DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9859]

RIN 1545–BO88

Amount Determined Under Section 956 for Corporate United States Shareholders

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that reduce the amount determined under section 956 of the Internal Revenue Code with respect to certain domestic corporations. This document finalizes the proposed regulations published on November 5, 2018. The final regulations affect certain domestic corporations that own (or are treated as owning) stock in foreign corporations.

DATES:
Effective Date: These regulations are effective on July 22, 2019.

Applicability Date: For the date of applicability, see § 1.956–1(g)(4).

FOR FURTHER INFORMATION CONTACT: Rose E. Jenkins, (202) 317–6934.

SUPPLEMENTARY INFORMATION:

Background

On November 5, 2018, the Department of the Treasury (“Treasury Department”) and the IRS published proposed regulations (REG–114540–18) under section 956 in the Federal Register (83 FR 55324) (the “proposed regulations”). No public hearing was requested or held, and no substantive comments were received with respect to the proposed regulations. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request. This Treasury decision adopts the proposed regulations, with the changes described in the Summary of Comments and Explanation of Revisions section of this preamble, as final regulations.

Summary of Comments and Explanation of Revisions

The final regulations, like the proposed regulations, exclude corporations that are United States shareholders (as defined in section 951(b)) (“U.S. shareholders”) from the application of section 956 to maintain symmetry between the taxation of actual repatriations and the taxation of effective repatriations. To achieve this result, the final regulations provide that the amount otherwise determined under section 956 (the “tentative section 956 amount”) with respect to a U.S. shareholder for a taxable year of a controlled foreign corporation (as defined in section 957) (“CFC”) is reduced to the extent that the U.S. shareholder would be allowed a deduction under section 245A if the U.S. shareholder had received a distribution from the CFC in an amount equal to the tentative section 956 amount (the “hypothetical distribution”).

In general, under section 245A and the final regulations, respectively, neither an actual dividend to a corporate U.S. shareholder, nor such a shareholder’s tentative section 956 amount, will result in additional U.S. tax.

I. Allocation of Hypothetical Distribution

While not raised in any written comments, published commentary on the proposed regulations raised concerns regarding how the proposed rules apply in the case of a CFC that has prior year earnings and profits (“E&P”) described in section 959(c)(1) and current-year E&P described in section 959(c)(3) that do not result in an inclusion under section 951 or section 951A. Even though a dividend of the current-year E&P would potentially be eligible for a deduction under section 245A, a distribution by the CFC would not qualify for a section 245A deduction, because under section 959(c), the distribution would be allocated to the prior-year E&P described in section 959(c)(1) first. Therefore, any tentative section 956 amount for the year might not be 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 section 959(c)(2), then to E&P described in section 959(c)(3), consistent with the allocation of an amount determined under section 956 pursuant to section 959(f)(1). This rule, which differs from the general rule for allocation of distributions in section 959(c) by not treating any amount as attributable to E&P described in section 959(c)(1), is necessary to reflect the fact that the amount to which the hypothetical distribution applies is in fact a tentative section 956 amount. This rule is illustrated in a new example in § 1.956–1(a)(3)(iv).

II. Domestic Partnerships and Their Partners

Section 245A(g) grants the Secretary authority to prescribe regulations for the treatment of U.S. shareholders owning stock of specified 10-percent owned foreign corporations through a partnership. As noted in the Comments and Request for Public Hearing section of the preamble to the proposed regulations, the Treasury Department and the IRS have studied the appropriate application of the regulations to U.S. shareholders that are domestic partnerships, which may have partners that are a combination of domestic corporations, U.S. individuals, or other persons. As noted in the Background section of this preamble, no substantive comments were received with respect to the proposed regulations, including with respect to the two methods of applying the rules in the case of domestic partnerships that were described in the preamble to the proposed regulations. Accordingly, consistent with the first method described in that preamble, the final regulations provide that the tentative section 956 amount with respect to a domestic partnership is reduced to the extent that one or more domestic corporate partners would be entitled to a section 245A deduction if the partnership received such amount as a distribution, and any remaining amount of the domestic partnership’s inclusion under sections 951(a)(1)(B) and 956 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). See § 1.956–1(a)(2)(i) and (iii). The rules concerning domestic partnerships are illustrated in a new example in § 1.956–1(a)(3)(iv).

III. Revisions to Existing Examples

The final regulations also update certain examples in the regulations under section 956 to reflect that section 956 may no longer apply in the case of corporate U.S. shareholders. See § 1.956–1(b)(4) (amended facts common to several examples, to refer to a United States citizen, rather than domestic corporation).

IV. Applicability Date

The final regulations apply to taxable years of a CFC beginning on or after July 22, 2019, and to taxable years of a U.S. shareholder in which or with which such taxable years of the CFC end. However, consistent with the reliance
allowed for the proposed regulations, taxpayers may apply the final regulations for taxable years of a CFC beginning after December 31, 2017, and for taxable years of a U.S. shareholder in which or with which such taxable years of the CFC end, provided that the taxpayer and United States persons that are related (within the meaning of section 267 or 707) to the taxpayer consistently apply the regulations with respect to all CFCs in which they are U.S. shareholders for taxable years of the CFCs beginning after December 31, 2017. See section 7805(b)(7).

Special Analyses

OIRA has determined that this final rule is a significant regulatory action pursuant to section 3(f) of Executive Order (E.O.) 12866 and the April 11, 2018, Memorandum of Agreement between the Department of Treasury and the Office of Management and Budget (OMB). However, OIRA has waived review of this final rule in accordance with section 6(a)(3)(A) of E.O. 12866.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities, although some small entities that are not domestic corporations could be affected by the regulations. However, even if a substantial number of small entities were to be affected by this regulation, the Treasury Department and the IRS estimate that the economic impact on such small entities would not be as significant as the regulation is expected to marginally reduce compliance costs for smaller entities. This is because the Treasury Department and the IRS believe that the cost-saving benefits of the regulations with respect to complex third-party borrowing arrangements, internal financial management structures, and restructurings of worldwide operations will generally be available only to large U.S. multinational corporations with 20 or more CFCs. The Treasury Department and the IRS believe that U.S. multinational corporations with fewer than 20 CFCs generally will not have the types of arrangements in place that would otherwise need to be structured and monitored to avoid section 956. The regulations generally will not affect small entities that are not domestic corporations.

Pursuant to section 7805(f), the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. No comments were received.

There are no information collection requirements associated with these final regulations.

The Administrator of OIRA has determined that this is a major rule for purposes of the Congressional Review Act (CRA) (5 U.S.C. 801 et seq.). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the Federal Register.

Drafting Information

The principal author of the final regulations is Rose E. Jenkins of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ PARAGRAPH 1. The authority citation for part 1 is amended by revising the entry for §1.956–1 to read in part as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.956–1 also issued under 26 U.S.C. 245A(g), 956(d), and 956(e).

■ PAR. 2. Section 1.956–1 is amended by:

1. Revising paragraph (a).

2. In the paragraph (b)(4) introductory text, removing the language “following examples” and adding in its place “examples in this paragraph (b)(4)” and removing the language “domestic corporation” and adding in its place “United States citizen.”

3. In paragraph (b)(4), designating Examples 1 through 8 as paragraphs (b)(4)(i) through (viii), respectively.

4. In newly designated paragraphs (b)(4)(i) through (viii), redesignating the paragraphs in the first column as the paragraphs in the second column:

<table>
<thead>
<tr>
<th>Old paragraphs</th>
<th>New paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b)(4)(i) and (ii)</td>
<td>(b)(4)(i)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(ii)(i) and (ii)</td>
<td>(b)(4)(ii)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(iii)(i) and (ii)</td>
<td>(b)(4)(iii)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(iv)(i) and (ii)</td>
<td>(b)(4)(iv)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(v)(i) and (ii)</td>
<td>(b)(4)(v)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(vi)(i) and (ii)</td>
<td>(b)(4)(vi)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(vii)(i) and (ii)</td>
<td>(b)(4)(vii)(A) and (B)</td>
</tr>
<tr>
<td>(b)(4)(viii)(i) and (ii)</td>
<td>(b)(4)(viii)(A) and (B)</td>
</tr>
</tbody>
</table>

■ 6. Revising the heading for paragraph (g).

7. In the first sentence of paragraph (g)(1), removing the language “Paragraph (a)” and adding in its place “Paragraph (a)(1)”.

8. Adding paragraphs (g)(4) and (5).

9. Removing the parenthetical authority citation at the end of the section.

The revisions and additions read as follows:

§1.956–1 Shareholder’s pro rata share of the average of the amounts of United States property held by a controlled foreign corporation.

(a) Overview and scope—(1) In general. Subject to the provisions of section 951(a) and the regulations in this part, a United States shareholder of a controlled foreign corporation is required to include in gross income the amount determined under section 956 with respect to the shareholder for the taxable year but only to the extent not excluded from gross income under section 956(a)(2) and the regulations in this part.

(2) Reduction for certain United States shareholders—(i) In general. For a taxable year of a controlled foreign corporation, the amount determined under section 956 with respect to each share of stock of the controlled foreign corporation owned (within the meaning of section 956(a)) by a United States shareholder is the amount that would be determined under section 956 with respect to such share for the taxable year, absent the application of this paragraph (a)(2) for the taxable year (such amount, the tentative section 956 amount, and in the aggregate with respect to all shares owned (within the meaning of section 956(a)) by the United States shareholder, the aggregate tentative section 956 amount), reduced by the amount of the deduction under section 245A, if any, that the shareholder would be allowed if the shareholder received as a distribution from the controlled foreign corporation an amount equal to the tentative section 956 amount with respect to such share on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation (hypothetical distribution). For purposes of the preceding sentence, in the case of a United States shareholder that is a domestic partnership, the aggregate amount of the deductions under section 245A, if any, that domestic corporations that are partners of the domestic
(iii) Special rule in the case of domestic partnerships—(A) In general. In the case of a domestic partnership whose tentative section 956 amount with respect to a share of stock of a controlled foreign corporation is reduced pursuant to paragraph (a)(2)(i) of this section for a taxable year, the portion of any inclusion under section 951(a)(1)(B) of the domestic partnership with respect to such share for the taxable year allocated to a partner of the domestic partnership (including an indirect partner through one or more other partnerships) must equal the product of the inclusion and the ratio determined by dividing—

(1) The net hypothetical distribution income with respect to the partner; by

(2) The aggregate of the net hypothetical distribution income with respect to all of the partners of the domestic partnership.

(B) Definition of net hypothetical distribution income. The term net hypothetical distribution income means, with respect to a hypothetical distribution to a domestic partnership and a partner of the domestic partnership (including an indirect partner through one or more other partnerships), the amount of the hypothetical distribution that would be allocable to the partner reduced by the amount of the deduction under section 245A with respect to the hypothetical distribution that would be allowable to the partner.

(3) Examples. The examples in this paragraph (a)(3) illustrate the application of paragraph (a)(2) of this section.

(i) Example 1—(A) Facts. (1) USP, a domestic corporation, owns all of the single class of stock of FC, a foreign corporation. The stock of FC consists of 100 shares, and USP satisfies the holding period requirement of section 246(c) (as modified by paragraph (a)(2)(ii)(B) of this section) with respect to each share of FC stock. Any dividend from FC to USP would not constitute a hybrid dividend for purposes of section 245A(e). FC owns all of the stock of USS, a domestic corporation. FC’s adjusted basis in the stock of USS is $0.

(2) The functional currency of FC is the U.S. dollar. FC has $100x of undistributed foreign earnings as defined in section 245A(c)(2) at the end of the taxable year. $90x of which constitute undistributed foreign earnings as defined in section 245A(c)(3), and $10x of which are described in section 245A(5)(B) (that is, earnings attributable to a dividend that FC received from USS). None of the earnings and profits of FC are described in section 959(c)(1) or (2) or are earnings and profits attributable to income excluded from subpart F income under section 952(b). FC’s applicable earnings (as defined in section 956(b)(1)) are $100x. FC also has held an obligation of USP with an adjusted basis of $120x on every day during the taxable year of FC, and such obligation was acquired while all of its stock was owned by USP.

(B) Analysis. Because USP directly owns all of the stock of FC at the end of FC’s taxable year, USP’s aggregate tentative section 956 amount with respect to FC is $100x, the lesser of USP’s pro rata share of the average amounts of United States property held by FC ($120x) and its pro rata share of FC’s applicable earnings ($100x).

Under paragraph (a)(2)(i) of this section, USP’s section 956 amount with respect to FC is its aggregate tentative section 956 amount with respect to FC reduced by the deduction under section 245A that USP would be allowed if USP received an amount equal to its aggregate tentative section 956 amount as a distribution with respect to the FC stock. USP would be allowed a $90x deduction under section 245A with respect to the foreign-source portion of the $100x hypothetical distribution (that is, an amount of the dividend that bears the same ratio to the dividend as the $90x of undistributed foreign earnings bears to the $100x of undistributed earnings). Accordingly, USP’s section 956 amount with respect to FC is $10x, its aggregate tentative section 956 amount ($100x) with respect to FC reduced by the amount of the deduction that USP would have been allowed under section 245A with respect to the hypothetical distribution ($90x).

(ii) Example 2—(A) Facts. The facts are the same as in paragraph (a)(3)(i)(A) of this section (the facts in Example 1), except that all $100x of FC’s undistributed foreign earnings are described in section 959(c)(2).

(B) Analysis. As in paragraph (a)(3)(i)(B) of this section (the analysis in Example 1), USP’s aggregate tentative section 956 amount with respect to FC is $100x, the lesser of USP’s pro rata share of the average amounts of United States property held by FC ($120x) and its pro rata share of FC’s applicable earnings ($100x). However, paragraph (a)(2) of this section does not reduce USP’s section 956 amount because USP would not be allowed any deduction under section 245A with respect to the $100x hypothetical distribution by reason of section 959(a) and (d).

Accordingly, USP’s section 956 amount is $100x. However, under sections 959(a)(2) and 959(a)(1)(B), USP’s inclusion under section 951(a)(1)(B) with respect to FC is $0, because USP’s section 956 amount with respect to FC does not exceed the earnings and profits of FC described in section 959(c)(2) with respect to USP. The $100x of earnings and profits of FC described in section 959(c)(2) are reclassified as earnings and profits described in section 959(c)(1).

(iii) Example 3—(A) Facts. The facts are the same as in paragraph (a)(3)(iii)(A) of this section (the facts in Example 1), except that FC has $200x of undistributed earnings, which constitute undistributed foreign earnings as defined in section 245A(5)(B), of which $100x are described in section 959(c)(1)(A) and $100x are described in section 959(c)(3).

(B) Analysis. USP’s aggregate tentative section 956 amount with respect to FC is $20x, the lesser of $20x, the excess of USP’s pro rata share of the average amounts of
United States property held by FC ($120x) over the earnings and profits described in section 959(c)(1)(A) with respect to USP ($100x), and its pro rata share of FC’s applicable earnings ($100x). Under paragraph (a)(2)(i) of this section, USP’s section 956 amount with respect to FC is its aggregate tentative section 956 amount with respect to FC reduced by the deduction under section 245A that USP would be allowed if USP received an amount equal to its aggregate tentative section 956 amount as a distribution with respect to the FC stock. USP would be allowed a $20x deduction under section 245A with respect to the foreign-source portion of the $20x hypothetical distribution, which, under paragraph (a)(2)(ii)(C) of this section, is treated as attributable to the earnings and profits of FC described in section 959(c)(3) despite the fact that FC has $100x of earnings and profits described in section 959(c)(1)(A) that would otherwise be distributed before earnings and profits described in section 959(c)(3). Accordingly, USP’s section 956 amount with respect to FC is $0, its aggregate tentative section 956 amount ($20x) with respect to FC reduced by the sum of the deduction that USP would have been allowed under section 245A with respect to the hypothetical distribution ($70x).

Section 956 amount with respect to FC...