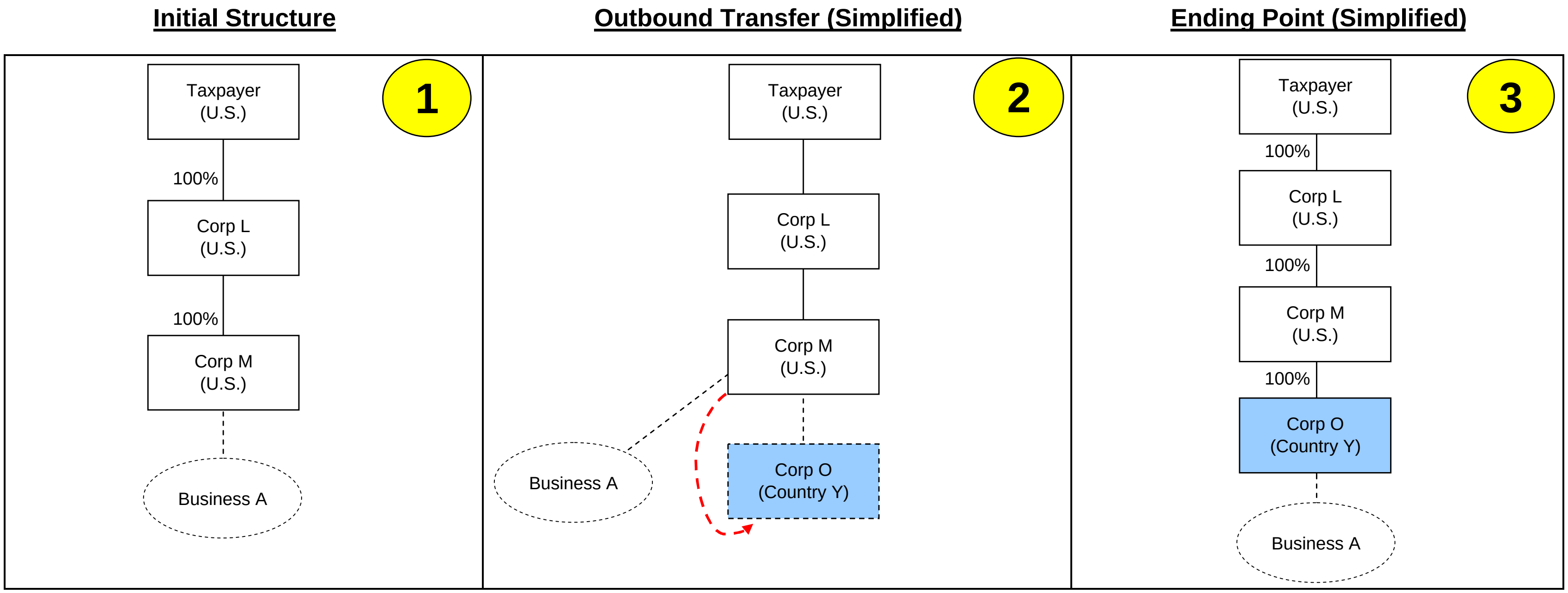
TAM 200907024

Network of Contracts Not Foreign Goodwill in Outbound Transfer



Taxpayer, a domestic corporation, owned all of the stock of Corporation L. Corporation L owned all of the stock of Corporation M. Corporations L and M were members of Taxpayer's consolidated group. Corporation M operated Business A in Region X and had developed, over the course of operating this business, a network of contracts with a large number of foreign agents in numerous countries ("Network").

Taxpayer reorganized its business model and centralized its Business A outside of the United States. Specifically, Corporation M created a wholly-owned subsidiary, Corporation O, located in Country Y. Corporation M then transferred all of the assets of Business A, except for the accounts receivable, to Corporation O. The transferred assets included intercompany services agreements, cash, software, and the Network. Taxpayer took the position that Corporation M's transfer to Corporation O of the assets associated with Business A qualified as a section 351 exchange. On its Form 926, Taxpayer treated the Network as part of the goodwill associated with, and the going concern value of, Business A. Taxpayer reported that the value of the foreign goodwill and going concern value was approximately ninety-seven percent of the total value of the Business A assets transferred in the section 351 exchange.

Section 367(d) requires a U.S. person that transfers intangible property to a foreign corporation in an exchange described in section 351 or 361 to take into income annual payments over the useful life of the intangible as though the transferor had sold the intangible for payments contingent upon productivity, use, or disposition of the property. Further, the statute requires that the payments be commensurate with the income attributable to the intangible. Section 367(d)(2)(A). Congress enacted section 367(d) because it thought it was inappropriate to allow a foreign corporation to earn deferred income from intangible property that was developed by claiming significant expenses in the United States. See H.R. Rep. No. 98-342 (1984); S. Rep. No. 98-169, at 361 (1984) ("the transferor U.S. companies hope to reduce their U.S. taxable income by deducting substantial research and experimentation expenses associated with the development of the transferred intangible and, by transferring the intangible to a foreign corporation at the point of profitability, to ensure deferral of U.S. tax on the profits generated by the intangible.")

Reg. 1.367(d)-1T(b), following on this legislative history, provides that section 367(d) and the regulations thereunder do not apply to the transfer of foreign goodwill or going concern value. For this purpose, "foreign goodwill or going concern value" is defined as "the residual value of a business operation conducted outside the United States after all other tangible and intangible assets have been identified and valued." Treas. Reg. § 1.367(a)-1T(d)(5)(iii). The ruling held that the Network is a type of intangible property described in section 936(h)(3)(B) and that the Network does not represent foreign goodwill or going concern value, as defined in Treas. Reg. §1.367(a)-1T(d)(5)(iii). Therefore, Corporation M's transfer of the Network to Corporation O is subject to section 367(d).