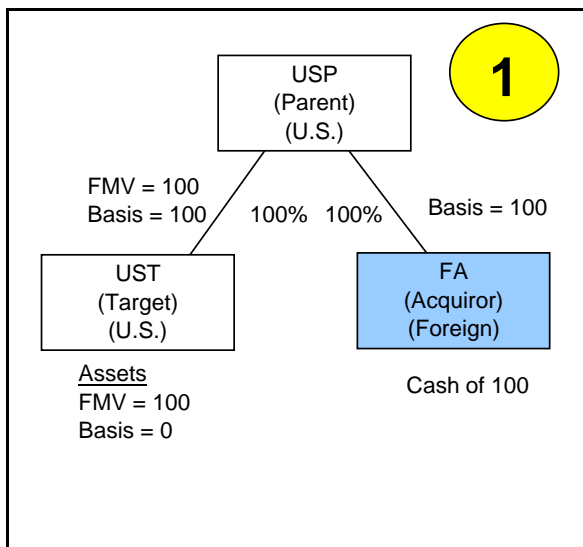
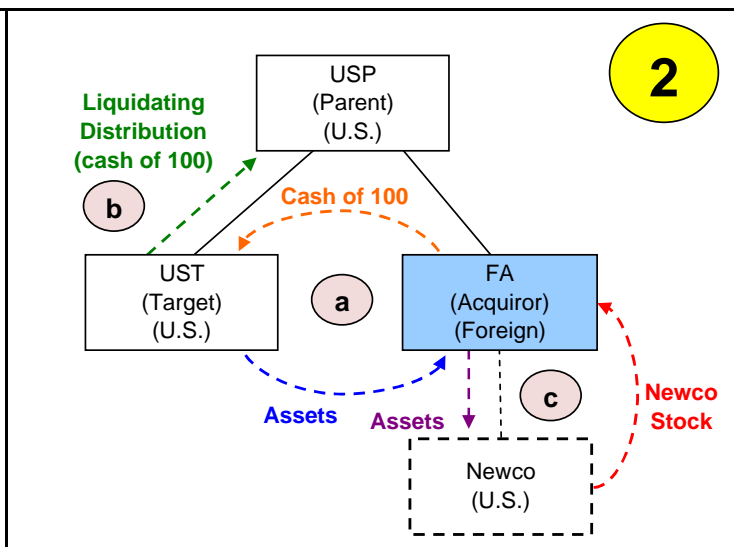


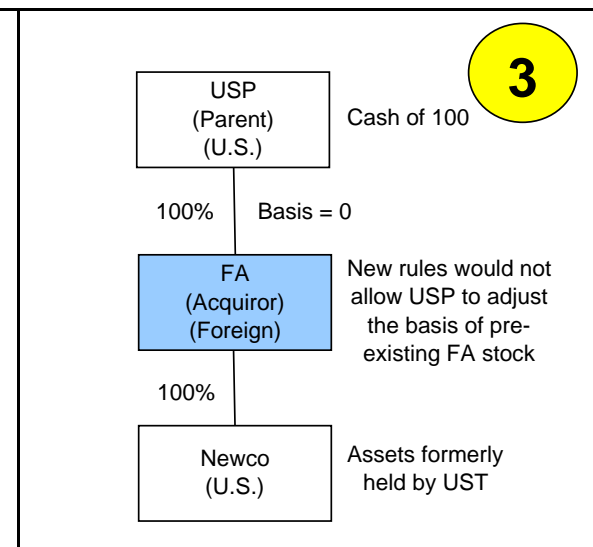
Initial Structure



Cash D With Drop



Ending Point



The Notice indicated that the IRS and Treasury are aware that certain taxpayers are engaging in transactions intended to repatriate cash or other property from foreign subsidiaries without the recognition of gain or a dividend inclusion. In one such transaction, for example, USP, a domestic corporation, owns 100% of the stock of FA, a foreign corporation, and USP's basis in its FA stock is \$100x. USP also owns 100% of the stock of UST, a domestic corporation, and USP's basis in its UST stock equals its fair market value of \$100x. UST's property consists of property with zero tax basis, such as self-created intangibles or fully depreciated tangible property. UST sells its property to FA in exchange for \$100x cash and, in connection with the transaction, UST liquidates and FA transfers all of the property acquired from UST to U.S. Newco, a newly formed domestic corporation, in exchange for 100% of the U.S. Newco stock (the Transaction). Taxpayers take the position that, pursuant to Reg. 1.367(a)-3(d)(2)(vi)(B)(1)(i), UST's transfer of property to FA is not subject to section 367(a) or (d) because the basis adjustment requirement of section 367(a)(5) is satisfied if USP reduces by \$100x its basis in the FA stock that it held prior to the Transaction.

The Notice indicated that the IRS and Treasury will issue regulations under section 367(a) to clarify how the two exceptions to the general coordination rule of §1.367(a)-3(d)(2)(vi)(A) are to be applied. The rule of Exception One contained in Reg. 1.367(a)-3(d)(2)(vi)(B)(1)(i) will be modified to clarify that the basis adjustment required as provided in section 367(a)(5) must be made to the stock of the foreign acquiring corporation received by domestic corporate shareholders of the U.S. transferor in the reorganization such that the appropriate amount of unrecognized gain in the U.S. transferor's property is reflected in such stock. Thus, the basis adjustment requirement cannot be satisfied by adjusting the basis in stock of the foreign acquiring corporation held by such shareholders prior to the reorganization. The regulations will clarify that to the extent the appropriate amount of unrecognized gain in the U.S. transferor's property cannot be preserved in the stock of the foreign acquiring corporation received in the reorganization, then the U.S. transferor's transfer of property to the foreign acquiring corporation shall be subject to sections 367(a) and (d). Reg. 1.367(a)-3(d)(2)(vi)(B)(2) will be modified to clarify that Exception Two shall not apply to a section 351 transfer that is also a section 361 exchange. Thus, a section 351 transfer that is also a section 361 exchange may only qualify, if at all, for Exception One.