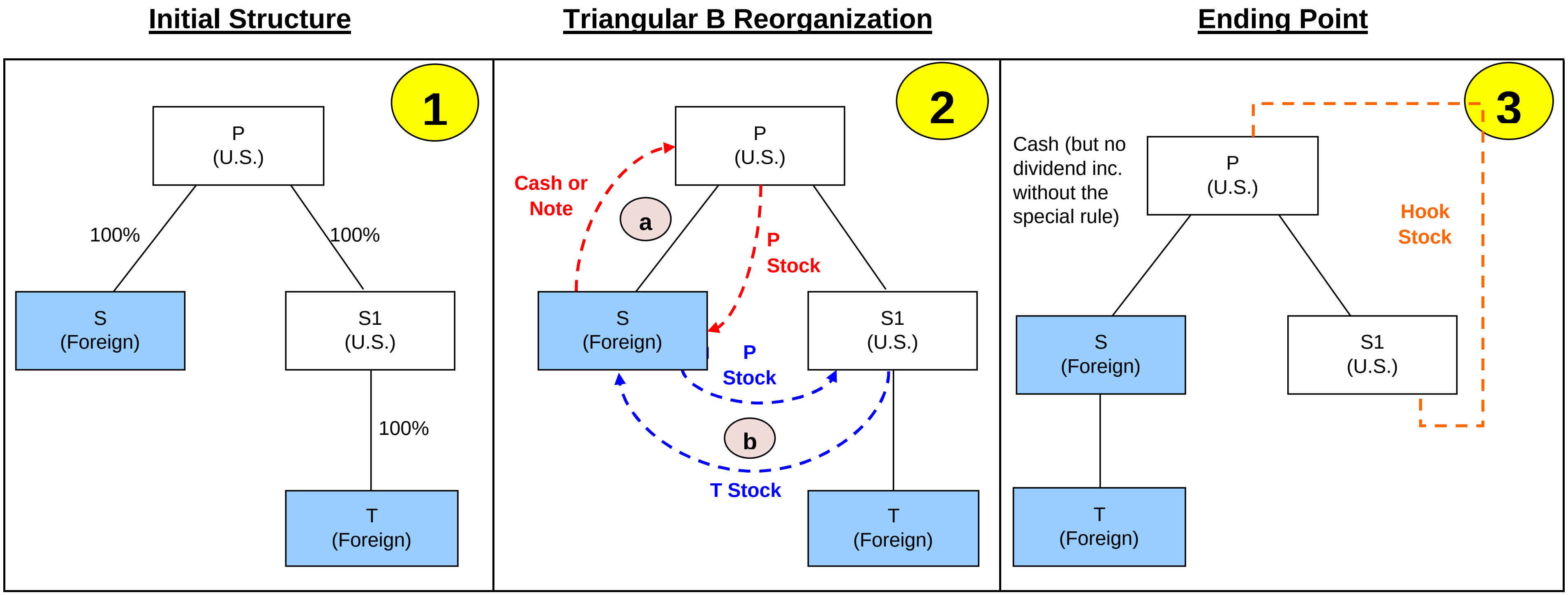
Notice 2006-85

Purchase of Parent Stock in Triangular Reorganizations Involving Foreign Corporations



In step 2a P recognizes no gain or loss on the sale under section 1032 and S takes a cost basis in the P shares under section 1012. In step 2b S recognizes no gain upon the transfer of the P shares because the basis and FMV of the shares are equal. The notice provides that the normal characterization of this transaction, and similar triangular reorganizations where either P or S (or both) are foreign corporations, raise significant policy concerns. The above transaction has the effect of repatriating foreign earnings of S to P without the corresponding dividend to P that would be subject to U.S. tax. The notice provides that regulations will be issued to treat the transfer of property from S to P (in step 2a) as a Sec. 301 distribution separate from the transfer of P stock to S. Similar adjustments would be made for other types of triangular reorganizations (e.g. forward triangular mergers, triangular reorganizations, and reverse triangular mergers).

<u>Concerns identified in the Notice:</u>

1. Repatriation of foreign cash to the United States without U.S. income tax.
2. Repatriation of U.S. cash to a foreign parent without withholding tax.
3. Creation of debt on U.S. subsidiary of foreign parent (earnings stripping).
4. Avoidance of subpart F income.
5. Foreign to Foreign transactions used to facilitate the repatriation of foreign cash to the United States without U.S. income tax.