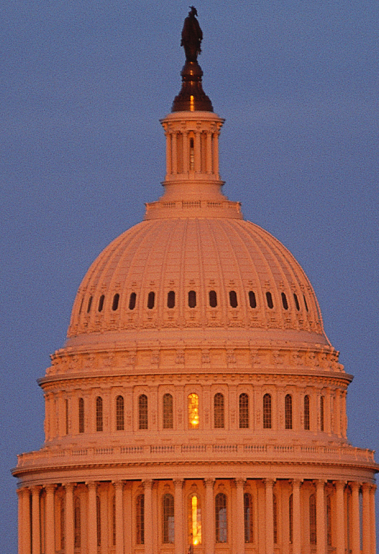




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U.S. Tax Court: Constructive transfer of intangible property in reorganization

The U.S. Tax Court today granted the government's motion for summary judgment in a case concerning whether the taxpayer was required to recognize ordinary income under section 367(d)(2)(A)(ii)(II) as a result of a constructive transfer of intangible property to a Swiss corporation, and, if so, whether, in determining the amount of that income, the property is to be treated, as a matter of law, as having a useful life limited to 20 years.

The case is: *TBL Licensing LLC v. Commissioner*, 158 T.C. No. 1 (January 31, 2022). Read the Tax Court's [opinion](#) [PDF 445 KB] (92 pages) (as corrected on February 8, 2022, correcting a citation to regulations on page 57 of the opinion)

Summary

The IRS determined a tax deficiency of approximately \$507 million in the income tax of an affiliated group of corporations of which the taxpayer had been the common parent for the group's tax year ended September 23, 2011.

The Tax Court briefly summarized the facts in this case, as follows:

- F1 (a foreign corporation) transferred to F2 (its foreign subsidiary) its sole member interest in a "disregarded entity" (DE).
- DE owned the taxpayer (a domestic limited liability that was treated as a corporation for federal tax purposes).
- The taxpayer owned intangible property (trademarks, foreign workforce, and foreign customer relationships) within the meaning of section 936(h)(3)(B).
- The taxpayer elected to be disregarded as a separate entity for federal tax purposes.
- The taxpayer and the IRS agreed that that F1's transfer of DE to F2 and the taxpayer's election to be disregarded constituted a "reorganization" within the meaning of section 368(a)(1)(F) and that,

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as part of that “F reorganization,” the taxpayer constructively transferred the intangible property to F2.

- For the tax years 2011 through 2017, a domestic corporation (US1) that was an indirect parent of F1 and F2, included in its income deemed annual payments under section 367(d)(2)(A)(ii)(I) attributable to the constructive transfer of the intangible property.

The Tax Court briefly summarized its holdings as follows:

- In order for the nonrecognition rules of sections 354, 356, and 361 to apply to this F reorganization, the transaction—however actually effected—is to be treated as involving: (1) a transfer of the old corporation’s assets to the new corporation, in exchange for stock of the new corporation and the new corporation’s assumption of any liabilities of the old corporation; and (2) the old corporation’s distribution to its shareholders of the stock of the new corporation in cancellation of their stock in the old corporation.
- Accordingly, the constructive distribution by the taxpayer to F1 of F2 stock that occurred as part of the reorganization by which F2 acquired the taxpayer was a “disposition” within the meaning of section 367(d)(2)(A)(ii)(II).
- The taxpayer’s constructive distribution of F2 stock to F1 necessarily followed the constructive transfer of intangible property by the taxpayer to F2 that occurred as part of the reorganization. As a consequence (and absent a provision in the regulations to the contrary), the taxpayer was required to recognize gain in the intangible property under section 367(d)(2)(A)(ii)(II).
- There is no provision in the regulations allowing the reporting of deemed annual payments under section 367(d)(2)(A)(ii)(I) rather than immediate gain recognition under section 367(d)(2)(A)(ii)(II) by reason of the taxpayer’s constructive transfer of intangible property. Because the taxpayer was no longer recognized as a separate entity for federal tax purposes after the reorganization, it could not report the deemed annual payments described in section 367(d)(2)(A)(ii)(I), and US1 was neither the U.S. transferor of the intangible property nor the recipient of the F2 stock.
- Finally, the fair market value of transferred intangible property, for the purpose of determining gain that must be recognized under section 367(d)(2)(A)(ii)(II), is to be determined on the basis of the property’s entire expected useful life, without regard to the 20-year limit imposed under Reg. section 1.367(d)-1T(c)(3).

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