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Proposed regulations: Single-entity treatment of consolidated groups for purposes of section 951(a)(2)(B) in context of section 959(b) distributions

The U.S. Treasury Department and IRS today released for publication in the Federal Register proposed regulations (REG-113839-22) treating members of a consolidated group as a single U.S. shareholder for purposes of applying section 951(a)(2)(B) with respect to CFC-to-CFC distributions of previously taxed earnings and profits (PTEP) under section 959(b) (section 959(b) distributions).

The **proposed regulations** [PDF 286 KB] (as published in the Federal Register on December 14, 2022) provide that the purpose of the proposed rule is "to facilitate the clear reflection of income of a consolidated group by ensuring that the location of ownership of stock of a foreign corporation within the group does not affect the amount of the group's income by reason of sections 951(a)(1)(A) and 951A(a)." The proposed regulations include two examples illustrating application of the proposed rule.

The preamble to the proposed regulations explains that, by treating members of a consolidated group as a single U.S. shareholder, a section 959(b) distribution from a controlled foreign corporation (CFC) preceding a transfer of such CFC by one member of the consolidated group to another member would not give rise to a reduction to the second member's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2)(B), because the numerator of the section 951(a)(2)(B) fraction reflects the period that both members owned stock of the CFC. As a result, the group's aggregate inclusions under sections 951(a)(1)(A) and 951A(a) with respect to a CFC would not be reduced under section 951(a)(2)(B) by reason of a section 959(b) distribution made by the CFC preceding a change in the location of ownership of stock of the CFC within the group. Treasury and the IRS have determined that this outcome facilitates the clear reflection of the U.S. tax liability of a consolidated group.

The proposed regulations are proposed to apply to tax years for which the original consolidated return is due (without extensions) after the date of publication in the Federal Register of a Treasury Decision adopting the proposed regulations as final regulations. Therefore, it is anticipated that Treasury and IRS will attempt to finalize the proposed regulations by April 15, 2023, the date that an original consolidated return is due for a calendar year taxpayer, in order that the regulations can apply retroactively to transactions occurring in 2022. However, the preamble to the proposed regulations states that no inference is intended with regard to the treatment of transactions involving a consolidated group before the applicability date of the proposed regulations, including under Treas. Reg. §1.1502-13.

The proposed regulations do not apply with respect to dividends out of non-PTEP or to section 959(b) distributions not involving members of the same consolidated group. However, the preamble notes that other rules (such as the "extraordinary reduction" rules of Reg. §1.245A-5) may result in dividend out of non-PTEP being (directly or indirectly) included in the gross income of a U.S. shareholder. Additionally, the preamble indicates that no inference is intended with regard to the treatment of similar transactions not involving a consolidated group, or with regard to whether section 959(b) distributions are taken into account generally under section 951(a)(2)(B). The preamble indicates that Treasury and the IRS are further considering the interaction of sections 951(a)(2)(B) and 959(b), and any additional guidance issued relating to those sections, including guidance to prevent abuse, may be retroactive. Thus, while the proposed regulations only apply to transactions involving CFCs whose direct or indirect ownership is transferred between members of a consolidated group, the preamble explicitly raises the possibility that Treasury and IRS could issue future guidance, with retroactive effect, applicable to the effect of section 959(b) distributions on section 951(a)(2)(B) outside of section 1502.

Comments on the proposed regulations and requests for a public hearing are due by January 18, 2023.

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