

Final regulations exclude corporate U.S. shareholders from application of Section 956

The IRS recently issued final regulations that reduce the amount determined under Internal Revenue Code Section 956 for certain domestic corporations that own (or are treated as owning) stock in foreign corporations. Under the regulations, neither an actual dividend to a corporate U.S. shareholder, nor such a shareholder's amount determined under Sec. 956, will result in additional U.S. tax. Let's look at a couple of important areas of change.

Allocation of hypothetical distribution

Under Sec. 957, a controlled foreign corporation (CFC) is one under which more than 50% of the total combined voting power of all classes of stock entitled to vote or of the total value of the stock of the corporation is owned (directly, indirectly, or constructively) by U.S. shareholders. A U.S. shareholder for CFC purposes is a U.S. person who owns 10% or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation, or 10% or more of the total value of shares of all classes of stock of such foreign corporation.

The final regulations add a rule regarding CFCs that have prior-year earnings and profits (E&P) and current-year E&P, both as described under regulations, that don't result in an inclusion under Sec. 951 or Code Sec. 951A. Although a dividend of the current-year E&P would potentially be eligible for a deduction, a distribution by the CFC wouldn't qualify for a deduction because the distribution would be allocated to the prior-year E&P. Therefore, any tentative applicable amount for the year might not have been reduced by the proposed rule.

To address this issue, the final regulations include an ordering rule treating a hypothetical distribution as attributable first to E&P described in Sec. 959(c)(2) and then to E&P described in Sec. 959(c)(3), consistent with the allocation of an amount determined under Sec. 956 pursuant to Code Sec. 959(f)(1). This rule differs from the general rule for allocation of distributions in Code Sec. 959(c) by not treating any amount as attributable to E&P described in Code Sec. 959(c)(1). It's necessary to reflect the fact that the amount to which the hypothetical distribution applies is, in fact, a tentative applicable amount.

Domestic partnerships and their partners

The final regulations provide that the tentative applicable amount with respect to a domestic partnership is reduced to the extent that one or more domestic corporate partners would be entitled to a deduction if:

- The partnership received such amount as a distribution, and
- Any remaining amount of the domestic partnership's inclusion under the regulations is allocated to the partners in the same proportion as net income would result to the partners upon a hypothetical distribution (that is, a distribution from the CFC to the domestic partnership).

The rules concerning domestic partnerships are illustrated in a new example provided in the final regulations.

Applicability dates

The final regulations apply to tax years of a CFC beginning on or after May 23, 2019, and to tax years of a U.S. shareholder in which or with which such tax years of the CFC end. However, consistent with the reliance allowed for the proposed regulations, taxpayers may apply the final regulations for tax years of a

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CFC beginning after December 31, 2017, and for tax years of a U.S. shareholder in which or with which such tax years of the CFC end — provided that the taxpayer and U.S. persons that are related (under regulations) to the taxpayer consistently apply the regulations with respect to all CFCs in which they're U.S. shareholders for tax years of the CFCs beginning after December 31, 2017.

Tax impact

These final regulations have an important tax impact on U.S. shareholders of CFCs. If they affect your situation, discuss them with your CPA. •