SIMPSON THACHER

MEMORANDUM

Temporary Regulations Regarding Outbound Transactions

January 21, 2014

On January 16, 2014, the Treasury Department issued temporary regulations under Section 7874[1] (often referred to as the "anti-inversion" rule) that provide additional rules for outbound acquisitions of a domestic company ("Domestic Target") by a foreign company ("Foreign Acquirer"). Specifically, the temporary regulations provide further guidance as to when a Foreign Acquirer is subject to adverse treatment as a "surrogate foreign corporation" under the anti-inversion rule. These new regulations are important because they help prevent the unintended application of the anti-inversion rule in outbound acquisitions predominantly for cash where management individuals roll over their equity into Foreign Acquirer stock (so long as the rollover represents under 5 percent of Foreign Acquirer stock).

SECTION 7874—CERTAIN GENERAL RULES

A Foreign Acquirer may be treated as a surrogate foreign corporation if (i) at least 80 percent of Foreign Acquirer stock is held by former shareholders of the Domestic Target by reason of their ownership of the Domestic Target (in which case the Foreign Acquirer would be treated as a U.S. corporation for U.S. federal income tax purposes), or (ii) at least 60 percent (but less than 80 percent) of the stock of the Foreign Acquirer is held by former shareholders of the Domestic Target (in which case a significant tax may be imposed on the transaction).

IMPACT OF ROLLOVER

For purposes of determining the percentage of stock held by former shareholders of a Domestic Target, an IRS notice issued in 2009 generally excluded Foreign Acquirer stock received for cash, cash equivalents or marketable securities, whether in a public or private offering. This approach could, for example, impose the adverse anti-inversion treatment in a transaction in which a newly formed Foreign Acquirer (capitalized with an equity contribution from a private equity fund or other acquirer) acquires a Domestic Target mostly for cash but where a small amount of stock is issued to Domestic Target shareholders (such as management holders that are rolling over their equity).

[1] All "Section" references are to the Internal Revenue Code of 1986, as amended.

NEW RULES CREATE A LIMITED EXCEPTION FOR ROLLOVERS

The temporary regulations generally adopt the approach of the 2009 IRS notice[2] but importantly include a *de minimis* exception that does not apply this rule when Domestic Target shareholders own less than 5 percent of Foreign Acquirer stock after the acquisition and the related issuance of Foreign Acquirer stock.

CERTAIN POLICY CONCERNS

The preamble to the temporary regulations notes that the *de minimis* exception may implicate the policies underlying the anti-inversion rule in certain transactions, including where a publicly traded Domestic Target is acquired for cash and a small management equity rollover and one of the intended exit strategies may be a public offering of the Foreign Acquirer. The preamble states that such transactions, which have the effect of converting a publicly traded domestic corporation into a publicly traded foreign corporation over time, can be viewed as inconsistent with the policies underlying the anti-inversion rule and remain subject to continuing study.[3]

CONCLUSION

The tax rules applicable to acquisitions of U.S. businesses by foreign companies will no doubt remain politically charged. While the *de minimis* exception is helpful for structuring outbound transactions (at least where the rollover falls within the less than 5 percent threshold), taxpayers should be mindful of not otherwise implicating the anti-inversion rule and be aware that the Treasury Department and IRS have requested comments on, and continue to study, the application of the anti-inversion rule to transactions involving publicly traded entities.

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[2] The temporary regulations address several aspects of when Foreign Acquirer stock is taken into account in determining surrogate foreign corporation status, in addition to including the *de minimis* exception discussed here.

[3] Moreover, under an anti-abuse rule contained in the temporary regulations, the *de minimis* exception does not apply to a transfer of Foreign Acquirer stock that is transferred in a transaction (or series of transactions) related to the Domestic Target acquisition with a principal purpose of avoiding the purposes of Section 7874.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

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