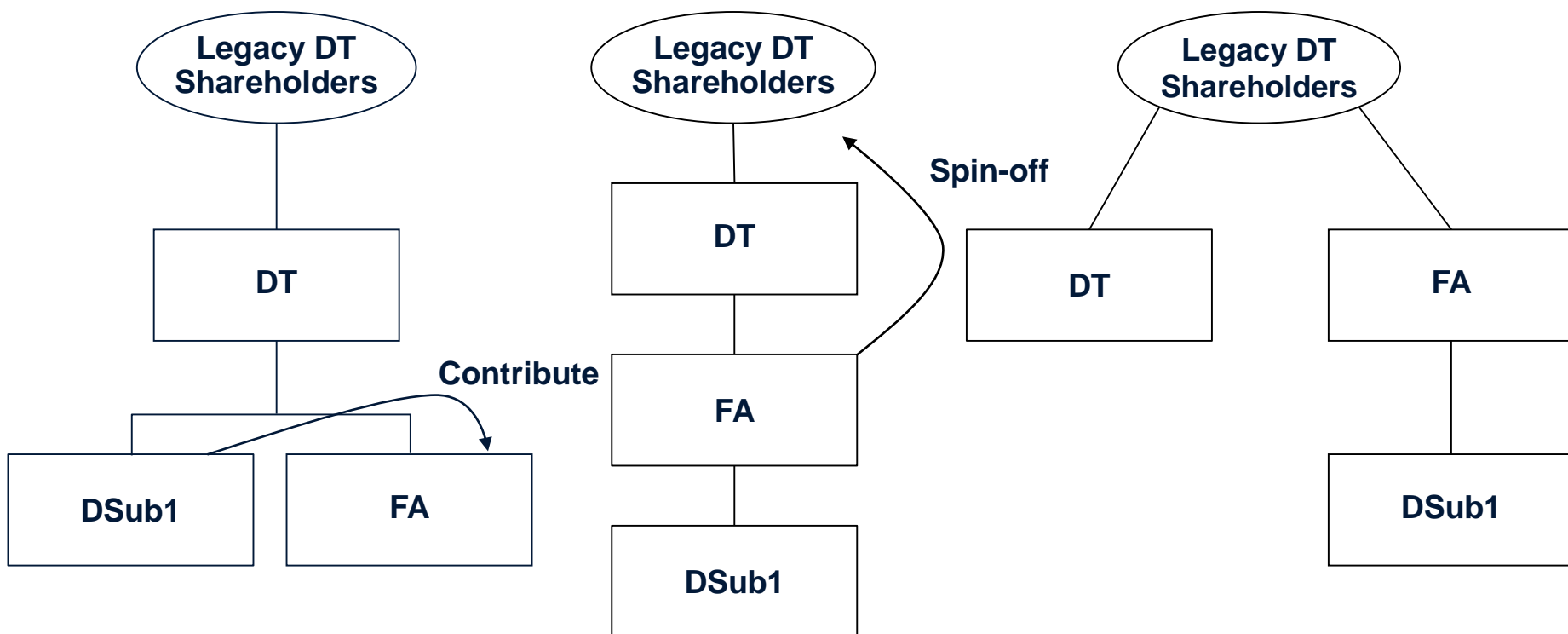
- Expanded Affiliated Group or “EAG” generally means 1 or more chains of corporations (including foreign corporations) connected through more than 50 percent stock ownership (by vote and value) with a common parent corporation
- Under Section 7874(c)(2)(A), foreign acquiror (“FA”) stock owned by members of the EAG of which foreign acquiror is a member is not included in the numerator or the denominator of the ownership fraction.
- Treas. Reg. sec. 1.7874-1 provides guidance addressing two situations where FA stock that is owned by members of the EAG of which FA is a member is nonetheless included in the denominator, but not the numerator, of the ownership fraction.
 - **Internal Group Restructurings** – where before the acquisition, 80 percent or more of the U.S. corporation was owned (directly or indirectly) by the common parent of the EAG after the acquisition, and after the acquisition, 80 percent or more of FA is owned (directly or indirectly) by the same common parent.
 - **Loss of Control** – where after the acquisition, former U.S. corporation shareholders do not hold, directly or indirectly, more than 50 percent of any member of the EAG.

Foreign and U.S. Parented Group Exceptions

- Foreign-parented group (“FPG”) exception: Transferred stock is treated as held by a member of the EAG for purposes of the EAG rules if (i) before the acquisition, the transferring corporation and the domestic entity are members of the same FPG; and (ii) after the acquisition, the transferring corporation is a member of the EAG or would be a member of the EAG absent the subsequent transfer of any stock of the foreign acquiring corporation by a member of the FPG in a transaction related to the acquisition (but taking into account all other transactions related to the acquisition)
- U.S.-parented group (“USPG”) exception: Transferred stock is treated as held by a member of the EAG for purposes of the EAG rules if (i) before and after the acquisition, the transferring corporation (or its successor) is a member of a USPG; and (ii) after the acquisition, both the person that holds the transferred stock (after all related transfers of the transferred stock are completed) and the foreign acquiring corporation are members of the USPG

Can a U.S. Group Spin a Foreign Sub?

"Spinversions" — Using a Spin to Achieve an Inversion



Temp Reg 1.7874-6T - USPG exception not available

Spin structurally achieves the inversion of DSub1 underneath FA

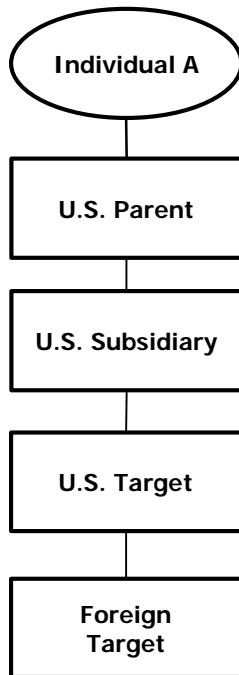
How is "substantially all" met? Because FA indirectly acquires the assets of DSub1? What if individual assets (rather than the stock of a U.S. corporation) were contributed?

Additional Issues in Spinversions: Corporate Level Tax

- Even if DT's distribution of the stock of FA navigates the inversion rules and qualifies as a good spin-off under Section 355, DT may nonetheless be taxed on gain realized on the distribution
- Section 1248(f) causes DT to recognize such gain as a dividend to the extent of FA's earnings and profits. CFC status lost
- Excess gain (above FA's E&P) may be taxed to DT under Sections 367(b) and (e). This can be huge

Example: U.S. Parented Group Exception Available

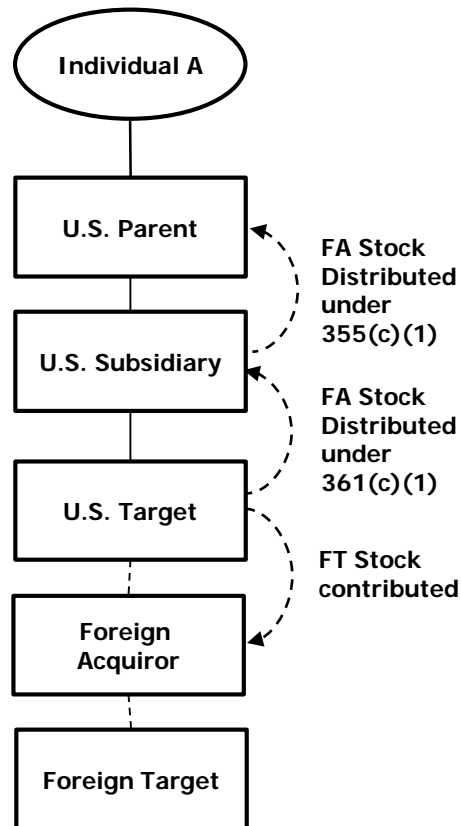
Beginning Structure



- Individual A owns 100% of U.S. Parent, a U.S. corporation
- U.S. Parent owns 100% of U.S. Subsidiary, a U.S. corporation
- U.S. Subsidiary owns 100% of the stock of U.S. Target, a U.S. corporation
- U.S. Target owns 100% of the stock of Foreign Target, a foreign corporation
- Foreign Target owns no other assets and has no liabilities

Example: U.S. Parented Group Exception Available

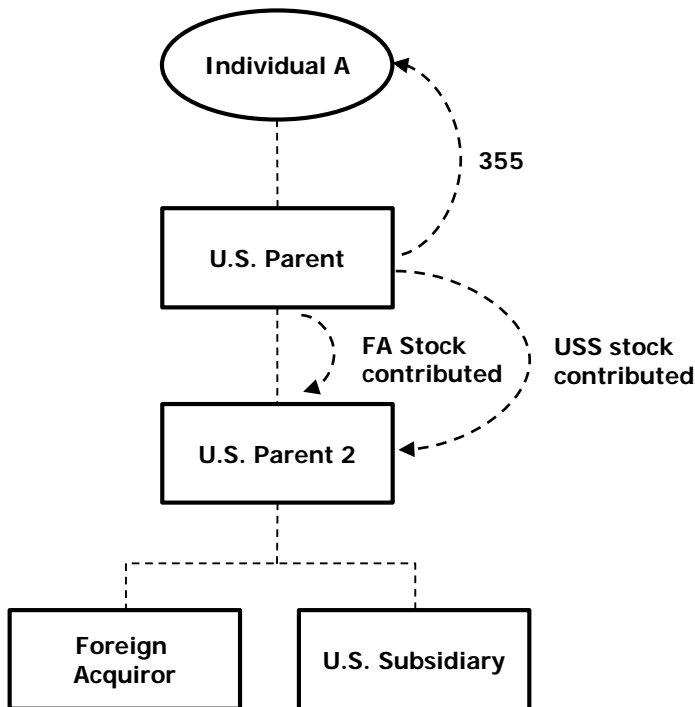
Section 368(a)(2)(D) and Internal Spin-Off



- In a transaction qualifying under Section 368(a)(1)(D), U.S. Target transfers its Foreign Target stock to Foreign Acquiror, a foreign corporation, and then U.S. Target distributes the stock up to U.S. Subsidiary under Section 361(c)(1)
- U.S. Subsidiary then distributes the Foreign Acquiror stock to U.S. Parent in a transaction qualifying under Section 355(c)(1)

Example: U.S. Parented Group Exception Available

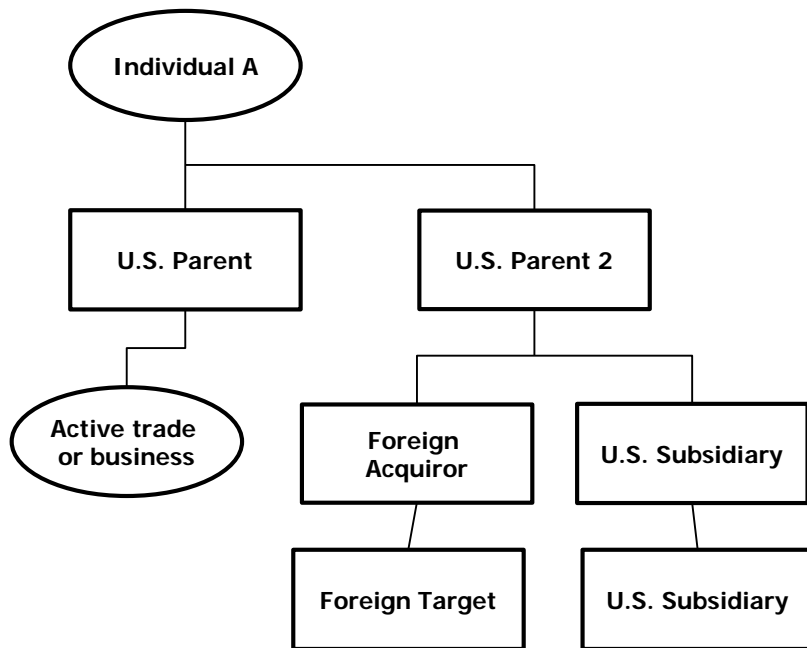
Section 368(a)(2)(D) and External Spin



- U.S. Parent then forms U.S. Parent 2, contributes the stock of Foreign Acquiror and U.S. Subsidiary to U.S. Parent 2, and then distributes to Individual A the stock of U.S. Parent 2 in a transaction qualifying under Section 355

Example: U.S. Parented Group Exception Available

Resulting Structure / Analysis



- Before the U.S. Target acquisition, U.S. Subsidiary (the transferring corporation) is a member of a U.S. parented group of which U.S. Parent is the common parent
- After the transaction, each of U.S. Subsidiary, U.S. Parent 2 (the person that holds the transferred stock) and Foreign Acquiror (the foreign acquiring corporation) are members of a USPG of which U.S. Parent 2 (a corporation formed in the transaction related to the U.S. Target acquisition and that, immediately after it was formed (but without regard to any related transaction) was a member of the USPG)

Adjustments to Numerator and Denominator of Ownership Fraction

- Several regulatory and statutory rules of application may modify the determination of the ownership fraction:
 - Disregard of EAG-owned stock (Code Sec. 7874(c)(2)(A)) (see slides above)
 - Internal group restructuring and loss of control rules (Reg. Sec. 1.7874-1(c)(2) and (3))
 - Disregard of transfers of properties or liabilities to avoid purposes of section 7874 (Code Sec. 7874(c)(4))
 - Aggregation of acquisition of domestic entity by multiple foreign corporations (Reg. Sec. 1.7874-2(d))
 - Aggregation of acquisitions of multiple domestic entities by foreign acquiring corporation (Reg. Sec. 1.7874-2(e))
 - Disregard of stock of foreign acquiring corporation issued in related public offerings or private placements (Reg. Sec. 1.7874-4)
 - **Disregard of non-ordinary course distributions (Temp. Reg. Sec. 1.7874-10T)**
 - Disregard of stock of foreign acquiring corporation if foreign acquiring group has significant passive assets (Temp. Reg. Sec. 1.7874-7T) (the “Foreign Group Nonqualified Property Rule”)

Non-Ordinary Course Distributions ("NOCD")

- "NOCD" is the excess of:
 - all distributions made by U.S. Target with respect to its stock or partnership interests during each of the look-back years across the 36-month period in advance of the inversion transaction, over
 - 110% of the average of such distributions during the 36-month period immediately preceding each such 12-month look-back year
- The amount of the distribution is determined based on the value of the property at the time of the distribution
 - Potentially harsh results in a declining share price context

NOCDs (cont.)

- *De minimis* rule:
 - A *de minimis* rule applies in cases where the ownership percentage (without regard to the NOCD rule or the new Foreign Group Nonqualified Property Rule) is less than 5% and the former U.S. target shareholders own less than 5% of each member of the EAG
- Distributions include distributions made by a predecessor entity
 - “Predecessor” included any entity acquired by the U.S. target in a transaction in which the former shareholders of the acquired entity receive $\geq 10\%$ of the U.S. target’s stock in the transaction
 - Consideration paid to former shareholders of the predecessor entity in the acquisition will be treated as NOCDs if it is provided by the acquired entity (e.g., in a leveraged buyout)

NOCDs (cont.)

- The NOCD rule is automatic:
 - Applies without regard to the reason the distribution is undertaken
 - Generally applies to any distribution by a corporation or partnership, regardless of its tax treatment (other than distributions under Sections 304 and 305, because they do not reduce the domestic entity's value, and certain distributions under Section 361(c)(1))
 - Includes “boot” sourced from the U.S. Target
 - For example, an unrelated Section 355 spin-off two-and-a-half years prior (in respect of which the IRS issued a favorable PLR), the distribution is still taken into account in calculating the NOCD amount
- Why was Section 7874(c)(4) anti-abuse rule not considered to adequately address concerns?

Acquisitions Consisting of a Mix of Stock and Cash

- Calculation of NOCDs (i.e., “add-back”) is not based on the actual mix of stock and cash or other non-stock consideration used in the foreign acquisition of the U.S. target
 - If the acquisition consideration consisted of 60% stock and 40% cash, then why shouldn’t only 60% of the NOCDs should be taken into account as “stock”- i.e., treat NOCDs in the same proportion of consideration as the actual transaction?
 - The Treasury and the IRS rejected this reasoning, citing:
 - administrative complexities
 - no reason to assume the same mix of stock and cash would have applied to any additional consideration (e.g., the Foreign Acquiror may have had a limited amount of cash available to use in the acquisition)

NOCD Calculation – A Few Observations

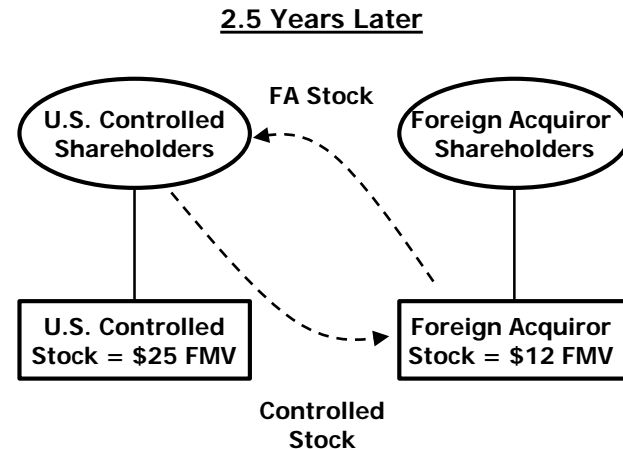
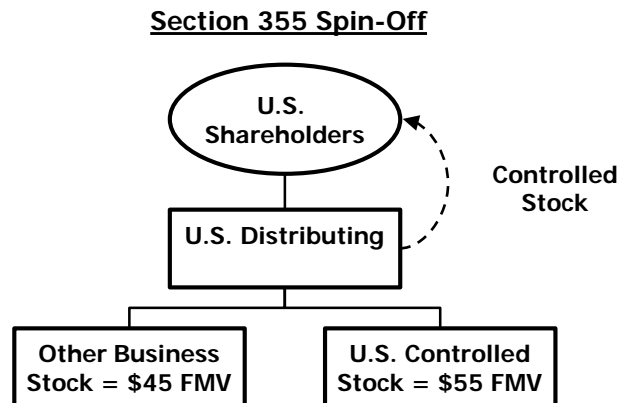
- Distributions need not be made shortly in advance of a transaction to significantly affect the ownership percentage– as seen in the example, a distribution three years prior can have a significant impact
- Distributions most likely to cause issues are those that are either disproportionate (aggregated for the year), such as a spin-off, or escalating across look-back years
- All distributions of a U.S. Target in existence for less than two years will be NOCDs (look-back years will have no distribution history periods)
 - E.g., a U.S. Target in existence for 22 months has both a 12-month look-back year and a 10-month look-back year
 - the earlier, 10-month look-back year has no distribution history period
 - the more recent, 12-month look-back year also has no distribution history period, because the 10 months prior is deemed to be zero pursuant to Reg. §1.7874-10T(h)(2)(iii)
 - Bizarre result? At a minimum, shouldn't the distribution history period for the more recent year be the preceding 10-month look-back year?

Application of NOCDs to Spin-Offs

- Section 355 transactions constitute distributions for purposes of the NOCD rule
- The regulations treat the controlled corporation as having distributed the stock of the distributing corporation for purposes of the NOCD rule if the fair market value of the stock of the controlled corporation is more than 50% of the value of the stock of distributing (ex controlled) immediately prior to the distribution, e.g., “reverse spin”
- Note that allocations of debt between distributing and controlled may affect whether this 50% threshold is hit, and the value of the NOCD

NOCDs – Fluctuations in Value

- Beware of fluctuations in value:



Assume due to decrease in value, U.S. Distributing is now worth \$15 and U.S. Controlled is now worth \$25.

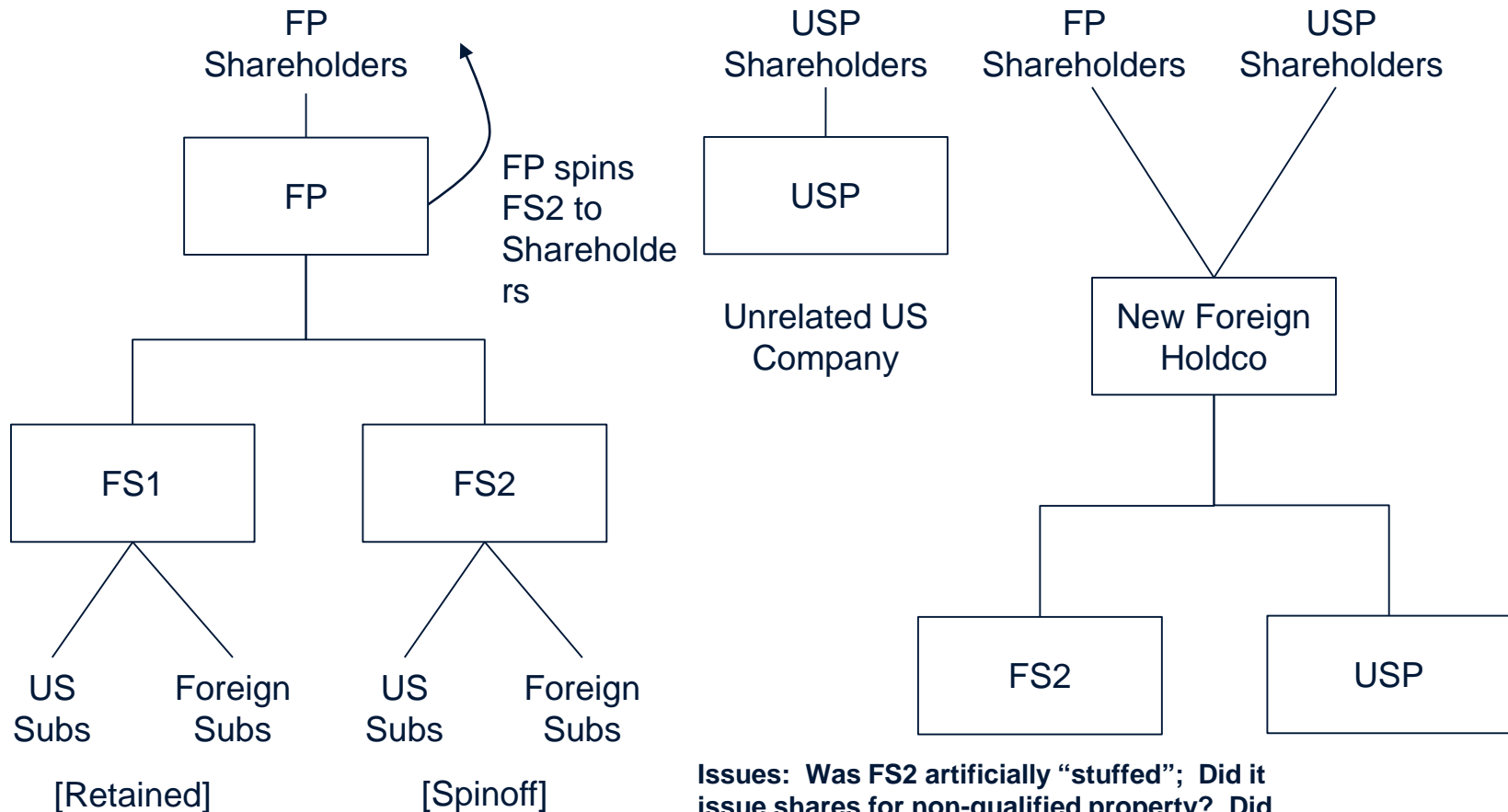
U.S. Controlled is treated as having made a \$45 distribution to U.S. Shareholders 2.5 years prior and therefore the ownership percentage of the U.S. Controlled shareholders is $70/82 = 85.4\%$

Cross-Border M&A Market

Spin-offs and other corporate separations setting stage for subsequent strategic merger?

- When that merger is under discussion, what are diligence issues which look back at spin?
- Did the structure of the spin contemplate a strategic partner waiting out there?

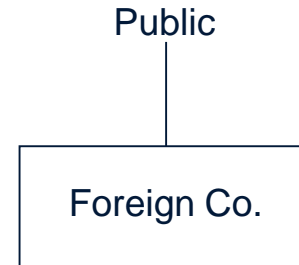
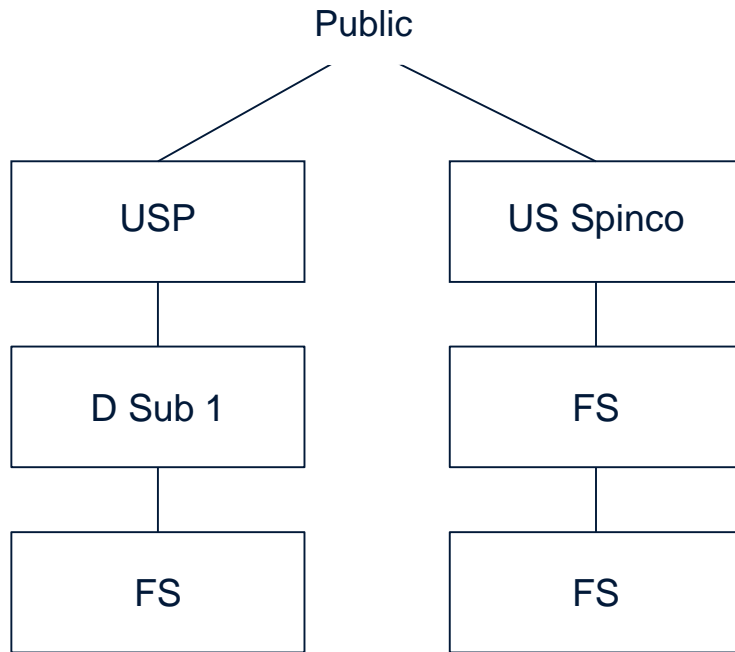
Inversion Diligence - Large Foreign Multinational Group Spins Off Division, which Combines with Unrelated US Company (USP)



Issues: Was FS2 artificially “stuffed”; Did it issue shares for non-qualified property? Did it acquire a U.S. affiliate before spin?

FS2 has a history: very relevant to USP.

Inversion Diligence: What if US Spin; and either USP or US Spinco to Combine with FC?

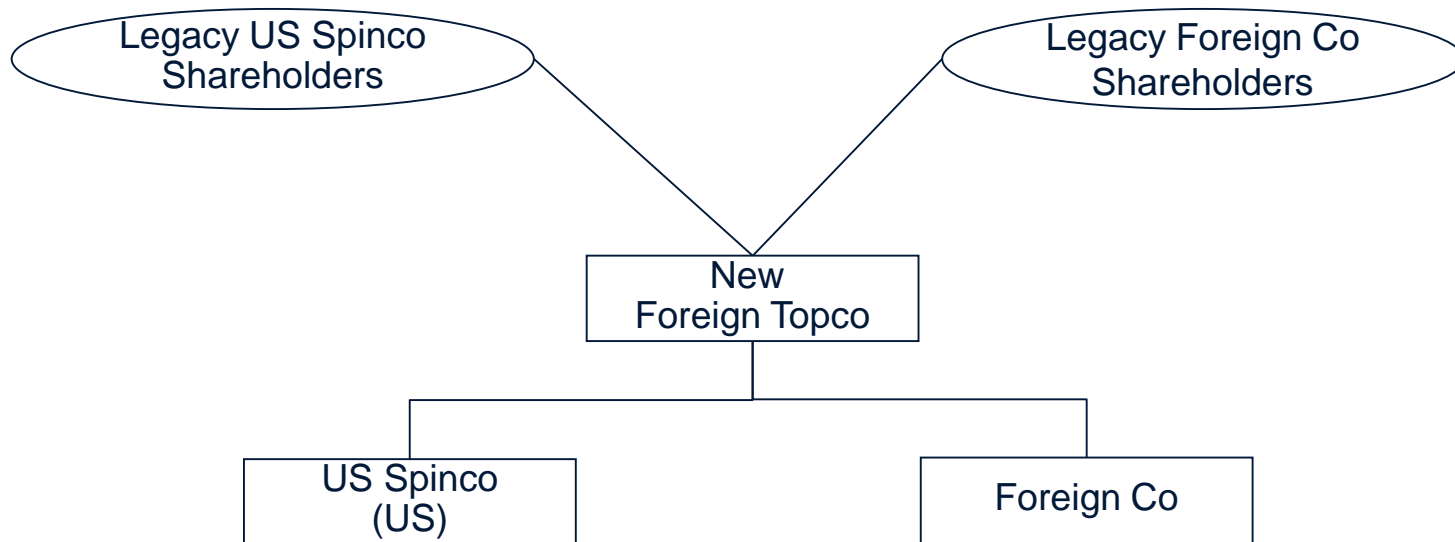


- USP has just spun US Spinco
- US Spinco to combine with unrelated Foreign Company (FC)
- Or, USP to combine with FC.

Issues

Must consider whether any calibrations of the size of USP or Spinco (debt allocation, cash extraction etc.); also distributions by US Spinco in dieting rules.

Inversion Issues in Spins: Section 367/Section 355 – At Odds



If Legacy US SpinCo Shareholders own >50%:

- 1) Good for 355(e)
- 2) Bad for 367(a)
- 3) 355 Device?

* Note: 367(a)/7874 Adjustments always at issue.

If Legacy Foreign Co Shareholders own >50%:

- 1) Bad for 355(e)
- 2) Good for 367(a) but that may not matter.