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US International Tax Alert

Notice 2024-16 addresses treatment of section 961(c) basis adjustments

On December 28, 2023, the Treasury Department and the Internal Revenue Service (IRS) released Notice 2024-16, which announced their intention to issue proposed regulations that address the treatment of basis adjustments made pursuant to section 961(c) in certain transactions in which a domestic corporation acquires the stock of a CFC ("acquired CFC") from another CFC ("transferor CFC") in a liquidation to which section 332 applies, or in an asset reorganization described in section 368(a)(1).

Treatment of section 961(c) basis as adjusted basis

Section 3 of Notice 2024-16 provides that the adjusted basis of CFC stock determined under section 334(b) or 362(b) in the hands of a domestic acquiring corporation that acquires the CFC stock in certain inbound transactions ("covered inbound transactions") should be determined as if the transferor CFC's section 961(c) basis adjustments were adjusted basis if the domestic acquiring corporation either (i) included in gross income the amounts that gave rise to the section 961(c) basis adjustments, or (ii) succeeded to the section 961(c) basis adjustments under the section 961(c) successor rules.

Covered inbound transactions include transactions where a domestic acquiring corporation acquires all the stock of the acquired CFC from a transferor CFC if immediately before the covered inbound transaction (and any related transactions) the domestic acquiring corporation owns directly or indirectly (within the meaning of section 958(a)(2)) all the stock of the acquired CFC. Covered inbound transactions include two categories of transactions. The first category includes (i) a liquidation described in section 332, (ii) a reorganization described in section 368(a)(1)(A) (that is not a triangular reorganization described in section 368(a)(2)(D) or 368(a)(2)(E), referred to as a "nontriangular A reorganization")), or (iii) a reorganization described in section 368(a)(1)(C) that is not a triangular reorganization (referred to as a "nontriangular C reorganization"). For the transaction to be a covered inbound transaction all the stock of the transferor CFC (*i.e.*, the CFC that transfers the acquired CFC) is owned directly by the domestic acquiring corporation immediately before the transaction.

The second category of transactions is asset reorganizations that are nontriangular A reorganizations, nontriangular C reorganizations, reorganizations described in section 368(a)(1)(D), or reorganizations described in section 368(a)(1)(F) where all the stock of the transferor CFC is owned directly by a single domestic corporation (or members of a consolidated group)

immediately before the transaction, and that domestic corporation (or members of the consolidated group) directly owns the stock of the domestic acquiring corporation immediately after the transaction and all related transactions.

De minimis exceptions

As described above, for each category of transaction to be a covered inbound transaction, either (i) the domestic acquiring corporation must directly own all the stock of the transferor CFC immediately before the transaction (referred to as "domestic corporation described in section 3.02(1)"), or (ii) a domestic corporation and members of its consolidated group must directly own all the stock of the transferor CFC immediately before the transaction and such domestic corporation and its consolidated members must directly own all the stock of the domestic acquiring corporation immediately after the transaction and any related transactions (referred to as "domestic corporation described in section 3.02(2)"). However, Notice 2024-16 provides a *de minimis* rule with respect to the ownership of the CFC transferor. Under this *de minimis* rule, the transaction is a covered inbound transaction provided one or more persons other than the domestic corporations described above own (in the aggregate) 1% or less of the total fair market value of the transferor CFC stock.

Also as described above, all the stock of the acquired CFC must be owned (directly or indirectly) by the transferor CFC immediately before the transaction and any related transactions. There is also a *de minimis* rule with respect to this requirement. Under this *de minimis* rule, 1% or less of the fair market value of stock of the acquired CFC not owned by the transferor CFC is disregarded, provided that the other person or persons continue to own stock of the acquired CFC after the transaction and all related transactions, if that person or persons is/are not related (within the meaning of section 267(b) or 707(b)(1)) to the domestic corporations described in section 3.02(1) or 3.02(2).

Scope limitations on covered inbound transactions

Generally, a reorganization that involves boot (money or other property) described in section 356(a) does not constitute a covered inbound transaction. However, a reorganization involving boot will be a covered inbound transaction provided the boot represents 1% or less of the total fair market value of the transferor CFC stock.

Certain transactions that would otherwise constitute an inbound covered transaction will not qualify as such in certain situations. In particular, a transaction that would otherwise constitute a covered inbound transaction fails to qualify if immediately before the transaction, the total amount of transferor CFC's basis in the acquired CFC stock (*i.e.*, the aggregate basis, including any section 961(c) basis adjustments) exceeds the total fair market value of the CFC stock (*i.e.*, there is a built-in loss in the acquired CFC stock, inclusive of section 961(c) basis adjustments).

Further, a transaction is not a covered inbound transaction if the stock of the acquired CFC is subsequently transferred pursuant to section 368(a)(2)(C) or Treas. Reg. § 1.368-2(k). However, notwithstanding such a transfer, the transaction does constitute a covered inbound transaction provided the

transferee is (i) a member of the same consolidated group that includes the domestic acquiring corporation and is wholly owned by such domestic corporations, or (ii) is the common parent of such consolidated group.

A transaction also is not a covered inbound transaction if the acquired CFC stock is subsequently transferred, as part of a plan or series of related transaction that includes the inbound transaction, to a partnership or a foreign corporation. A plan to transfer the acquired CFC is deemed to exist if the acquired CFC is transferred to the partnership or foreign corporation within a two-year period beginning on the date the original inbound transaction is completed.

Finally, a transaction is not a covered inbound transaction if the domestic acquiring corporation is either a RIC (regulated investment company as defined in section 851), a REIT (real estate investment trust as defined in section 856), or an S corporation as described in section 1361.

Note that the above limitations apply separately to each acquired CFC to the extent multiple acquired CFCs are transferred by a single transferor CFC.

Reliance on Notice 2024-16

A taxpayer may rely on Notice 2024-16 for *transactions completed on or before the date the proposed regulations are published in the Federal Register*, provided the taxpayer and all related persons (within the meaning of section 267(b) and 707(b)(1)) apply the rules in Notice 2024-16 in their entirety and consistently.

The Notice provides that no inference should be drawn with regard to section 961(c) basis for transactions other than covered inbound transactions. The Treasury Department and the IRS are considering whether to issue additional guidance with respect to section 961(c) basis outside of covered inbound transactions.

For taxpayers that have not maintained section 961(c) basis in the US dollar, the Notice must be applied only after translating section 961(c) basis to US dollars using a reasonable method that is to be applied consistently to all acquired CFCs in covered inbound transactions undertaken by one or more domestic acquiring corporations. For this purpose, a reasonable method includes an exchange rate that reflects the original US dollar inclusions of the US shareholder that resulted in the section 961(c) basis adjustments, reduced for any distributed PTEP.

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