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February 25, 2016

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: *Report No. 1338 on Notice 2015-79*

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report of the Tax Section offering comments and recommendations on Section 2 of Notice 2015-79, released on November 19, 2015. Section 2 of Notice 2015-79 describes regulations to be issued that would address the avoidance of the purposes of section 7874.

First, the regulations would treat a foreign acquiring corporation in an inversion transaction of an expatriated domestic entity as a surrogate foreign corporation within the meaning of section 7874(a)(2)(B) if, in addition to satisfying certain ownership tests, it failed to have substantial business activities not only in the country of its creation or organization, but also if it failed to have substantial business activities in the country in which the foreign acquiring corporation is subject to income tax as a resident.

Second, the regulations would, solely for purposes of the owner-

ship tests under section 7874, disregard stock issued by the foreign acquiring corporation to shareholders of a foreign target corporation if, in a transaction related to the inversion of the expatriated domestic entity, the foreign acquiring corporation acquired (directly or indirectly) substantially all of the properties of the foreign target corporation and certain other conditions were satisfied (a "Third-Country Transaction"). This would not apply, however, if the foreign target corporation were tax resident in the same country as the foreign acquiring corporation or if the gross value of the property of foreign target acquired by the foreign acquiring corporation did not exceed 60 percent of the gross value of all "foreign group property."

Third, the regulations would clarify that any property could potentially qualify as "avoidance property" so that stock issued by the foreign acquiring corporation in connection with an inversion transaction in exchange for such avoidance property would be disregarded in determining the ownership tests under section 7874.

Regarding the modification of the substantial business activities test, we suggest that the Treasury Department and the Internal Revenue Service consider replacing, rather than expanding, the requirement that the substantial business activities (as further elaborated under existing regulations) be conducted by the foreign acquiring corporation in the country of its organization with the requirement that its activities be conducted in the country of its tax residence. In addition, we propose that

(1) a foreign acquiring corporation that is resident only in a no-income-tax jurisdiction should be treated as tax resident in that jurisdiction;

(2) a foreign corporation that is an investment or similar vehicle able to deduct dividends paid to its equity holders should, unlike a foreign acquiring corporation treated as a partnership for foreign tax law purposes, not fail to be treated as tax resident in the relevant country on account of the dividends-paid deduction; and

(3) the standard for determining tax residence should be the standard of determining tax residence under the U.S. model income tax treaty, except for the case of foreign acquiring corporations located in no-income-tax jurisdictions.

The report notes that the Third-Country Transaction rule in general can play a useful role in limiting potential avoidance of section 7874 and agrees with applying the rule only in situations where the domestic inversion otherwise would fall under the 60% ownership test of section 7874(a)(2)(B)(ii). The report further notes that the existence of other, non-tax business purposes for a Third-Country Transaction should not suspend the rule. We propose that the Treasury Department and the Internal Revenue Service

(1) clarify whether the more-than-60 percent gross asset test does or does not include any assets acquired from the foreign target group;

(2) consider whether no Third-Country Transaction should be present if the foreign acquiring corporation meets the substantial business activities test in the third country after the foreign inversion and before the domestic inversion, or if the foreign acquiring corporation is eligible for the benefits of an income tax treaty that is substantially equivalent to the benefits of the income tax treaty for which the foreign target corporation is eligible; and

(3) consider, if the substantial income tax treaty equivalence exception is adopted, whether, to the extent that the income tax treaty for which the foreign acquiring corporation is eligible is not substantially equivalent to the income tax treaty for which the foreign target corporation is eligible, the foreign acquiring corporation should alternatively be able to elect reduced benefits equal to those afforded by the income tax treaty of the foreign target corporation in respect of the relevant item.

We also propose that a mere change in tax residence of a foreign acquiring corporation should be tested as a Third-Country Transaction as if it were a foreign inversion.

With respect to the concept of "avoidance property" under § 1.7874-4T(i)(7)(iv) of the temporary Treasury regulations, the report agrees with the Notice that under the plain language of the regulations, *any* property could be classified as avoidance property. However, the report asks for additional guidance describing factors that should be considered in determining whether property is avoidance property under the broad interpretation of the Treasury regulations. Specifically, we propose that regulations should clarify that there is no avoidance property if the (directly or indirectly) transferred assets constitute a trade or business within the meaning of § 1.367(a)-2(b)(2) of the Treasury regulations or otherwise are related to the existing business of the foreign acquiring corporation and are, in each case, transferred without a plan to dispose of them at a later time.

We very much appreciate your consideration of these recommendations and would be happy to discuss them with you or provide additional assistance.

Respectfully submitted,

Stephen B. Land
Chair

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