Reg. 1.7874-11T(e)
Example 1

Effect of Inversion Gain

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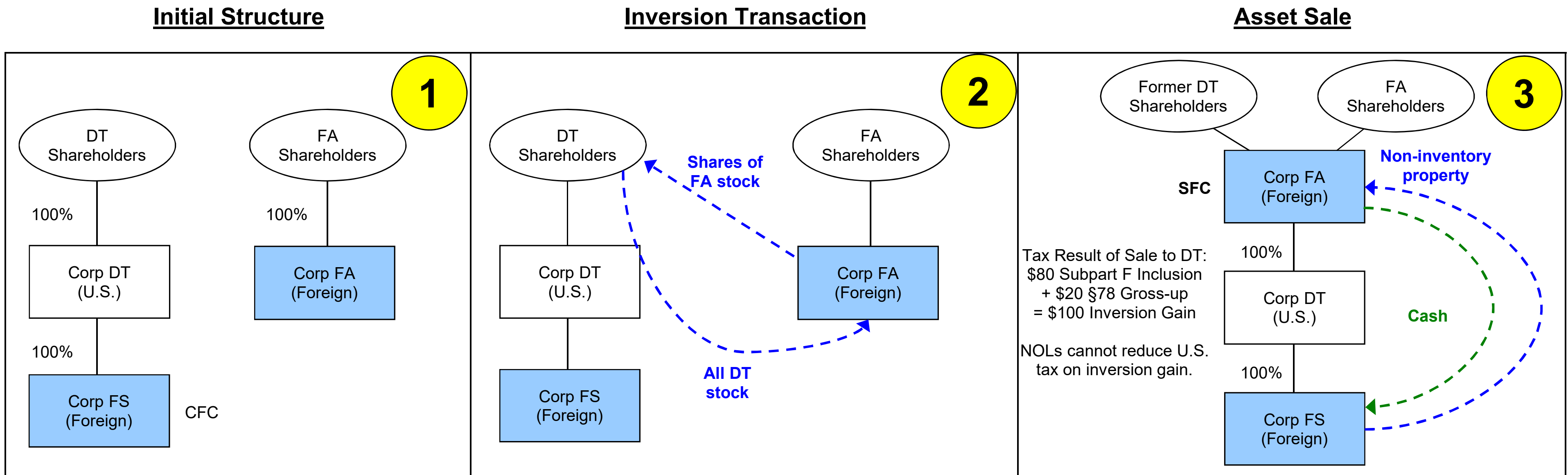

On July 1, 2016, FA, a foreign corporation, acquires all the stock of DT, a domestic corporation, in an inversion transaction. When the inversion transaction occurred, DT wholly owned FS, a foreign corporation that is a controlled foreign corporation (within the meaning of Code §957(a)). During the applicable period, FS sells to FA property that is not described in Code §1221(a)(1) in the hands of FS. Under Code §951(a)(1)(A), DT has a $80x gross income inclusion that is attributable to FS's gain from the sale of the property. Under Code §960(a)(1), DT is deemed to have paid $20x of the post-1986 foreign income taxes of FS by reason of this income inclusion and includes $20x in gross income as a deemed dividend under Code §78. Accordingly, DT recognizes $100x ($80x + $ 20x) of gross income because of FS's sale of property to FA.

Pursuant to Code §7874(a)(2)(A), DT is an expatriated entity. Under Treas. Reg. §1.7874-11T(b)(1), DT's $100x gross income recognized under Code §§951(a)(1)(A) and 78 is inversion gain, because it is income recognized by an expatriated entity during the applicable period by reason of an indirect transfer of property by DT (through its wholly-owned CFC, FS) after the inversion transaction to a specified related person (FA). Code §§7874(a)(1) and (e) therefore prevent the use of certain tax attributes (such as net operating losses) to reduce the U.S. tax owed with respect to DT's $100x gross income recognized under Code §§951(a)(1)(A) and 78.

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