



Hot Topics in Cross-Border M&A

June 11 & 12, 2024

Ahead
of the **wave**

2024 U.S. Cross-Border Tax Conference



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Agenda

Section 338(g) Elections and Acquisitions of Foreign Corporations

- Overview
- Pillar 2 and CAMT Considerations
- The QSP Requirement

Entity Classification Considerations

- Tested Losses
- Foreign Withholding Taxes

Debt Restructuring Considerations in Connection Acquisitions of Foreign Targets

- Information to Gather
- Gratuitous Cancellations
- Lower-tier Cancellations
- Brother-Sister Cancellations
- Liquidation of Subsidiary
- Merger of Debtor into Creditor

Share Repurchase Excise Tax Update

- Overview
- The Funding Rule
- Applicability

Section 338(g) Elections and Acquisition of Foreign Corporations

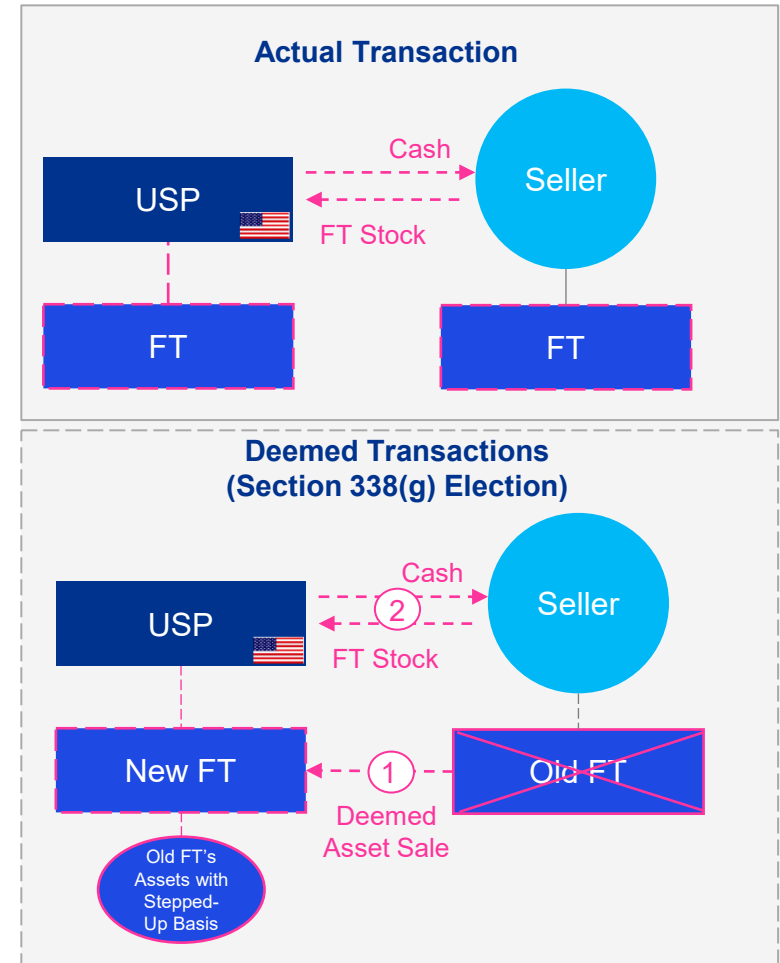


Overview

A large, powerful blue wave is crashing against a purple and pink sunset sky. The wave is the central focus, with white foam at its base. The sky is a mix of deep purple and bright pink, suggesting a sunset or sunrise. The overall mood is dramatic and energetic.

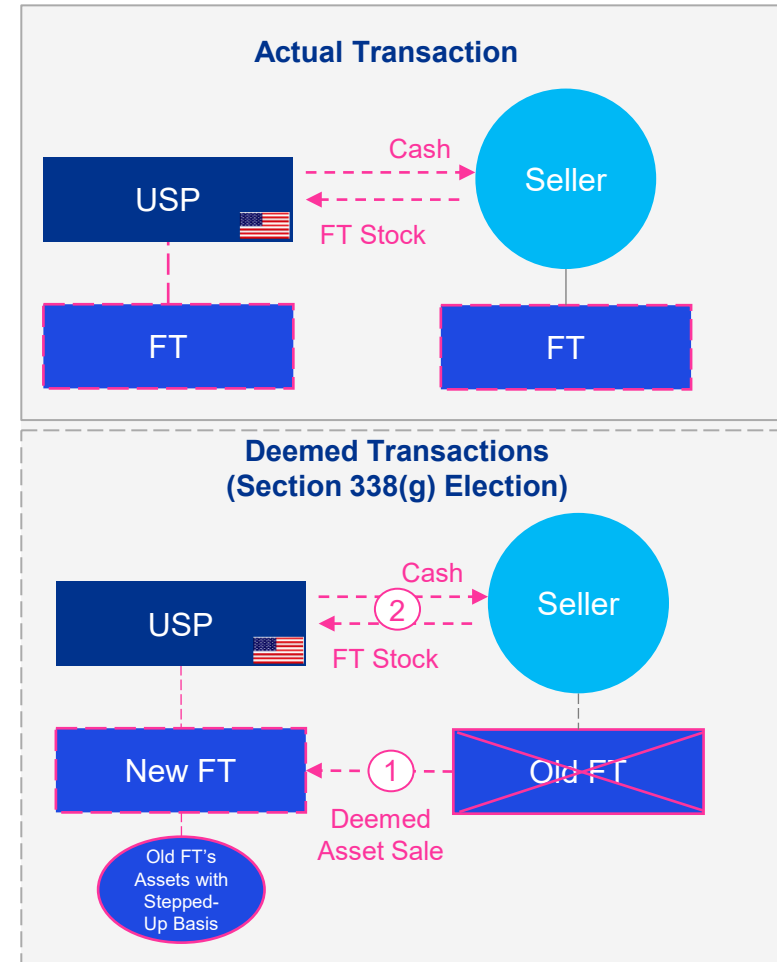
General

- When a US acquirer corporation (“**USP**”) purchases the stock of a foreign target corporation (“**FT**”) in a fully taxable transaction, USP takes a cost basis in the stock of FT with no step-up (or step-down) in FT’s assets.
- Section 338 generally permits USP to make an election to treat a “qualified stock purchase” (“**QSP**”) of FT as a purchase of FT’s assets by new FT (a “**Section 338(g) Election**”).
 - Section 338 elections are also available in the context of QSPs of US target corporations but involve different considerations and are beyond the scope of this presentation.
- If a Section 338(g) Election is made, then FT is treated as two separate corporations, old FT and new FT. Old FT is treated as selling all of its assets to an unrelated person, and new FT is treated as acquiring all of its assets from an unrelated person (the “**Deemed Asset Sale**”). This provides new FT, under USP’s ownership, with a stepped-up basis in its assets where FT’s assets have a value greater than basis.



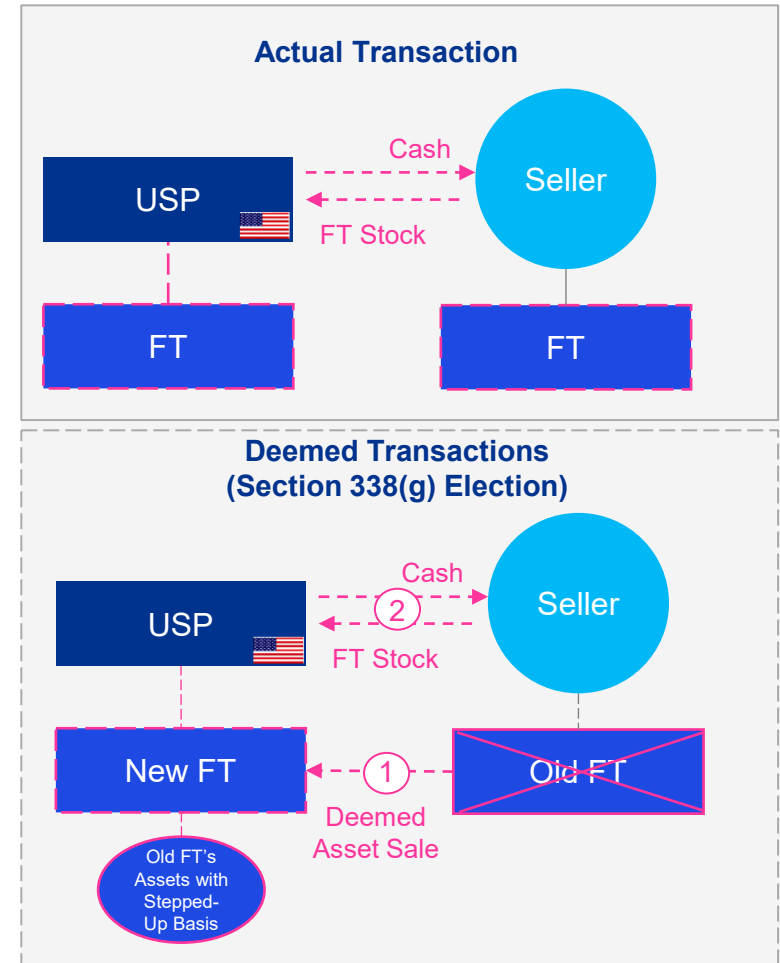
General (cont.)

- The increased basis resulting from a Section 338(g) Election can reduce new FT’s income going forward for USFIT purposes, thereby reducing USP’s GILTI and Subpart F inclusions with respect to new FT.
 - In addition:, Section 338(g) Elections can:
 - Close the taxable years of FT and lower-tier foreign corporations under FT; and,
 - Provide new FT with a “clean slate” for USFIT purposes, eliminating FT’s historical USFIT basis and earnings and profits (“**E&P**”).
 - Where a Section 338(g) Election is not available or not made, recreating FT’s historical USFIT basis and E&P can be challenging and expensive, especially where FT’s US tax attributes have not been relevant prior to the acquisition.



General (cont.)

- Making a Section 338(g) Election may also have a positive, a negative or no impact on the seller of FT. If a Section 338(g) Election is made:
 - FT recognizes gain with respect to the deemed asset sale while owned by the seller. Any gain recognized also increases FT's E&P while in the seller's hands.
 - Where the seller is a foreign corporation without any Section 951(a) US shareholder (a "**US Shareholder**"), the foregoing consequences generally will be irrelevant.
 - Where the seller is a US Shareholder or a foreign corporation with US Shareholders however, the recognition of gain by FT can result in the recognition of GILTI or Subpart F income by the US Shareholders and a corresponding increase in their basis in their FT stock.
 - Whether this impact is positive or negative will depend on a number of factors, including:
 - Whether the increased basis reduces gain otherwise recognizable by the US Shareholder on a sale of its FT stock that would be taxable at a higher rate; and
 - The extent to which FT's E&P results in gain to the US Shareholder on a disposition of FT stock being recharacterized as a dividend pursuant to Section 1248, and the impact of that recharacterization.



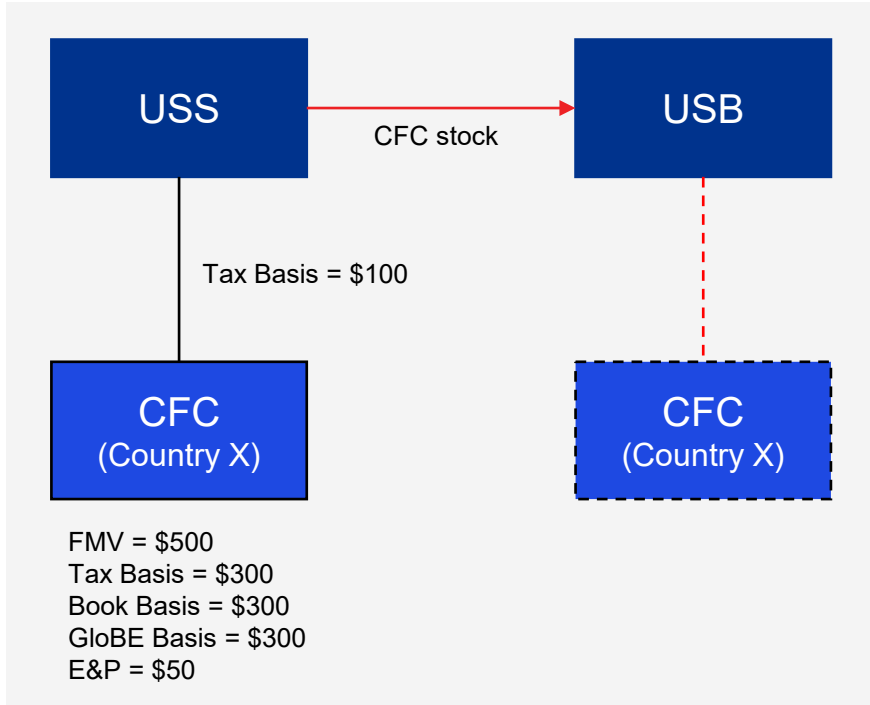
Pillar 2 and CAMT Considerations



Pillar 2 and CAMT Impacts

- In general, a Section 338(g) Election, while stepping up FT's asset basis for USFIT purposes, will not result in an equivalent step up for Pillar 2 purposes. See OECD (2021), Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, Articles 4.1.3(a) and 4.4.1(a).
- As a result, the desirability of making a Section 338(g) Election in today's world needs to be reexamined.
 - To the extent the result of making a Section 338(g) Election is merely to reduce USFIT GILTI or Subpart F tax that would otherwise be "pushed down" to FT and offset Pillar 2 taxes, the election may be of little economic value.
 - In addition, even where there remains a net benefit to making a Section 338(g) Election, the amount of that net benefit will need to factor in any offsetting Pillar 2 tax impact, especially where the value of the Section 338(g) Election is being factored into the price being paid for FT.
 - Moreover, other impacts such as high tax elections, Section 901(m) consequences and benefits or detriments to the seller, if any, of making a Section 338(g) Election need to be considered.
 - Accordingly, modeling will be key.
- With the advent of CAMT, the impact of CAMT will also need to be factored into the decision of whether to make a Section 338(g) Election and how much of a benefit there is of making the election.

Taxable stock transactions – Seller consequences



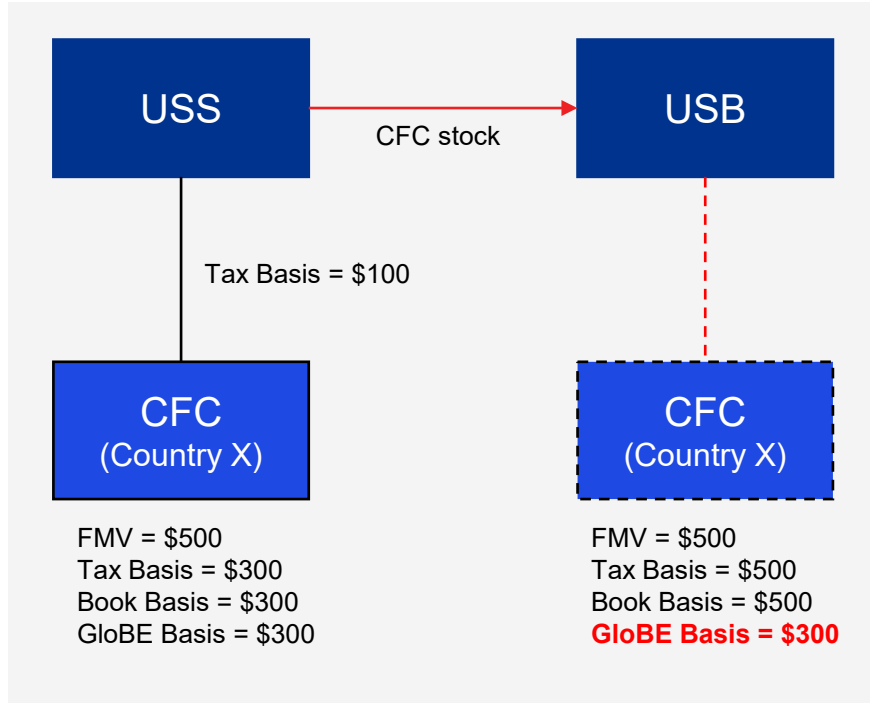
Facts

- After the first year in which CFC is subject to the GloBE rules, USS sells all of the stock of CFC to USB for \$500. USS has made the equity investment inclusion election.
- USB makes a §338(g) election with respect to CFC. As a result, CFC recognizes \$200 of gross tested income for US tax purposes, resulting in a \$200 GILTI inclusion to USS. Taking into account the \$250 deduction, the GILTI inclusion results in US tax of \$21 ($\$200 \times 10.5\%$). The GILTI inclusion also results in an increase in basis in the CFC stock by \$200 (from \$100 to \$300).
- Of the remaining \$200 of gain, \$50 is treated as a dividend under §1248, eligible for a 100% §245A DRD. The remaining \$150 of gain results in \$31.5 of US tax ($\$150 \times 21\%$).
- In sum, the sale results in \$52.5 of US tax imposed on USS.

GloBE Implications

- Of the \$400 of book gain, \$250 is included in the domestic taxable income of USS, after taking into account the \$250 deduction (equal to \$100) and the §245A DRD (equal to \$50). As a result, USS includes \$250 of its book gain in its GloBE income.
- USS also includes the \$52.5 of US taxes associated with this income in adjusted covered taxes.

Taxable stock transactions – Target consequences



Facts

- On 4/14/2023, USS sells all of the stock of CFC to USB for \$500.
- USB makes a §338(g) election with respect to the purchase of CFC.

GloBE Implications

- For purposes of computing GloBE income when effective, under Article 6.2.1(c), for all stock sales that occur on or after December 1, 2021, CFC's basis in its assets is generally determined without regard to purchase accounting.
- Therefore, CFC retains its historical carrying value of its assets (\$300) for purposes of GloBE.
- In future years, under Article 4.3.2(c), USB's GILTI taxes with respect to CFC may be allocated to CFC for the purposes of computing Country X top-up tax; but GILTI taxes will likely be reduced by reason of the §338(g) election.
 - However, February Administrative Guidance ("AG") clarifies that the top-up tax computation for purposes of the QDMTT does not take into account GILTI and other CFC taxes. Assuming that the U.S. foreign tax credit rules treat QDMTTs as creditable foreign taxes, the increased local taxes in conjunction with the §338(g) election could cause CFC to be "high-taxed" within the meaning of the GILTI high-tax exception election or otherwise create excess FTCs.

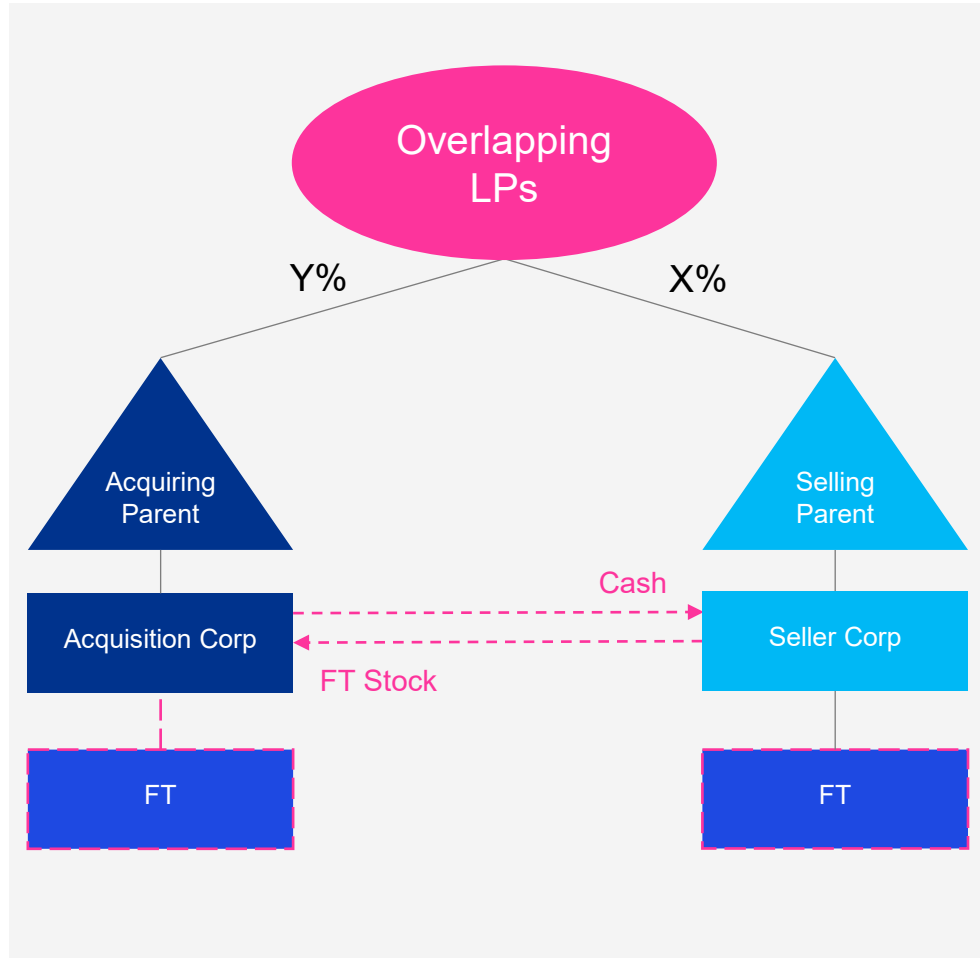
The QSP Requirement



The QSP Requirement

- In order to make a Section 338(g) Election with respect to FT there must be a QSP of FT. Determining whether a QSP has occurred can often be more complex than it would first appear.
- A QSP is defined as “any transaction or series of transactions in which stock (meeting the requirements of Section 1504(a)(2)) of 1 corporation is acquired by another corporation by purchase during the 12-month acquisition period.” Section 338(d)(3).
- To acquire another corporation “by purchase,” Section 338(h)(3)(A) requires that all of the following requirements be met:
 - The basis of stock in the hands of the purchasing corporation is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the seller or (ii) under Section 1014 (the “**Substituted Basis Prohibition**”);
 - The stock is not acquired in an exchange to which Sections 351, 354, 355, or 356 applies or any other transaction described in regulations in which the transferor does not recognize the entire amount of gain or loss recognized on the transaction (the “**Nonrecognition Exchange Prohibition**”); and
 - The stock is not acquired from a person the ownership of whose stock would under Section 318(a) (other than Section 318(a)(4), relating to options) be attributed to the person acquiring such stock (the “**Related Party Prohibition**”, and collectively with the Substituted Basis Prohibition and the Nonrecognition Exchange Prohibition, the “**Section 338(h)(3)(A) Prohibitions**”).
- The next few slides show examples of where it is difficult or impossible to show that none of the Section 338(h)(3)(A) Prohibitions are tripped.

“Related Party Prohibition” Attribution (Example 1)



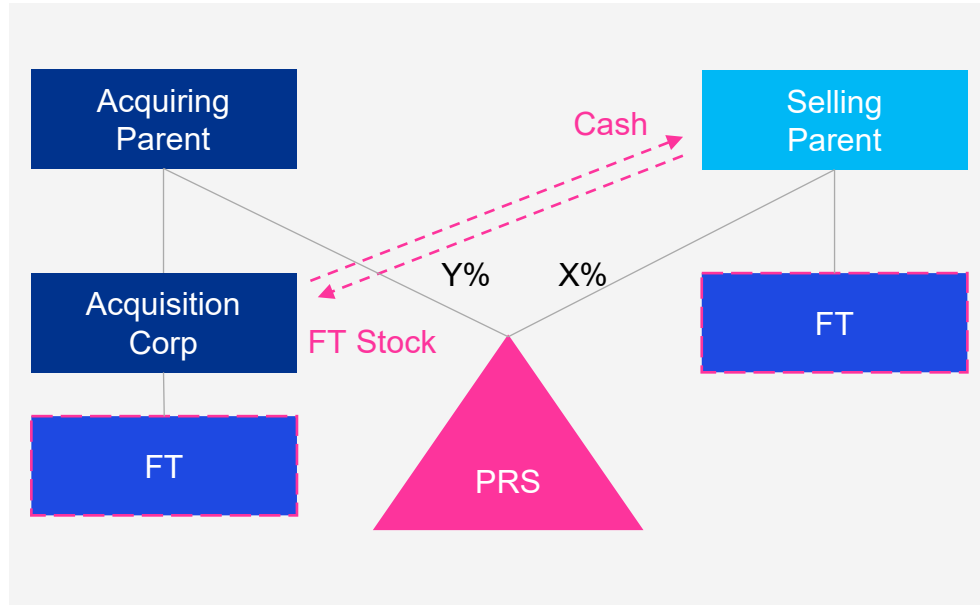
Facts

Selling Parent and Acquiring Parent are both partnerships. There are some limited partners that own stock in both Selling Parent and Acquiring Parent (“**Overlapping LPs**”). Selling Parent owns all of the stock of Seller Corp, and Seller Corp owns all of the stock of FT. Acquiring Parent owns all of the stock of Acquisition Corp. Acquisition Corp purchases all of the stock of FT from Seller Corp.

Analysis

- If any stock owned by Seller Corp would be attributed to Acquisition Corp under Section 318(a) (other than Section 318(a)(4)), the Related Party Prohibition will prevent the parties from being able to make a Section 338(g) Election.
- Under Section 318(a)(2)(C), stock owned by the Seller Corp (“**Seller Corp’s Stock Ownership**”) would be attributed to its owner, Selling Parent.
- Under Section 318(a)(2)(A), Seller Corp’s Stock Ownership is then attributed from Selling Parent to its owners, which include the Overlapping LPs.
- Under Section 318(a)(3)(A), Seller Corp’s Stock Ownership that is attributed to the Overlapping LPs is then attributed from the Overlapping LPs to Acquiring Parent.
- Under Section 318(a)(3)(C), Seller Corp’s Stock Ownership is attributed from Acquiring Parent to Acquisition Corp. Accordingly, Seller Corp’s Stock Ownership is attributed to Acquisition Corp in violation of the Related Party Prohibition and a Section 338(g) Election cannot be made.

“Related Party Prohibition” Attribution (Example 2)



Note: If FT is acquired at the Acquiring Parent-level, then the Related Party Prohibition generally should not prevent a Section 338(g) Election, Acquiring Parent stock is not attributed to PRS under Section 318(a) absent owners of Acquiring Parent being partners in PRS and the Selling Parent’s Stock Ownership that is attributed to PRS cannot be reattributed to Acquiring Parent. See Section 318(a)(5)(C) (preventing stock attributed from a partner to a partnership from being reattributed out to another partner).

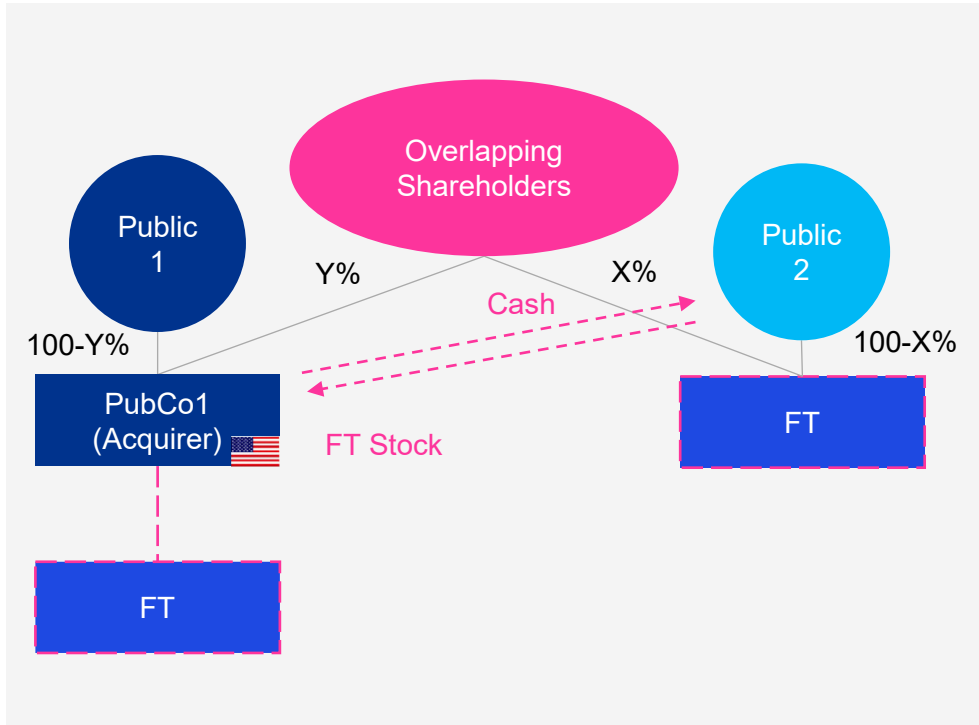
Facts

Selling Parent and Acquiring Parent are both corporations that own X% and Y% interests, respectively, in the same partnership (“**PRS**”). Selling Parent owns all of the stock of FT and Acquiring Parent owns all the stock of Acquisition Corp. Acquisition Corp purchases all of the stock of FT from Selling Parent.

Analysis

- If stock owned by Selling Parent (“**Selling Parent’s Stock Ownership**”) would be attributed to Acquisition Corp under Section 318(a) (other than Section 318(a)(4)), the Related Party Prohibition will prevent the parties from being able to make a Section 338(g) Election.
- Under Section 318(a)(3)(A), Selling Parent’s Stock Ownership is attributed to PRS. Similarly, the Acquisition Corp stock owned by Acquiring Parent is attributed to PRS.
- Under Section 318(a)(3)(C), Selling Parent’s Stock Ownership is then attributed from PRS to Acquisition Corp. Accordingly, Selling Parent’s Stock Ownership is attributed to Acquisition Corp in violation of the Related Party Prohibition and a Section 338(g) Election cannot be made.

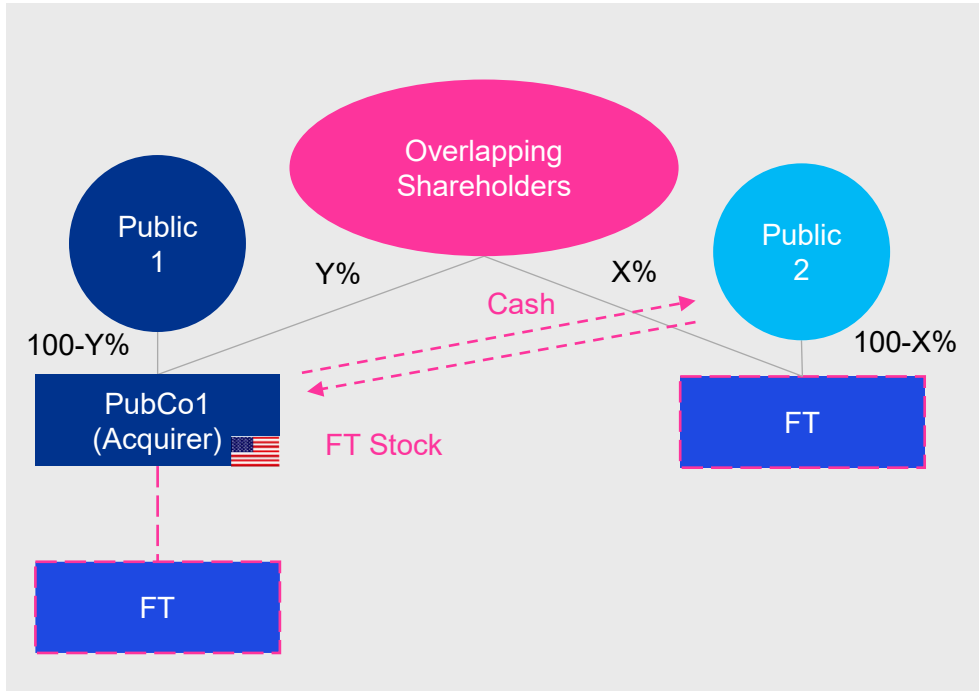
Section 304 Example



Facts

PubCo1 and FT are both publicly traded corporations. PubCo1 is a domestic corporation, and FT is a foreign corporation. Shareholders that own stock in both FT and PubCo1 (“**Overlapping Shareholders**”) own X% and Y%, respectively, of the shares of stock in such corporations. The remaining shares of PubCo1 are owned by persons that are only shareholders in PubCo1 (such persons, “**Public 1**”), and the remaining shares of FT are owned by persons that are only shareholders in FT (such persons, “**Public 2**”). PubCo1 agrees to acquire all of the issued and outstanding stock of FT from Public 2 (such acquisition, the “**FT Acquisition**”).

Section 304 Example (cont'd)



Analysis

- If Overlapping Shareholders are “in control of” PubCo1 and FT within the meaning of Section 304, then Section 304(a)(1) applies. As such, the cash received by each respective Overlapping Shareholder, in their capacity as shareholders of FT, is treated as a redemption of their respective PubCo1 stock. This redemption is tested for dividend equivalency under Section 302(b) by reference to the stock of FT.
- If Section 301 applies, the FT Acquisition is treated as if Public 2 transferred the stock of FT to PubCo1 in exchange for stock of PubCo1 in a Section 351 exchange (the “**Deemed Section 351 Exchange**”), followed by a redemption of such PubCo1 stock by PubCo1 (the “**Deemed Redemption**”).
- Because Section 351 applies to the Deemed Section 351 Exchange, the FT Acquisition is a transaction that violates both (i) the Substituted Basis Prohibition, and, seemingly, (ii) the Nonrecognition Exchange Prohibition. Thus, the FT Acquisition is not a QSP.
- Also, if Section 301 applies, Public 2 may be treated as receiving an outbound dividend subject to withholding taxes.

Further Considerations

- What due diligence should/needs to be done to determine whether the Section 338(h)(3)(A) Prohibitions apply?
 - *Cf.* PLR 202141005 (July 16, 2021) (describing degree of diligence done in a public transaction to get the IRS comfortable to issue a ruling that section 304 did not apply); *see also* Hoffenberg, Marencik and Murphy, Determining Control in Public M&A Transactions, 173 Tax Notes Federal 1487 (2021); New York State Bar Assoc. Tax Section, *Report on Section 304 in Public M&A Transactions*, Report No. 1445 (Nov. 19, 2020) (recommending adoption of certain counting conventions for determining whether Section 304(c) control is met in public M&A transactions to address the “evidentiary difficulties” taxpayers encounter in such transactions); New York State Bar Assoc. Tax Section, *Report on Proposed Regulations Implementing Section 336(e)*, Report No. 1174 (Dec. 31, 2008) (discussing among other things, the recursive application of the Section 318 attribution rules and partnership/partner attribution in the context of determining whether there has been a QSP).
- In borderline cases, can issues be taken off the table by planned dispositions?
 - Note that in the case of a series of transactions pursuant to an integrated plan to dispose of target stock, whether there is a Related Party Prohibition is tested immediately after the last transaction in such series. *See* Treas. Reg. § 1.338-3(b)(3)(ii)(C).
 - For examples of testing the Related Party Prohibition immediately after the last transaction in a series of transactions pursuant to an integrated plan, *see e.g.*, PLR 201220020 (Feb. 17, 2012); PLR 201203004 (Oct. 19, 2011); PLR 201145007 (Aug. 8, 2011); and PLR 201126003 (Apr. 4, 2011).

Further Considerations (cont'd)

- Alternatively, in certain cases can the issues with respect to Section 338(h)(3)(A) Prohibitions be taken off the table by having the acquisition be at a different level in the acquiring corporation group ? See *e.g.*, Slide 17.
- Instead of acquiring the stock of FT and making a Section 338(g) Election, is it possible to take Section 338(h)(3)(A) Prohibition issues off the table by having seller convert FT to a disregarded entity (or partnership) prior to the acquisition of FT?
 - What are the pros and cons of such an approach?

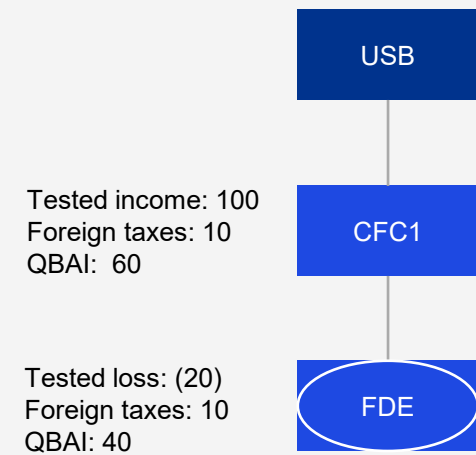
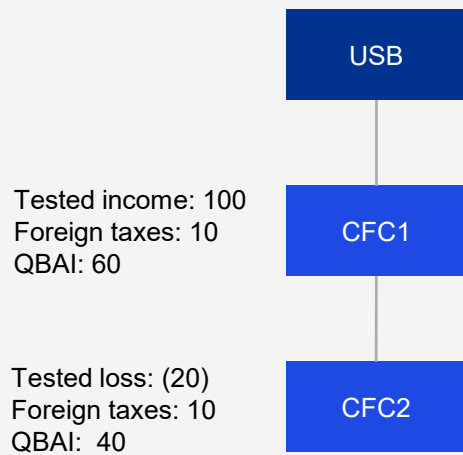
Entity Classification Considerations



Entity Classification Considerations

- An eligible entity with one owner can elect to be treated as a corporation or disregarded entity for US federal tax purposes.
- The classification of foreign entity as a CFC or a disregarded entity can impact its US owners in a number of ways, including:
 - Regarded vs. disregarded post-acquisition integration transactions
 - QBAI and FTC effects of tested losses
 - GILTI high-tax election qualification
 - Creditability of withholding taxes on regarded vs. disregarded distributions
 - Foreign branch regime vs. GILTI
 - BEAT treatment of regarded vs. disregarded outbound payments

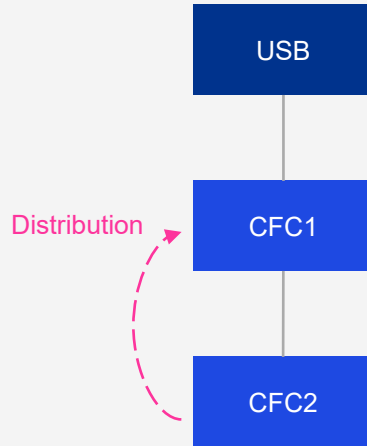
Tested Losses



USB tax calculation	
Net tested income (loss)	80
Less: DTIR (60 x 10%)	-6
GILTI	74
Add: Section 78 gross-up (10 x 74/100)	7.40
Total inclusion	81.40
Less: Section 250 deduction (50%)	-40.70
Net inclusion	40.70
Tentative US tax (21%)	8.55
Less: Section 960(d) credits (10 x 74/100 x 80%)	-5.92
Residual US tax (excess credit)	2.63

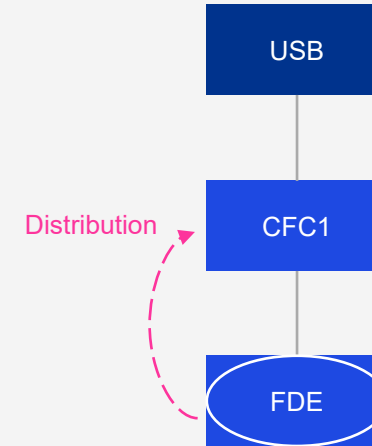
USB tax calculation	
Net tested income (loss)	80
Less: DTIR (100 x 10%)	-10
GILTI	70
Add: Section 78 gross-up (20 x 70/100)	14
Total inclusion	84
Less: Section 250 deduction (50%)	-42
Net inclusion	42
Tentative US tax (21%)	8.82
Less: Section 960(d) credits (20 x 70/100 x 80%)	-11.20
Residual US tax (excess credit)	-2.38

Foreign Withholding Taxes



FTC considerations

- Tax not creditable under Section 960(a) or (d)
- No current FTC in all events
- If distribution is of untaxed E&P or is a tiered hybrid dividend, no FTCs at all
- If distribution is a PTEP distribution, credits may be available (in the future) under Section 960(b)
- Characterization of tax depends on category of PTEP to which tax is allocated
- Potential for haircut under Section 965(g).
- Additional Section 78 gross-up associated with Section 960(b) credits
- Potential CAMT implications; disregarding Covered CFC Distributions. Notice 2024-10.



FTC considerations

- Foreign tax allocated based on the characterization of the assets of FDE
- If FDE's assets are all "GILTI assets" all of the foreign withholding tax may be allocable to tested income and may be creditable under Section 960(d) (subject to otherwise applicable limitations)
- What if CFC1 has no tested income in the year of distribution?
- Presumably, no CAMT implications because no dividend for US tax purposes.

Debt Restructuring Considerations in Connection with Acquisitions of Foreign Targets



Information to gather

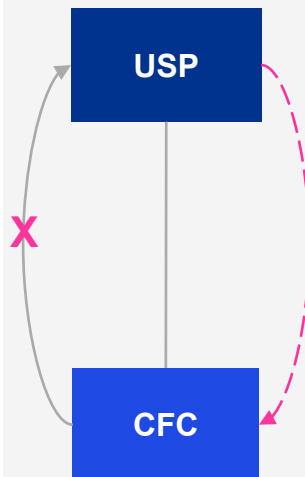
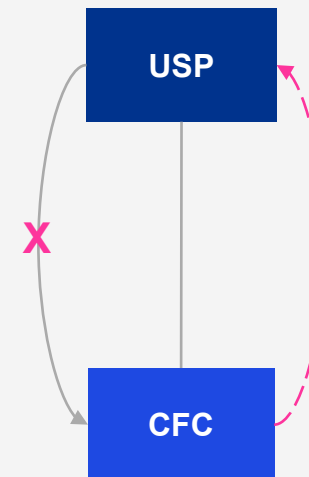
In General

- Location and amount of existing intercompany debt
- Recourse or non-recourse nature of the debt
- Treatment of instruments as debt or equity
- Debtor solvency
- Instrument FMV, basis, and adjusted issue price (“**AIP**”)
- Commercial constraints (e.g., external covenants, guarantees)

Cross-Border

- Legal constraints (e.g., distributable reserves, share issuance requirements)
- Whether the parties to the debt instrument qualified business units (“**QBUs**”)
- The functional currency of the QBUs
- The currency in which the instrument is denominated

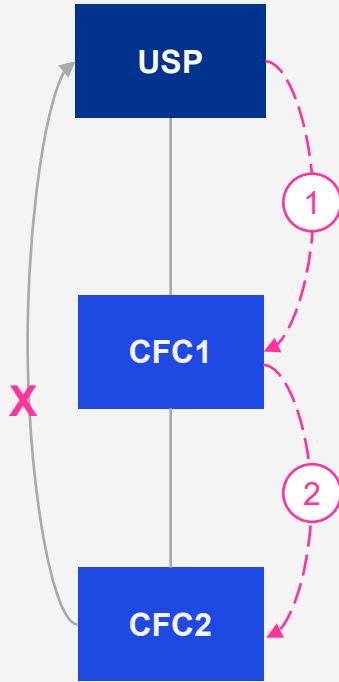
Gratuitous cancellations

 <p>Facts</p> <ul style="list-style-type: none"> • CFC is indebted to USP. • USP cancels the S debt. <p>USFIT Considerations</p> <ul style="list-style-type: none"> • The cancellation is generally treated as a capital contribution by USP to S to the extent of principal. See Treas. Reg. § 1.61-12(a). • Consider cancellation of indebtedness income (“CODI”) to S. • Interaction of sections 108(e)(6)/(8) and 367(c)(2). 	 <p>Facts</p> <ul style="list-style-type: none"> • USP is indebted to CFC. • CFC cancels the USP debt. <p>USFIT Considerations</p> <ul style="list-style-type: none"> • The cancellation is generally treated as a distribution of property. See Treas. Reg. § 1.301-1(k). • Consider CODI to USP. • CFC generally takes into account any gain in the USP debt; any loss is generally disallowed.
<ul style="list-style-type: none"> • Section 988 gain / loss on debt • Section 988 applies before section 108 	<ul style="list-style-type: none"> • Section 988 gain/loss on debt • Section 988 applies before section 108 • Section 986(c) if deemed distribution is PTEP

What are the results if the cancellations are simultaneous?

Debtor → Creditor

Lower-tier cancellations



- Section 988 gain / loss on debt
- Section 988 gain / loss is limited to overall gain / loss recognized on the transaction

Facts

- CFC2 is indebted to USP.
- USP cancels the CFC2 debt.

USFIT Considerations

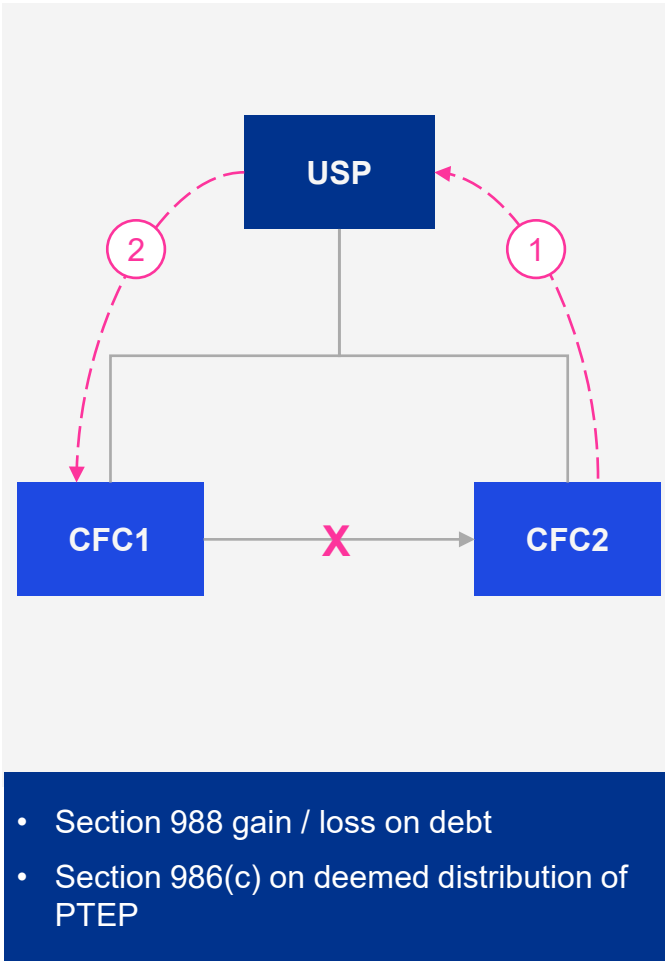
- The cancellation is treated as a contribution by USP to CFC1, followed by a contribution by CFC1 to CFC2.
- If there is a built-in-loss in the debt, consider the application of section 362(e)(2)(A) on the contribution by USP to CFC1, including:
 - Desirability of a section 362(e)(2)(C) election; and
 - Impact on the application of section 108(e)(6) on the contribution by CFC1 to CFC2.

Alternative Facts

- What are the results if there is a built-in gain in the debt?

Debtor → Creditor

Brother-sister cancellations



- Section 988 gain / loss on debt
- Section 986(c) on deemed distribution of PTEP

Facts

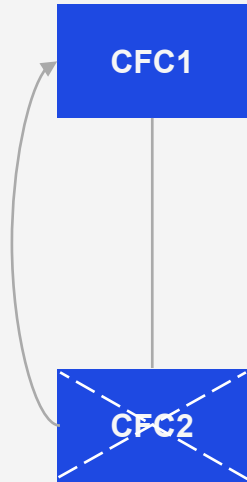
- CFC1 is indebted to CFC2.
- CFC2 cancels the CFC1 debt.

USFIT Considerations

- The cancellation is treated as a distribution by CFC2 to USP, followed by a contribution by USP to CFC1.
- Consider CODI to CFC1.
- Consider gain or loss to CFC2.

Debtor → Creditor

Liquidation of a subsidiary



- Section 988 gain / loss on debt

Facts

- CFC2, which is solvent, has debt outstanding to CFC1.
- CFC2 liquidates.

USFIT Considerations

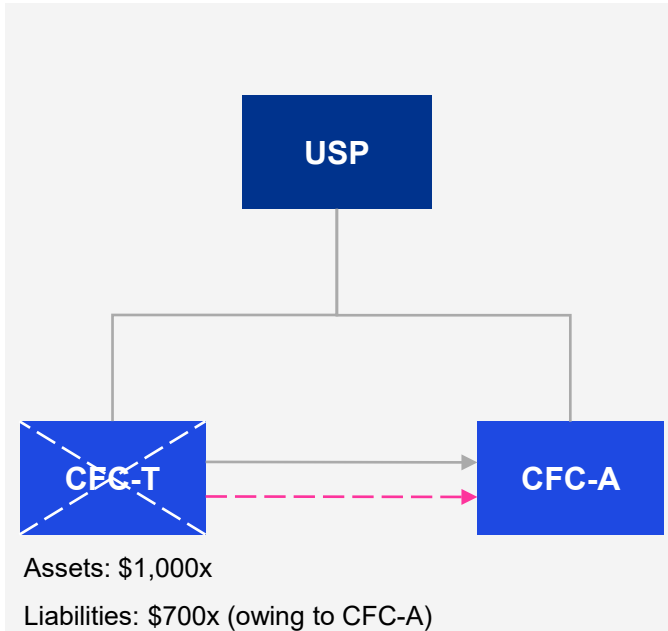
- CFC2 is treated as first transferring assets to CFC1 in satisfaction of its debt.
- Because CFC2 also makes at least partial payment to CFC1 with respect to its stock, the liquidation of CFC2 constitutes a complete liquidation under section 332. See Treas. Reg. § 1.332-2(b); Rev. Rul. 2003-125, Situation 1.
- CFC2 does not recognize gain or loss, including on the satisfaction of its debt. See section 337(b)(1).
- However, CFC1 recognizes any gain in the CFC2 debt. See Treas. Reg. § 1.332-7.

Additional Considerations

- What are the results if the debt is cleaned up prior to the liquidation of CFC2?
- What are the results if S is insolvent?

Debtor → Creditor

Merger of debtor into creditor



- Section 988 gain / loss on debt
- Section 986(c) on deemed distribution of PTEP
- Consider possible change in functional currency of CFC-A

Facts

- CFC-T has gross assets of \$1,000x and \$700x of debt owing to CFC-A.
- CFC-T merges with and into CFC-A in a section 368(a)(1) reorganization.

USFIT Considerations

- CFC-T is treated as transferring \$700x of assets in satisfaction of its debt. See Rev. Rul. 72-464.
- CFC-T does not recognize gain or loss on the satisfaction of its debt under sections 361 and 357(a).
- However, CFC-A recognizes any gain in the CFC-T debt.
- A takes a carryover basis in the assets under section 362(b) (including with respect to the \$700x of assets used to satisfy the T debt).

Debtor → Creditor

Share Repurchase Excise Tax Update



Overview

A large, powerful blue wave crashing against a purple and pink sunset sky. The wave is the central focus, with white foam at its crest. The sky is a mix of deep purple and bright pink, suggesting a sunset or sunrise. The overall mood is dramatic and energetic.

Statute: Highlights

- In August 2022, Congress enacted Section 4501 imposing a 1% excise tax on certain stock repurchases by publicly traded US corporations after December 31, 2022.
 - The FY25 Green Book proposes to raise this 1% rate to 4%.
- Section 4501, among other things, excludes certain repurchases from its scope and applies the 1% rate to the net amount of repurchases made each year less certain issuances during the same year.
- It also treats certain purchases of stock of publicly traded foreign corporations, as well as US corporations, by certain affiliates as being subject to the excise tax rules.
- As drafted, many uncertainties existed with respect to various aspects of Section 4501, including among other things, what constituted a “repurchase”.

Notice: Highlights

- On December 27, 2022, the Treasury released Notice 2023-2 (the “**Notice**”), providing interim guidance on the application and scope of the excise tax that the taxpayer may rely upon until the issuance of proposed regulations.
- The Notice took a broad approach to what constitutes a repurchase, including all actual and deemed exchanges under Sections 354 and 356.
 - Importantly, however, the Notice exempted from the repurchase ambit shares deemed acquired in Section 304 transactions and any non-qualifying consideration (i.e., boot) paid in a Section 351 transaction.
 - Contrary to the expectation of many, the Notice did not provide any special rules for non-publicly traded mandatorily redeemable preferred stock.
 - In addition, the Notice contained:
 - a controversial “funding rule” whereby certain fundings by US affiliates of stock repurchases by publicly traded foreign parent corporations would be subject to the excise tax rules, and
 - rules regarding the application of the excise tax to purchases of publicly traded foreign parent stock by certain affiliates, including foreign partnerships with any US partners.

Proposed Regulations: Highlights

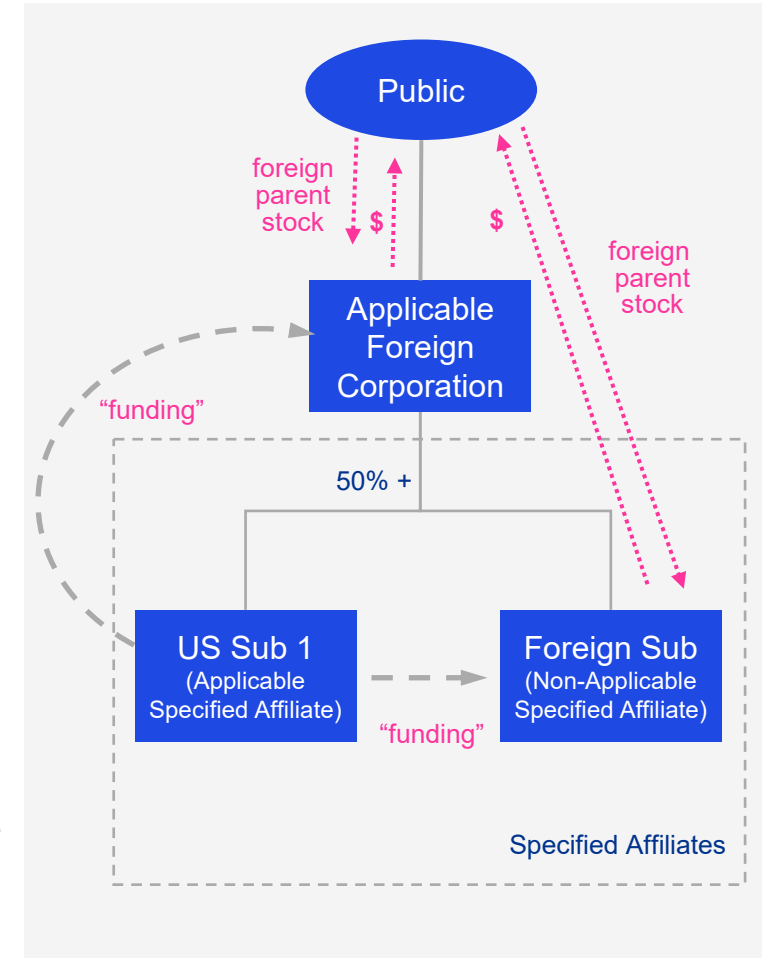
- On April 9, 2024, the Treasury released REG-115710-22 and REG-118499-23 (the “**Proposed Regulations**”) with respect to the excise tax.
- The latter set of Proposed Regulations set forth rules providing procedural guidance regarding the reporting and payment requirements for the excise tax, while the former set of Proposed Regulations address substantive applications of the excise tax.
- The substantive Proposed Regulations largely follow the approach of the Notice with several changes and additions, the most important of which are highlighted below.
 - The Proposed Regulations exclude “additional tier 1 preferred stock” from the ambit of the excise tax. No other special rules for preferred stock are provided.
 - Accordingly, for example, any net redemption of non-publicly traded “plain vanilla” mandatorily redeemable preferred stock by a publicly traded US corporation would be subject to the excise tax, regardless of when the preferred stock was issued.
 - Other changes in the Proposed Regulations, compared to the Notice, include rules regarding (i) certain repurchases after cessation of public trading, (ii) netting of shares issued to non-employees of a specified affiliate, (iii) “non-stock interests”, (iv) acquisitions of entities owning acquiror stock, and (v) the specified affiliate status of foreign partnerships with less than 5% domestic entity partners.
- The Proposed Regulations also make changes to the “funding rule”. These funding rule changes are explored further in the following slides.

The Funding Rule



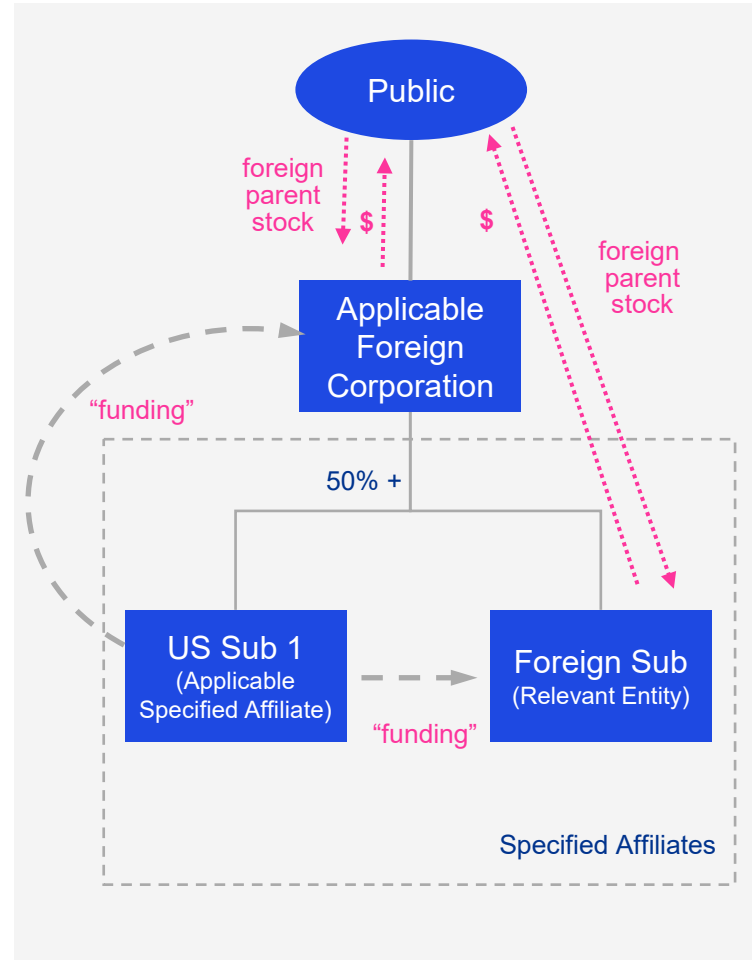
Notice Funding Rule

- Under the Notice, the excise tax applies to acquisitions by an applicable foreign corporation or non-applicable specified affiliates of applicable foreign corporation stock that are funded “by any means (including through distributions, debt, or capital contributions)” by an applicable specified affiliate with a principal purpose to avoid the excise tax (the “**Notice Funding Rule**”).
 - If such funding occurs, other than by a distribution, within two years of the acquisition or repurchase, a principal purpose is deemed to exist (the “**Per Se Rule**”).
- The scope of what constitutes a “funding” was not set forth in the Notice, creating significant uncertainty.
 - For example, it was unclear whether a royalty payment, interest payment or other payments by a US subsidiary for value to a publicly traded foreign corporation could be treated as a funding.
 - It was also unclear which distributions, and which other “fundings” outside the two-year window of the per se rule, would be treated as having a principal purpose to avoid the excise tax.



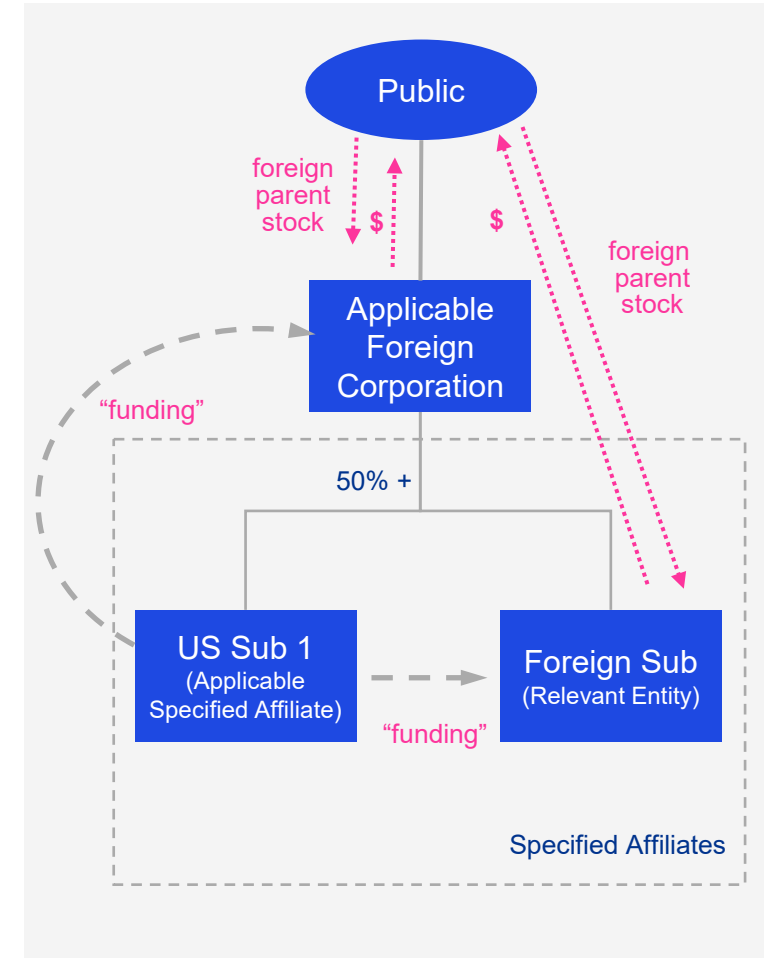
Proposed Regulations Funding Rule

- The Proposed Regulations modify the Notice Funding Rule, providing that the excise tax applies to acquisitions by an applicable foreign corporation or non-applicable specified affiliates (“**relevant entities**”) of applicable foreign corporation stock that are funded “by any means (including through distributions, debt, or capital contributions), directly or indirectly,” by an applicable specified affiliate with a principal purpose to avoid the excise tax (the “**New Funding Rule**”).
- The Proposed Regulations also provide that, if based on all the facts and circumstances, a principal purpose of the funding is to fund, directly or indirectly, a repurchase, then there is a principal purpose of avoiding the excise tax (the “**Principal Purpose Rule**”).



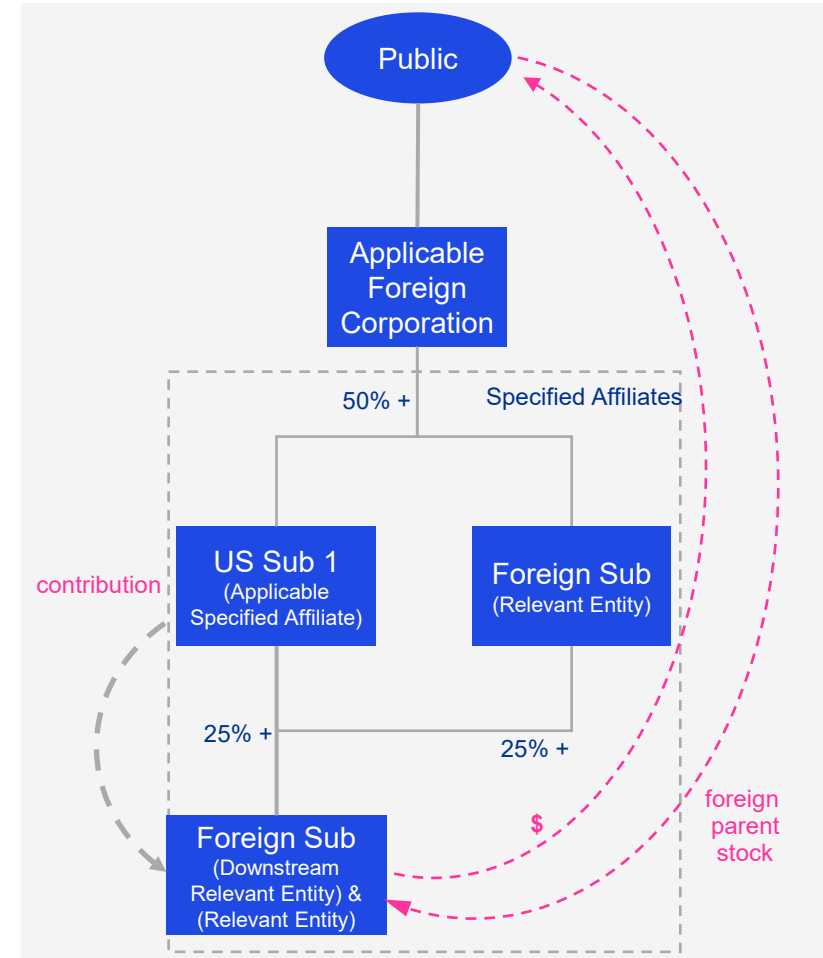
Proposed Regulations Funding Rule: Observations

- **Broader.** New Funding Rule seems broader than Notice Funding Rule.
 - Purpose of avoiding the excise tax vs. Purpose of funding a repurchase.
 - “Funds by any means (including through distributions, debt, or capital contributions), **directly or indirectly.**”
- **Whose Purpose?** Whose purpose is relevant? (US Sub 1? Applicable Foreign Corporation?)
- **Distributions.**
 - The Per Se Rule explicitly excluded distributions.
 - No such exclusion in the New Funding Rule.
- **Funding Timing.** The Per Se Rule presumption was limited to 2 years (presumably before and after the funding).
 - No such time constraints to the New Funding Rule.
 - Prop. Reg § 58.4501-7(p)(3), Example 3. (New Funding Rule applied with March 1, 2024 distribution to May 15, 2026 repurchase).
- **Ordinary Course Transactions.** No specific exception.



Proposed Regulations Funding Rule: Downstream Presumption

- **Downstream Presumptive Principal Purpose.** A principal purpose of avoiding the excise tax is presumed to exist if an applicable specified affiliate funds by any means, directly or indirectly, a “downstream relevant entity,” and the funding occurs within two years of a covered purchase by or on behalf of the downstream relevant entity.
 - **Rebuttable.** This presumption may be rebutted only if facts and circumstances clearly establish that there was not a principal purpose of avoiding the excise tax.
 - **“Downstream Relevant Entity”.** Means a relevant entity 25% or more of the stock of which is owned (by vote or by value) (or the capital interests or profits interests of which is held), directly or indirectly, by, individually or in aggregate, one or more applicable specified affiliates of an applicable foreign corporation.
- **FY25 Greenbook.** Proposal to extend the excise tax to the acquisition of stock of an applicable foreign corporation by a specified affiliate of the applicable foreign corporation that is a CFC.
- **Observation.** The fact patterns these downstream rules would apply to seem limited and unusual.



Applicability



Proposed Regulations: Applicability

- **Applicability**

- **General Rule.** In general, the Proposed Regulations would apply to any transactions occurring in tax years ending after December 31, 2022.
- **Funding by Applicable Specified Affiliate.** The Proposed Regulations. provisions addressing “fundings” by an applicable specified affiliate apply to transactions that occur after April 12, 2024.
- **Transition Rule.** Under a transition rule, rules similar to the Notice Funding Rule would apply to a situation where both a funding and a covered purchase occur between January 1, 2023, and April 12, 2024.
 - However, the Proposed Regulations invite taxpayers to choose to apply the rules of the Proposed Regulations (including the New Funding Rule) in lieu of the Notice Funding Rule to transactions occurring after December 31, 2022, subject to certain consistency requirements.

- **Filing**

- Any covered corporation (or person treated as a covered corporation) that makes a stock repurchase after December 31, 2022 (or that is treated as making a stock repurchase) would be required to file a stock repurchase excise tax return.
- **Forms.** The “stock repurchase excise tax return” means a Form 720, Quarterly Federal Excise Tax Return, where the tax liability is reported, with an attached Form 7208, Excise Tax on Repurchase of Corporate Stock, where the excise tax is calculated.

Proposed Regulations: Applicability (cont.)

- **Filing (cont.)**

- **No De Minimis Filing Rule.** The requirement to file a stock repurchase excise tax return would apply to all covered corporations (or persons treated as a covered corporation) that make a repurchase in a taxable year, even if each repurchase in that year is eligible for a statutory exception or is fully offset by issuances.

- **Due Date**

- **Payment.** Payment is due the same date as filing.
- **For taxable years ending after the date final regulations are published.** The due date would be the due date of the Form 720 for the first full calendar quarter (generally the last day of the first month after such period) after the taxable year of the covered corporation (or person treated as a covered corporation) ends.
- **For taxable years ending prior to the time final regulations are published.** The due date would be the due date of the Form 720 for the first full calendar quarter after the final regulations are published.

- **Comments**

- **Procedure Proposed Regulations.** Comments to the procedural package of the Proposed Regulations are due by May 13, 2024.
- **Substantive Proposed Regulations.** Comments to the package of substantive rules are due by June 11, 2024.



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