intention to follow the principles of those regulations in the preamble to the final regulations under section 367(e)(1) (see the preamble to the final section 367(e)(1) regulations in TD 8472, adopted January 15, 1993).

The revised statement of the general rule herein refers explicitly to transfers that may be indirect or constructive. Thus, transactions that are recharacterized as indirect or constructive stock transfers will be subject to the section 367(a) stock transfer regulations and will be taxable unless an exception applies.

The restatement of the general rule herein is not intended to change the 1986 temporary regulations' treatment of a case in which stock or securities of a foreign corporation are transferred pursuant to a reorganization described in section 368(a)(1)(B), including a transaction that is described in both section 368(a)(1)(B) and section 351. It is anticipated, however, that the final regulations issued with respect to an outbound transfer of foreign stock or securities will incorporate the principles of the 1991 proposed regulations, and thus, for example, a transaction described in both section 368(a)(1)(B) and section 351 will be subject to section 367(a).

Notice 87–85 and the 1991 Proposed Regulations

Under Notice 87–85 and the 1991 proposed regulations, a U.S. transferor of stock or securities that owns five percent or more of either the total voting power or the total value of the transferee foreign corporation immediately after the transfer generally is not subject to current taxation under section 367(a)(1) if that transferor enters into a gain recognition agreement (GRA). The term of the GRA is five years if all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer, or ten years if the U.S. transferors, in the aggregate, own 50 percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer. U.S. transferors that own an interest of less than 5 percent in the transferee foreign corporation immediately after the transfer are not taxable under section 367(a)(1) and are not required to enter into a GRA. If a single U.S. transferor transfers stock or securities of a domestic corporation and owns directly or by attribution more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer, gain is recognized on the exchange.

The determination whether (i) a U.S. transferor owns five percent or more of the transferee foreign corporation immediately after the transfer, (ii) U.S. transferors own in the aggregate 50 percent or more of the transferee foreign corporation (and, thus, whether a 10-year GRA is required), or (iii) a single U.S. transferor owns more than 50 percent of the transferee foreign corporation (and, thus, whether gain is recognized) takes into account both stock of the transferee foreign corporation received by the U.S. transferor(s) in the exchange and stock in the transferee foreign corporation owned by the U.S. transferor(s) independent of the exchange (referred to as cross-ownership).

Notice 87–85 and the 1991 proposed regulations presume that U.S. transferors own in the aggregate 50 percent or more of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (and thus a ten-year GRA is required), unless U.S. transferors can demonstrate otherwise (referred to as the ownership presumption). The ownership presumption contained in both the Notice and the 1991 proposed regulations actually consists of two rebuttable presumptions, one relating to ownership of stock in the U.S. corporation the stock or securities of which are transferred (referred to as the U.S. target company) and the other relating to ownership of stock in the transferee foreign corporation.

Under the first presumption, all persons that exchange U.S. target company stock (or other property) for stock of the transferee foreign corporation in the exchange are presumed to be U.S. persons. Thus, if shareholders of the U.S. target company receive 50 percent or more of the stock of the transferee foreign corporation in the exchange, U.S. transferors are presumed to own 50 percent or more of the stock of the transferee foreign corporation immediately after the transfer. Even if application of this first presumption does not result in U.S. transferors being deemed to own at least 50 percent of the total voting power or the total value of the transferee foreign corporation immediately after the transfer, the second presumption may do so. The second presumption is that U.S. transferors also own stock of the transferee foreign corporation independent of the exchange in an amount sufficient to bring their total ownership immediately after the exchange up to 50 percent. This second component of the ownership presumption is referred to as the cross-ownership presumption.

Notice 94–46

Notice 94–46 modified the exceptions set forth in Notice 87–85 with respect to post-April 17, 1994 transfers of stock or securities of domestic corporations. The purpose of Notice 94–46 was to forestall outbound transfers that are structured to avoid or that lay a foundation for future avoidance of the Internal Revenue Code anti-deferral regimes by imposing a shareholder-level tax on such transfers. Notice 94–46 stated that regulations would provide that the transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation described in section 367(a) would be taxable if all U.S. transferors owned, in the aggregate, 50 percent or more of either the total voting power or the total value of the stock of the transferee corporation immediately after the exchange. All U.S. transferors, regardless of their level of ownership, would be subject to tax in such a case.

The rules of Notice 94–46 incorporated the ownership presumption of Notice 87–85. As a result of the cross- ownership aspect of that presumption, even if U.S. shareholders receive significantly less than 50 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a), the transaction could still be taxable. If, for example, U.S. shareholders of a U.S. target company received 30 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a)(1), those shareholders would be presumed to own independently at least an additional 20 percent of the stock of the transferee foreign corporation immediately after the transfer, with the result that the exchange would be taxable (unless the cross-ownership presumption were rebutted). Commentators argued that where a U.S. target company and a foreign acquirer were publicly traded or widely-held, taxpayers' ability to rebut the cross-ownership aspect of the ownership presumption was limited. As a result, Notice 94–46 potentially had the effect of forestalling acquisitions of U.S. public companies by larger foreign corporations in cases where they were unrelated and both engaged in the active conduct of a trade or business.

In response to comments received from taxpayers, and in particular with respect to the difficulties of rebutting the cross-ownership presumption, these temporary regulations modify positions taken in Notice 94–46 in two significant ways. First, the regulations shift the ownership threshold from ‘‘50 percent