

No Inversion as a Result of an F Reorganization & an IPO

US Co is a State A LLC treated as a domestic corporation for U.S. tax purposes. US Co is currently constructing a facility in State A in order to conduct Business B. All the shares of US Co are held by Foreign Sub 2, a Country C entity classified as a foreign corporation for U.S. tax purposes. All the shares of Foreign Sub 2 are held by Foreign Sub 1, a Country D entity also classified as a foreign corporation for U.S. tax purposes. Foreign Sub 1 also holds all the interests in FDE3, a Country E entity disregarded for U.S. tax purposes. FDE2 holds x% of the outstanding shares of Foreign Sub 1; the remaining y% of the outstanding shares of Foreign Sub 1 is held by other investors. FDE2 is a Country C entity disregarded for U.S. tax purposes, and x% represents a majority interest in the shares of Foreign Sub 1. FDE1, also a Country C entity disregarded for U.S. tax purposes, holds all the interests in FDE2. Parent, a Country F entity classified as a foreign corporation for U.S. tax purposes, holds all the interests in FDE1.

In order to help fund the cost of expanding its Business B operations, Parent intends to conduct stock offerings of Foreign Sub 2. However, based on its own analysis and the recommendations of its financial advisers, Parent believes the stock offerings would be better effectuated under Country G law. Accordingly, and in anticipation of the stock offerings, in year 1 FDE1 formed FA, a Country G corporation.

In order to carry out the stock offerings in Country G, Parent will convert Foreign Sub 2 into FA in what it intends will qualify as a reorganization under Code §368(a)(1)(F) ("F reorganization"). Specifically,

- 1) Foreign Sub 1 will contribute all its shares of Foreign Sub 2 to FDE3;
- 2) FDE3 will contribute all the shares of Foreign Sub 2 to FA in exchange for additional shares of FA;
- 3) Foreign Sub 2 will make an entity classification election pursuant to Treas. Reg. §301.7701-3(c) to be treated as an entity disregarded for U.S. tax purposes, effective two days after FDE3's contribution of the shares of Foreign Sub 2 to FA.

After the F reorganization, Parent intends to initiate offerings of FA shares, in exchange for cash, in the following manner:

- 4) A private placement by FA of its only class of common stock ("FA Private Placement") with an unrelated private investor for no more than 20 percent of such outstanding stock.
- 5) An initial public offering ("FA IPO") by FA of its only class of common stock on a Country G stock exchange. After the FA IPO, the private investor that acquired FA shares in the FA Private Placement and the public shareholders of FA will together hold no more than 49 percent of the outstanding shares of FA.

The IRS ruled:

- 1) The FA shares treated as received by FS 2 in the Code §361(a) exchange in connection with the F reorganization will be described in Code §7874(a)(2)(B)(ii) and will not cease to be so described as a result of FS 2's section 361(c) distribution of such shares that is deemed to occur as a result of the F reorganization. Treas. Reg. §1.7874-5T(a).
- 2) Shares issued by FA pursuant to the FA Private Placement and the FA IPO will not be included in the denominator of the Ownership Fraction. Code §7874(c)(2)(B) and Treas. Reg. §1.7874-4T(b).
- 3) The FA shares treated as issued in exchange for the shares of US Co pursuant to the F reorganization will be excluded from both the numerator and the denominator of the Ownership Fraction. Code §7874(c)(2)(A) and Treas. Reg. §1.7874-1(b).
- 4) The Ownership Fraction will be zero over zero. Accordingly, the requirement described in Code §7874(a)(2)(B)(ii) will not be satisfied, and FA will not be a surrogate foreign corporation within the meaning of Code §7874(a)(2)(B).

