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Final regulations: Goodwill, going-concern value transferred to foreign corporations

The U.S. Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9803) addressing the tax treatment of transfers by U.S. persons of property—including goodwill and going-concern value—to foreign corporations in nonrecognition transactions pursuant to section 367.

Overview

The [**final regulations**](#) [PDF 300 KB] finalize regulations that were proposed in September 2015 and withdraw temporary regulations that date from 1986. The preamble to today's release states that while "minor wording changes" have been made to certain portions of the 1986 temporary regulations, "...the final regulations are not intended to be interpreted as making substantive changes to those regulations."

The final regulations adopt with minor changes the proposed regulations (September 2015) despite significant criticisms having been levelled against the proposed regulations in public comments. The preamble to the final regulations consists primarily of the government's response to those comments in an attempt to justify the retention of the rules from the proposed regulations.

With today's release, certain sections of existing regulations under section 367(a) are combined into a single section. Read a [**document**](#) [PDF 889 KB] that compares the final to proposed regulations (this is not an official comparison).

Background

The 2015 proposed regulations concerned "United States persons" that transfer certain property—including foreign goodwill and going-concern value—to foreign corporations in nonrecognition transactions described in section 367. As a justification for the revised approach to foreign goodwill and going-concern value, the preamble to

the proposed regulations alluded to Treasury and IRS concerns that some taxpayers may be undervaluing section 936(h)(3)(B) intangibles and concomitantly overvaluing the amount treated as nontaxable foreign goodwill.

Broadly speaking, the proposed regulations excluded intangible property from the exception for gain recognition under section 367(a)(3) otherwise available to property in an active trade or business outside the United States. Under the proposed regulations—at the taxpayer’s election—transfers of intangible property (with certain exceptions but including goodwill and going-concern value) would be taxed under the section 367(d) deemed royalty regime rather than, as currently, under section 367(a), even if the taxpayer takes the position that the property is not section 936(h)(3)(B) property.

The proposed regulations also eliminated the deemed 20-year maximum useful life of property for purposes of inclusions under section 367(d) would be eliminated, and instead the useful life would be the entire period during which the exploitation of the intangible property is anticipated to occur, as of the time of the transfer.

Final regulations

The final regulations describe in detail the legislative history and the treatment by taxpayers of goodwill and going-concern value under the rules of section 367. In sum, the final regulations, consistent with the proposed regulations, eliminate the favorable treatment of foreign goodwill and going-concern value from the 1986 temporary regulations. The preamble consists primarily of Treasury and IRS’s observations on policy issues involved and their views that such considerations justifies the elimination the favorable treatment.

Specifically, the final regulations do not provide a special exemption to continue the favorable treatment of foreign goodwill and going-concern value, and do not expand the types of assets that are eligible for the active trade or business exception pursuant to section 367. Not only do the final regulations retain the general approach of the proposed regulations, but they also reject a number of exceptions to the new rule suggested by commenters. Among such suggestions were an exception for or based on: (1) incorporations as a result of foreign legal or regulatory compulsion or pressure; (2) professional service businesses; (3) foreign goodwill and going-concern value that is not associated with any highly valuable section 936 intangibles; (4) allowing the tax-free transfer of intangibles up to a value derived from a formula based on expenses; or (5) information reported to a foreign country’s tax authority. According to the preamble, none of the approaches for more directly valuing foreign goodwill and going-concern value offered a “principled and administrable basis” for allocating value or otherwise distinguishing between transactions that pose a “potential of tax avoidance” and those that do not.

With respect to the 20-year limitation on useful life, the final regulations provide that taxpayers may—in the year of transfer—elect to take into account section 367(d) inclusions only during the 20-year period beginning with the first year in which the U.S. transferor takes into account income under section 367(d). This optional limitation,

however, is not to affect the present value of all amounts included by the taxpayer under section 367(d). The final regulations also revise the definition of the term “useful life” to provide that this includes the entire period during which exploitation of the transferred intangible property is reasonably anticipated to affect the determination of taxable income, including use in the development of other intangible property and any exploitation of that other developed intangible property.

Effective date

The final regulations retain the effective date that the rules apply to transfers occurring on or after September 14, 2015 (related to the release of the proposed regulations).

Accordingly, the final regulations generally apply to transfers occurring on or after September 14, 2015, and to transfers occurring before September 14, 2015, resulting from entity classification elections that were filed on or after September 14, 2015.

Future guidance

The preamble explains that Treasury and the IRS acknowledge that additional guidance under section 367(a) and (d) would be beneficial, but that certain items are beyond the scope of today's release—for example, regarding the application of the subsequent transfer rules to transactions involving hybrid partnerships. While today's release finalizes the subsequent transfer rules, Treasury and the IRS expect those rules will be amended “after a more detailed consideration of transactions involving partnerships.”

For more information, contact a tax professional with KPMG's Washington National Tax:

Ron Dabrowski | +1 (202) 533 4274 | rdabrowski@kpmg.com

Devon Bodoh | +1 (202) 533 5681 | dbodoh@kpmg.com

Pat Jackman | +1 (203) 406 8109 | pjackman@kpmg.com

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