Domestication of Foreign Corporations: Tax Planning in the Net of Internal Revenue Code Section 7701(b)

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Domestication of Foreign Corporations: Tax Planning in the Net of Internal Revenue Code
Section 7701(b)*

I. Introduction

Nonresident aliens are taxed differently by the U.S. Government than resident aliens.1 An individual’s tax treatment depends on which tax regime is imposed on him; thus, it is critical for tax planning to determine whether the individual will be taxed as a resident or a nonresident. The current United States Internal Revenue Code2 provides objective standards for determining whether an alien is a resident of the United States for federal income tax purposes.3 The residency tests of new section 7701(b)4 have swept many nonresident aliens into the income tax scheme used for U.S. residents. Consequently, many individuals who structured their affairs as nonresidents are now exposed to severe tax consequences. One method used to adjust and restructure an individual’s holdings is to domesticate5 foreign held corporations. Domestication has widespread uses in international tax planning where the residence of the corporation is material.

To illustrate the advantages of domestication, assume that indi-

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1 An alien who is a resident of the United States is taxed substantially the same as a citizen. Treas. Reg. § 1.871-1(a) (1957), as amended by T.D. 7532 (1974) and T.D. 7670 (1980). Nonresident aliens are taxed only on income derived from sources within the United States, I.R.C. § 871(a)(1) (1985), or “effectively connected,” id. § 871(b), with the conduct of U.S. trade or business. Resident aliens are taxed on worldwide income, regardless of its source. Id. § 61.


3 Section 138(a) of the Deficit Reduction Act of 1984 (DEFRA) inserted new I.R.C. § 7701(b), and redesignated former §§ 7701(b), (c), and (d) as §§ 7701(c), (d), and (e), respectively. Pub. L. No. 98-369, § 138(a), 98 Stat. 494 (to be codified at 26 U.S.C. § 1). DEFRA was enacted July 18, 1984. Division A of that Act is known as the Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 1057; Division B, as the Spending Reduction Act. Pub. L. No. 98-369, 98 Stat. 1057. For legislative history, see 1984 U.S. CODE CONG. & AD. NEWS 697.

4 Section 7701(b) proposes two tests for determining residency: a green card and a substantial presence test. I.R.C. § 7701(b) (1985). See infra text accompanying notes 55-79.

5 Domestication refers to the inbound migration of a corporation’s charter from a foreign jurisdiction to the United States. See infra text accompanying note 99.
Individual A is a citizen of country P, which has neither an income nor an estate tax treaty with the United States. A derives 10x in salary income from X Corporation, in which he owns one hundred percent of the stock. X Corporation is organized under the laws of country P and engages solely in the business of manufacturing in country P. A periodically visits the United States for extended holidays on a B-2 (unlimited entry for pleasure or travel) nonimmigrant visa.

In 1980 A became interested in securities investment in the United States. Because A was not domiciled in the United States, he would be taxed under the estate tax system for nonresidents. A calculated that if he purchased the stock in a U.S. company as an individual, he would be subject to U.S. estate tax on the transfer of stock to his heirs. Alternatively, if A purchased the securities through X Corporation, a foreign entity, he could pass the shares of the U.S. corporation to his heirs without being subject to U.S. estate tax.

In 1981 A caused X Corporation to purchase the U.S. stock. Between 1980 and 1985, X Corporation suffered losses related to the manufacturing business in country P. In 1986 A became a U.S. resident for income tax purposes by virtue of being present in the United States for more than 183 days. Consequently, A's worldwide income was subject to U.S. taxation. Moreover, A could not offset his salary income from X Corporation and his income from the eurobonds with the losses suffered by X Corporation because his investment was in corporate form. Exacerbating this problem, A's interest in X Corporation became subject to the controlled foreign corporation and foreign personal holding company rules.

A domesticated X Corporation, then elected S Corporation status so the net tax losses would flow through to him. The domestication improved A's income tax position, but his U.S. taxable estate now included the shares of X. Because A is a nondomicil-
Iary, he cannot take advantage of the unlimited marital deduction and the full unified credits to reduce his estate. A attempts to resolve this by leveraging the U.S. stock and placing the proceeds in a foreign bank account.

II. Pre-1985 Planning for Nonresident Aliens

The objective residency standards of section 7701(b) are a significant departure from prior law. Internal Revenue Code section 871, concerning U.S. taxation of nonresidents, does not define the term "nonresident alien." Until the enactment of section 7701(b), residency was determined by the regulations enacted under section 871. These regulations focused on the nature and duration of an alien's stay in the United States, and his intentions regarding his stay and contemplated return. Treasury Regulation section 1.871-2(b) provided that residency depended on the subjective intent of the alien to become a resident of the United States. Absent a finding of such intent, the presumption was that the alien was a nonresident unless he remained in the United States longer than one year, or immigration laws limited his stay to a definite duration. This presumption was easily rebutted, however, by other facts and circumstances indicating intent. Factors determinative in establishing an alien's intent included time spent in the United States and abroad, the location of the alien's residence, and other factors

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18 Id. § 2056. The deduction is only allowed for citizens and residents. Treas. Reg. § 20.2056(a)-1(a) (1985).
19 I.R.C. § 2010 (1985). Nonresidents are limited to a unified credit of $3,600. Id. § 2102(c).
20 Deposits with foreign banks or foreign branches of domestic banks are not property within the United States. Id. § 2105(b)(2).
21 Prior to the introduction of § 7701(b) the determinants of residency remained almost unchanged since the promulgation of Treasury Regulation § 1.871-2(b) in 1921. Treas. Reg. § 1.871-2(b) (1957). For an explanation of the bright line standard, see H.R. REP. No. 432 (Part II), 98th Cong. 2d Sess. 1523, reprinted in 1984 U.S. CODE CONG. & AD. NEWS 1162, 1170.
24 Id.
25 Id. § 1.871-2. The absence of requirements led many aliens to believe that the Internal Revenue Service had the burden of locating them and proving they were residents. Because many aliens never filed a tax return, the IRS was not on notice that a return should have been filed. There was little exchange of information between the IRS and other government agencies, particularly the Immigration and Naturalization Service. Consequently, though it was difficult for the Service to establish the residency of the alien, it was even more difficult to locate the alien.
26 Id. § 1.871-4(b).
29 Id. § 1.871-4(c); Treas. Reg. § 1.871-2(b) (1985).

Subjective residency standards made tax planning difficult and uncertain.\footnote{The Tax Law Simplification and Improvements Act of 1983, S. 390, 98th Cong., 1st Sess. (1983), attempted to address the shortcomings of § 501. For an analysis of earlier versions of § 7701(b), see Alpert & Feingold, \textit{Proposal Before Congress To Define U.S. Resident Status}, 31 \textit{Canad. Tax J.} 855 (1983); Report, supra note 32.} Determination of residence is a fundamental issue in U.S. taxation.\footnote{Tillighast, \textit{A Matter of Definition: “Foreign” and “Domestic” Taxpayers}, 3 \textit{Int’l Tax & Bus. Law} 239 (1984). For surveys of income tax consequences of residency, see id. at 240; Report, supra note 32, at 176.} The U.S. income tax liability of nonresident aliens is determined from different sources of income,\footnote{Nonresident aliens, like foreign corporations, are subject to U.S. tax only on income derived from a source within the United States. I.R.C. § 172 (1985). Resident aliens are taxable on their worldwide income, regardless of its source, in the same manner as a U.S. citizen. Id. § 61. They may, however, claim a foreign tax credit for taxes paid. Id. § 27. See supra note 1.} and different types of income\footnote{Nonresident aliens are taxed only on income “effectively connected” with business in the United States, I.R.C. § 871 (1985), and on passive income sourced in the United States. They are not subject to U.S. income taxes on interest derived from certain bonds and from domestic banks and savings institutions if that income is not effectively connected with the nonresident alien’s U.S. trade or business. Id. § 861(a)(1)(A). A resident alien, on the other hand, is subject to tax on interest income derived from deposits in domestic banks and savings institutions and all other types of income, id. § 61(a)(4), except for interest from U.S. municipal bonds. Id. § 103.} at different rates.\footnote{Residents are taxed at graduated rates determined by id. § 1 and may reduce their tax liability by foreign tax credits. Id. § 901. A nonresident alien is taxed at rates of up to 50% on “effectively connected” income, id. § 871(b), and 30% or lower treaty rate on non-“effectively connected” passive income (e.g., interest, dividends, rents, etc.). Id. § 871(a). When the 30% rate applies, no deduction of foreign tax credits is allowed. Id. § 873. Capital gains for a nonresident are subject to tax only if they are “effectively connected” or if they result from the sale or disposition of a U.S. real property interest. Id. §§ 871(a)(2), 897. Generally, the rate at which resident aliens are taxed ranges from 11% to 50%. Id. § 1. Capital gains are taxed at rates up to 20% on both U.S. and foreign sources based on historic cost. Id. §§ 1201-1256.} This liability is subject to different recognition transactions\footnote{A nonresident’s transfer of appreciated property to a foreign corporation or foreign trust is not subject to excise tax, while similar transactions by a resident are subject to a 35% excise tax. Id. § 367.} and penalty tax\footnote{A nonresident alien is not subject to the controlled foreign corporation, id. §§ 951-964, or foreign personal holding company restrictions, id. §§ 551-558. These rules require a shareholder of a foreign corporation to include his income the undistributed earnings of the corporation. The controlled foreign corporation and foreign personal holding company rules may prevent a resident alien from shielding income from U.S. taxes} systems than that of...
U.S. citizens and resident aliens.41 The primary source of an individual's income is the best indicator of whether residency or nonresidency offers the most favorable tax treatment. Nonresidency usually is preferred if the individual has large income from foreign sources, as the tax liability of nonresidents is limited to income connected with the United States. U.S. citizens and residents, on the other hand, are taxed on their worldwide income, regardless of its source.42

At death, U.S. citizens and residents are taxed upon "all property... wherever situated,"43 while nonresidents are taxed only on the portion of their gross estates44 which at the time of death is situated in the United States.45 "Resident" in the context of estate and gift taxation has a different meaning than it does in the income taxation context. Section 7701(b) defines "resident" for the purpose of income tax only.46 Residency for U.S. estate and gift tax purposes is synonymous with domicile.47 Domicile is residence within the United States with intent to remain permanently.48 Domiciled aliens pay estate and gift taxes on different assets,49 at different rates,50 and are allowed different credits and deductions51 than nondomiciled aliens. Nondomiciled aliens are not taxed on assets outside the United States,52 and because the stock of a foreign corporation is considered property outside the United States,53 a nondomiciled alien can avoid U.S. estate taxes by holding U.S. property in a foreign corporation, even though that corporation makes no actual cash distributions to him. See infra note 88.


42 A resident alien working in the United States can split his income by filing a joint return with his spouse, claiming the standard deductions and exemptions, and using losses incurred abroad to offset U.S. income. I.R.C. § 6013 (1985).

43 Id. § 2031(a). The tax is imposed on all residents. Id. § 2001(a).

44 As determined by id. § 2103.

45 Id., as imposed by id. § 2101.

46 Id. § 7701(b).


49 See supra note 9.

50 Assets in the United States owned by nondomiciled aliens are taxed at graduated rates up to a maximum of 30% for estates over $2,000,000. I.R.C. § 2101(d) (1985).

51 There is no unlimited marital deduction for transfers to a spouse, as may be claimed by domiciled aliens. See supra note 18. Whereas domiciled aliens are allowed a unified credit of $192,800 after 1986, I.R.C. § 2010(a) (1985), nondomiciled aliens may only claim a credit of $3,600. Id. § 2102(c).

52 Id. § 2103.

53 Id. § 2105.
The provisions of the Tax Reform Act of 1984 change tax matters significantly. Section 7701(b) defines residency for income tax purposes. An alien who does not meet the requirements is a non-resident. For tax years beginning in 1985, an alien who either holds a green card or spends 183 or more days in the United States in any one calendar year will be considered a resident alien for U.S. income tax purposes.

The new law provides that any person who has entered the United States as a permanent resident for immigration purposes (Immigration Form I-551—a "green card") will automatically be
treated as a U.S. resident for income tax purposes regardless of the actual time spent in the United States during the calendar year. Therefore, any alien who has a green card, whether in the United States or abroad, will receive resident tax treatment. Residency status continues until revocation or administrative or judicial determination of abandonment.

An alien will also be considered a resident if he spends 183 or more days in the United States over a three-year period based upon a weighted average of days present in the United States. This second test, known as the substantial presence test, provides that an alien will satisfy U.S. residency requirements for income tax purposes if such individual: (1) was present in the United States at least thirty-one days during the calendar year in question; and (2) was present in the United States over a three-year period for 183 or more days, computed by adding:

(1) the number of days which the alien was present in the United States during the current year; plus,

(2) one-third the total number of days the alien was present in the United States in the first preceding year; plus,

(3) one-sixth the total number of days present in the United States during the second preceding year.

Certain days are not counted, such as days spent in transit between two foreign points and days in which the alien was unable to leave the United States as a result of a medical condition. The “transit between two points” exception, which appears in the Conference Report, only exempts time spent in the United States of less than twenty-four hours’ duration while the alien is in transit without a visa. Presence in the United States as a result of certain medical conditions, on the other hand, is expressly exempted by section 7701(b). An alien will not be considered present in the United States on any day such individual was unable to leave the country because of a medical condition arising while in the United States. Consequently, the exception does not apply if an alien enters the United States for medical treatment of an ailment which arose

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63 Id. § 7701(b)(5).
64 Id. § 7701(b)(3)(A).
65 Id. § 7701(b)(3).
66 Id. § 7701(b)(3)(A)(i).
68 Id. § 7701(b)(3)(D)(ii).
70 Id. § 7701(b)(3)(D)(ii).
outside U.S. borders.\textsuperscript{71}

The time spent in the United States by certain individuals is not included in the calculations for the substantial presence test. Days spent by persons who live in Canada or Mexico and regularly commute to work in the United States are not counted.\textsuperscript{72} Qualified students, teachers, trainees, or “foreign government-related individuals” also do not count days present in the United States during which they qualify as “exempt individuals.”\textsuperscript{73}

One significant exception to the substantial presence test is when an alien shows he has a “tax home” in a foreign country that he is “more closely connected” to than his home in the United States.\textsuperscript{74} Section 7701(b) refers to section 911(d)(3) for the definition of the term “tax home.”\textsuperscript{75} Generally, an individual’s tax home is located at his regular place of business.\textsuperscript{76} The legislative history gives no guidance as to the meaning of “closer connection.”\textsuperscript{77} The report accompanying the 1983 legislative recommendation by the Tax Section of the American Bar Association\textsuperscript{78} that initiated the enactment of section 7701(b) states that the closer connection test is deliberately vague to allow for a multitude of different fact situations.\textsuperscript{79} It suggested that all facts and circumstances be taken into account in applying the substantial presence test.\textsuperscript{80} It appears, however, that a balancing of various factors, similar to the approach taken in the for-

\textsuperscript{71}Committee Report, supra note 68, at 1527.
\textsuperscript{72}I.R.C. § 7701(b)(6)(C) (1985).
\textsuperscript{73}Id. § 7701(b)(4); Heizer & Braun, supra note 32, at 114.
\textsuperscript{74}I.R.C. § 7701(b)(3)(B) (1985); Heizer & Braun, supra note 32, at 114. A precondition to this exception is that the alien have been present in the United States for fewer than 183 days in the current year and have not taken affirmative steps to become a lawful permanent resident. I.R.C. § 7701(b)(3)(B)(i) (1985).
\textsuperscript{76}For criticism of the ambiguities of the phrase “tax home,” see Report, supra note 32, at 182.
\textsuperscript{77}Treas. Reg. § 1.911-2(b) (1985). If the individual has more than one place of business, the “tax home” is located at his principal place of business. Id. If the individual has no regular or principal place of business, the tax home is located at his regular place of abode. Id. The Committee Report unequivocally instructs that maintaining a U.S. abode does not automatically prevent an individual from establishing a tax home in a foreign country. Committee Report, supra note 68, at 1525.
\textsuperscript{78}The concept appears to be related to the term used in article 4(2)(a) of the Treasury Department Model Income Tax Treaty of May 17, 1977. 1 Tax Treaties (CCH) ¶ 153 (“center of vital interests”) borrowed from 1977 OECD Model Income Tax Convention, art. 4(2)(a). 1 Tax Treaties (CCH) ¶ 151. See Report, supra note 32, at 183.
\textsuperscript{79}ABA Sect. of Taxation, Comm. on U.S. Activities of Foreigners and Tax Treaties, Legislative Recommendation No. 1982-9, at 41 (1982) [hereinafter cited as ABA Recommendation].
\textsuperscript{80}2 R. Rhodees & M. Langer, Income Taxation of Foreign Related Transactions, 1A-30, -31 (1985); ABA Recommendation, supra note 78, at 49.
mer subjective test for residency, will be applied in establishing in which country the alien is more closely connected.\textsuperscript{81}

Many aliens unwittingly became income tax residents upon the enactment of section 7701(b), necessitating a restructuring of their financial affairs. Absent this financial reorganization, they become subject to penalty systems such as the controlled foreign corporation rules\textsuperscript{82} and the foreign personal holding company rules.\textsuperscript{83} For these aliens, and for all aliens contemplating residency, an important preliminary step in tax planning is both to assess the individual's home country tax obligations and consult any tax treaties which may bear on the individual.\textsuperscript{84} If residency is undesirable,\textsuperscript{85} a number of steps may be taken to avoid triggering section 7701(b).\textsuperscript{86} If, on the other hand, residency is desirable and voluntarily elected, the individual's personal investments should be structured to minimize adverse consequences and to take advantage of opportunities for tax savings.\textsuperscript{87} Pre-immigration planning is critical, because the combination of

\textsuperscript{81} I.R.C. §§ 951-964 (1985).
\textsuperscript{82} Id. §§ 551-558.
\textsuperscript{83} Home country obligations may be significantly lower than U.S. obligations; thus, it may be desirable to avoid residency. See infra text accompanying note 85. Certain treaties lower or reduce various U.S. obligations, affecting an individual's U.S. tax liability. See, e.g., art. 9, U.S. Treasury Dep't Model Income Tax Treaty of June 16, 1981, 1 Tax Treaties (CCH) § 158 (interest income). As the Committee Report indicates, § 7701(b) was not meant to affect tie breaker provisions of residency, and although the individual is within § 7701(b), article 4 of the treaty may characterize the individual as a resident of the foreign country. See, e.g., id. art. 4. For more information on the relationship of § 7701(b) to treaty definitions, see Heizer & Braun, supra note 32, at 118; Benson, U.S. Taxation of Foreign Nationals Under the 1984 Act: Analysis and Planning, 10 Int'l Tax J. 433, 441 (1984); Report, supra note 32, at 186.

\textsuperscript{84} The possibilities of expatriation to avoid U.S. taxes are circumscribed by I.R.C. § 877 (1985).

\textsuperscript{85} To avoid the application of the green card test, the alien should attempt to enter the country on a nonimmigrant visa. An individual holding a green card can only escape residency by having his status revoked or administratively or judicially determined to be abandoned. Id. § 7701(b)(5).

To avoid the substantial presence test, the alien should carefully schedule international travel and maintain a substantiated record of the days present in the United States. An alien's term of stay should be limited to 121 days a year. To avoid the test for the current year, terms of employment may be arranged so the individual does not enter the United States until after July 2.

An alien may also attempt to come within the closer connection exception to avoid residency. Id. § 7701(b)(3)(B). Aliens coming within this exception must observe a six-month limit on their stay in the United States, id., and not apply for status as a permanent resident. Id. § 7701(b)(3)(C). A relative may apply on behalf of the alien for lawful permanent resident status without running afoul of the prohibitions against seeking resident status. See Committee Report, supra note 68, at 1526. Filing a Biographic Information form (Immigration and Naturalization Form G-325A), however, constitutes an affirmative step toward residency even if filed by another. Id.

\textsuperscript{86} A number of actions may be taken to time income recognition, establish fiscal years, sell or purchase a U.S. residence, and conduct other transactions with income tax implications most advantageously. See Deloitte, Haskins & Sells, Taxation of Foreign Nationals by the United States 58 (1985); Benson, supra note 83, at 442.

\textsuperscript{87} See supra text accompanying note 54.
rigid tax rules coupled with the flexibility of choosing a residency status affords many aliens the opportunity for great tax savings.

The opportunities for restructuring finances are dramatically limited when the alien is involuntarily snared within the net of section 7701(b). The consequences are especially severe for an individual deemed a resident under section 7701(b) but not domiciled in the United States for estate tax purposes. This anomaly arises because the standards for residency for income tax purposes are more easily met than those for estate tax purposes.

Individuals in this position face difficult tax planning issues. Although it is beneficial for nondomiciled aliens to hold U.S. investments in foreign corporations, such corporate entities often are an unsuitable investment vehicle for income tax "residents" because of various anti-avoidance provisions. By using a foreign corporation to hold a U.S. interest, a U.S. income tax resident is precluded from offsetting expenses and other losses related to those investments against his personal income from other sources, even though he is taxed on that corporation's income. The controlled foreign corporation and foreign personal holding company penalty systems exacerbate these tax difficulties.

Furthermore, because the alien is not domiciled, he may not claim the unlimited marital deduction and the higher unified credit. The solution for many aliens is to become domiciled in the United States. Other aliens, however, because of their immigration status, may be incapable of legally forming the intent requisite for domicile. The holders of U.S. visas under some nonimmigrant categories are required by immigration laws to maintain a residence in a foreign country without intent to abandon it. Therefore, it will be difficult for holders of such visas to argue to the Immigration and Naturalization Service that they have no intent to remain in the United States, while making the opposite argument to the Internal Revenue Service.

88 Shares owned in a foreign corporation may subject the resident alien to U.S. income tax on his prorata share of the foreign corporation's undistributed earnings if the foreign corporation is either a foreign personal holding company, I.R.C. §§ 551-558 (1985), or a controlled foreign corporation, id. §§ 951-964.

89 A foreign corporation, like a domestic corporation, is recognized as a distinct entity.

90 See supra text accompanying note 82.

91 See supra note 51.

92 8 U.S.C. § 1101(a)(15)(B) (1982). "[A]n alien ... having residence in a foreign country which he has no intention of abandoning" and who enters the United States for business or pleasure is one such category. See also id. § 1101(a)(15)(C), (D), (F), (H).

Revenue Service.\textsuperscript{94}

\textit{Adams v. Commissioner}\textsuperscript{95} lends support to the claim that domicile has a different meaning for tax purposes than it has for immigration purposes. Moreover, in Revenue Ruling 80-209, an illegal alien was found to be domiciled in the United States.\textsuperscript{96} Therefore, a nondomiciliary whose stay in the United States is limited by his visa, may nevertheless argue that he intends to reside permanently in the United States albeit illegally under the immigration laws. Although this claim risks the alien’s deportation or expulsion,\textsuperscript{97} the issue of domicile might not arise until after the death of the taxpayer,\textsuperscript{98} when his deportation is of less concern.

Domestication of foreign corporations mitigates adverse tax consequences for those caught in the net of section 7701(b). Although domestication of a company solves some U.S. income tax problems, it has no effect on estate tax problems. If an individual is unable to become domiciled, pending a reconciliation in the estate and income definitions of residency, he must use every available technique to reduce his U.S. taxable estate. One possibility is leveraging the assets of the corporation and depositing the proceeds in a foreign bank account.\textsuperscript{99}

\section*{IV. Corporate Migrations}

Domestication is a form of corporate migration. A corporate migration involves the transfer of a corporation’s charter from one jurisdiction to another. For such transfer to be tax free, it is typically accomplished through a corporate reorganization\textsuperscript{100} or by operation of a domestication\textsuperscript{101} or continuance statute.\textsuperscript{102} Corporate migra-


\textsuperscript{95} See Rev. Rul. 80-209, 80-2 C.B. 248 (illegal alien had domicile in United States). An additional argument may be made under tax treaty “nondiscrimination” or “equal treatment” clauses. See Gordon & Leightman, supra note 32, at 6 n.14.


\textsuperscript{97} Domicile is determined at the date of death. Rev. Rul. 80-209, 80-2 C.B. 248, 249.


\textsuperscript{100} DEL. CODE ANN. tit. 8, § 388 (1985).


tions having U.S. tax implications arise in three situations: (1) a transaction occurring entirely abroad, as where a foreign corporation either becomes a different entity or transfers its charter to another jurisdiction within the same country or to a different country; 103 (2) an outbound migration, where a U.S. corporation migrates abroad; 104 and (3) an inbound migration, where a foreign corporation domesticates in the United States. 105 As with most transactions, the form employed to effect a migration dictates the tax consequences. 106

The tax aspects of migration through reorganization are fairly clearly defined and do not vary significantly from the same transaction in a purely domestic context. 107 The tax consequences of a statutory migration, on the other hand, are not well defined. 108 Early private letter rulings considered statutory migrations to be "F"-type reorganizations ("a mere transfer of place of organization"). 109 These rulings found continuances to be constructive transfers by the corporation of all assets to the continued corporation in constructive exchange for the stock of the continued corporation and the assumption of liabilities of the old corporation by the continued corpora-


106 Recognition of gain or loss, and carryover of tax attributes vary. I.R.C. § 367, Notice is required by § 367, and the limitations on net operating loss carryovers of § 381(a)(2) apply through § 382(b). For other considerations, see infra note 136.

107 One notable exception is the application of § 367 to the transactions.


tion. This constructive transfer of assets qualified as an "F" reorganization. Neither the corporation nor the shareholders recognized gain, and both took the same bases and holding periods in their stock and assets. For purposes of section 1248 earnings and profits and section 381 carryovers, the transaction was treated as if there had been no reorganization. The taxable year did not end on the date of migration. The notice requirements of the regulations under section 367 were held to apply. These results were the same whether the migration was purely foreign or inbound.

Theoretically, this approach had some shortcomings. Unlike an "F" reorganization, the old corporation does not cease to exist. Strictly speaking, the "place of organization" has not changed, merely the place that governs the internal affairs of the corporation.

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111 I.R.C. §§ 357(a), 361(a).

112 Id. § 354(a)(1).

113 Id. § 358.

114 Id. § 362(b). The holding period was tacked. Id. § 1223(1).

115 Id. § 1248(c).

116 Id. § 381(c); Treas. Reg. § 1.381(b)-1(a)(2) (1985).


118 Treas. Reg. §§ 7.367(b)-1(c), -1(d), -7(a), -12 (1985).


120 Compare P.L.R. 8103058, I.R.S. Letter Rul. Rep. (CCH) (Oct. 21, 1980) (purely foreign continuance treated as a constructive transfer of assets); with P.L.R. 7927063, I.R.S. Letter Rul. Rep. (CCH) (Apr. 6, 1979) (outbound migration). In GCM 38989, supra note 107, the reasoning of tax effects of purely foreign migrations was applied to inbound migrations. 19 Tax Notes at 888.

In P.L.R. 7927063 the outbound migration was viewed as a transfer by Corporation of all assets subject to liabilities to Continued Corporation in exchange for Continued Corporation stock and assumption of liabilities, followed by a distribution of Continued Corporation stock received by Corporation to the shareholders upon dissolution of Corporation. The transaction qualified as an "F" reorganization. No gain or loss was recognized by Corporation upon the transfer of assets to Continued Corporation in return for stock because I.R.C. §§ 361(a) and 357(a) applied. No gain or loss was recognized by Continued Corporation on the receipt of Corporation assets because I.R.C. § 1032(a) applied. The basis of Corporation assets held by Continued Corporation was equal to that of the assets in Corporation's hands under § 362(b). The holding period was tacked under § 1223(2). Sections 367(a) and (b) were found inapplicable. Continued Corporation was treated for purposes of § 381 as if there had been no reorganization. Thus, the tax year did not end upon migration. Treas. Reg. §§ 1.381(b)-2(b), -1(a)(2) (1985). Continued Corporation was eligible to file a consolidated return on the effective date of the continuance under § 1504(c). The shareholders recognized no gain or loss under § 354(a)(1), their basis carried over, § 358(a)(1), and the holding period was tacked, § 1223(1). P.L.R. 7927063, I.R.S. Letter Rul. Rep. (CCH) (Apr. 6, 1979).

Though the rulings constructed a fictitious transfer, there is no transfer of assets in exchange for stock in a statutory migration as with typical "F" reorganizations.\footnote{\[122\] Rev. Rul. 72-420, 1972-2 C.B. 473.}

Later private letter rulings no longer construed statutory migrations as fictitious transfers of assets, but began to view them as constructive exchanges of stock. This interpretation was supported by the reasoning of Revenue Ruling 72-420\footnote{\[123\] Id.} which involved the conversion of a Dutch corporation from a public to a private company\footnote{\[124\] Id. (citing Rev. Rul. 65-248, 1965-2 C.B. 92) (finding a stock interest).} without creating a new entity. Though no stock was actually exchanged, sections 368(a)(1)(F) and 1036 applied to the transactions because it was an exchange of a "stock interest."\footnote{\[125\] P.L.R. 8329023, I.R.S. LETTER RUL. REP. (CCH) (Apr. 15, 1983; I.R.C. § 368(a)(1)(F) (1985).}

The dual application of sections 368(a)(1)(F) and 1036 produces a hybrid analysis of the transaction. At the corporate level, the transaction, a mere change in identity, qualifies as an "F" reorganization.\footnote{\[126\] I.R.C. § 354(a)(1) (1985).} Section 361 protects the corporation from recognizing gain or loss on the transaction.\footnote{\[127\] Rev. Rul. 66-171, 1966-1 C.B. 181, found a mere change of identity to be a § 1036 transaction; thus, there was no gain even though the transaction was also described in § 368(a)(1)(F) because § 1036 is not listed in § 367. \textit{See also} Treas. Reg. § 7.367(b)-1(c) (1985). Persons required to file information returns by § 6012 need not give notice if § 1036 also applies to the transaction. \textit{Id.} § 7.367(b)-4(c); Rev. Rul. 79-150, 1979-1 C.B. 149.} Section 367 does not apply because the transaction can qualify solely under section 1036.\footnote{\[128\] I.R.C. § 1036 (1985).} Section 1036 precludes the shareholders from recognizing gain or loss.\footnote{\[129\] \textit{Id.} § 1036(a).} Their basis in the new stock constructively received is the same as the old stock deemed constructively surrendered,\footnote{\[130\] ISO Provided it was held as a capital asset on the date of exchange. \textit{Id.} § 1223(l).} and the holding period is tacked.\footnote{\[131\] \textit{Id.} § 1248. \textit{See also} Treas. Reg. § 8.8225088, I.R.S. LETTER RUL. REP. (CCH) (Mar. 24, 1982); P.L.R. 8108072, I.R.S. LETTER RUL. REP. (CCH) (Nov. 26, 1980).} Section 1248 earnings and profits attributable to the old shares are assigned to the new shares.\footnote{\[132\] Del. Code Ann. tit. 8, § 388(d) (1985).}

Finding a constructive transfer of stock is equally inaccurate. Treasury Regulation section 1.1001-1(a) provides that income or loss is sustained in the amounts of gain or loss realized from the conversion of property into cash or from the exchange of property for other property differing materially either in kind or extent.\footnote{\[133\] Del. Code Ann. tit. 8, § 388(d) (1985).} No such conversion of property occurs in a statutory migration. The Delaware domestication statute provides that on the filing of certifi-
icates of domestication and of incorporation, the corporation becomes domesticated in Delaware and, as of that date, subject to Delaware law. The corporate existence, however, is deemed to have commenced on the date the corporation was first formed.\footnote{134}{Id. \$ 388(e).} The domestication does not affect any prior obligations or liabilities of the corporation\footnote{135}{Id. \$ 388(f).} or the applicable choice of law.\footnote{136}{The requirement of a \$ 367 ruling is eliminated because a statutory migration is a pure \$ 1036 transaction. \textit{See} Rev. Rul. 66-171, 1966-1 C.B. 181. Dock stamps are often conditioned on a transfer. Mortgages that become due on sale potentially might not be due in a statutory migration as contrasted with a reorganization).}

Because the concept of exchange is fundamental to many taxation and certification requirements of the Internal Revenue Code and state tax codes, the possibility that no exchange would result from a statutory migration is provocative.\footnote{137}{Rev. Rule. 79-250, 1979-2 C.B. 156, held that a change of place of incorporation has separate economic significance; thus, it is not integrated by the "step transaction" doctrine. A survey of the Private Letter Rulings on migrations, \textit{see}, \textit{e.g.}, supra notes 102, 103, 104, indicate that the Service has accepted migrations as tax free transactions when as a result of the migration: there was no surrender or change of charter; a new corporate entity was not created; the stock before the migration is identical (except for name change) to the previous stock; the fair market value of the stock constructively surrendered was the same as that constructively received; there was no change in the business location or properties; no change in business activities; the corporation possessed the same assets and liabilities except for the assets used to pay the expenses of the migration (must be less than one percent of all assets); the migrating corporation's liabilities were in the ordinary course of business and associated with the assets transformed; the shareholders have no plans to dispose or sell the stock other than by a disclosed subsequent amalgamation; no amount was attributable under Treas. Reg. \$ 7.367(b)-5 through -12 to the stock of the migrating corporation as a corporation governed under the laws of the new country; and no parties to the transaction were or are investment companies under \$ 368(a)(2)(F)(iii) and (iv), or foreign investment companies under \$ 1246(b). The motives the Service has accepted are: not having as one of the principal purposes the avoidance of U.S. taxes within the meaning of \$ 367; to consolidate all operations in one jurisdiction; to take advantage of flexible procedures for the operation of corporate matters in the new jurisdiction; to avail the corporation of foreign tax benefits; to comply with foreign amalgamation or banking law; to eliminate double recordkeeping required by operating in two jurisdictions; to achieve operating efficiencies as a result of consolidated management; to reduce general and administrative expenses; to achieve economies of scale; to obtain access to U.S. capital markets; and to avoid confusion of consumers.\textit{Conceivably, almost any abusive scheme devised prior to \$ 367 can be accomplished through a statutory migration.}

Section 367 was enacted to prevent abuses in international transfers of property.\footnote{138}{Section 367 was enacted to prevent abuses in international transfers of property.\textit{Conceivably, almost any abusive scheme devised prior to \$ 367 can be accomplished through a statutory migration.}}}
migrations have very favorable uses even if they constitute constructive exchanges of stock.

V. Conclusion

Statutory migrations, which await further refinements from the Internal Revenue Service, may be effectively used to ameliorate difficulties created by the residence of a corporation. Practitioners employing statutory migrations must carefully assess a migration's desirability and the certainty with which it will accomplish the desired results. Both assessments require consideration of the tax laws of at least two countries and any applicable treaties, as well as a survey of alternative approaches to achieving a client's goal.

—Charles TheLEN PlAMBECK