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From:

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To:

Cc:

Subject: Interaction of Sections 965(e) and 53(c)

You asked us to address whether restrictions on the computation of regular taxes owed by recipients of section 965 dividends also apply for purposes of computing the minimum tax credit under section 53. More specifically, you asked whether the floor on taxable income under section 965(e)(2)(A) precludes the reduction of AMTI below the amount of nondeductible dividends for purposes of computing the limit on minimum tax credits under section 53(c).

Section 965 provides a temporary 85% dividends received deduction for certain qualifying dividends paid by controlled foreign corporations and used in the United States. In providing this relief, however, Congress imposed several limits that deviate from generally applicable tax rules. Among those limitations were special rules for section 965 dividends under the alternative minimum tax (AMT), a taxable income floor that precluded taxpayers from reducing taxable income below the amount of nondeductible dividends, and limitations on the use of tax credits against the tax on section 965 dividends. A basic understanding of these limits is important to understanding the issue at hand.

With regard to the AMT, section 965(e)(1)(B) provides that the tax on section 965 dividends is not considered a tax for purposes of determining the amount of tax imposed by section 55. The legislative history indicates that Congress was concerned that the inclusion of the nondeductible portion of the section 965 dividends in both the regular and minimum tax base would have the effect of lowering the minimum tax that would have been owed in the absence of the section 965 dividend. See House Rep. No. 108-755 (Conference Report), 108th Cong., 2d. Sess. p. 316. If the nondeductible dividends under section 965 had been subject to the lower AMT rates, then the U.S. tax owed by recipients of such dividends would have been reduced by approximately fifteen percent (the spread between regular and AMT rates) of such dividends and Congress rejected that outcome. Section 56(g)(4)(C)(vi) specifies that the dividends-received deduction (DRD) under section 965 is not treated as a preference item for AMT purposes. In other words, both section 965(e)(1)(B) and section 56(g)(4)(C)(vi) reflect Congress' decision to tax section 965 dividends at the regular corporate rates, not the reduced alternative minimum tax rate. This was accomplished by excluding the nondeductible dividends from both AMTI and regular taxable income solely for the purpose of computing the amount of AMT owed under section 55. See Notice 2005-38, section 9.01; Notice 2005-64, section 9.05 and relevant examples. In general, this approach subjects taxpayers who would otherwise owe AMT to the minimum tax regime on income other than the section 965 dividends and to the higher regular rate on the nondeductible dividend income.

The taxable income floor in section 965(e)(2)(A) provides that "the taxable income of any United States shareholder for any taxable year shall in no event be less than the amount of nondeductible CFC dividends received during such year." This means that taxable income could not be reduced below the amount of nondeductible dividends -- notwithstanding that taxpayers may have expenses or losses that otherwise could offset such income. However, as discussed above, the notional regular taxable income calculated for purposes of computing the amount of AMT under section 55(a)(2) could be less than that amount, because section 965(e)(1)(B) expressly excludes the regular tax on nondeductible dividends from the AMT computation. See section 7, Notice 2005-64. Thus, section 965(e)(1)(B) provides for notional computations of tax liability under section 55 that differ from those used for other tax purposes.

Lastly, section 965(e)(1) provides that any tax by reason of nondeductible dividends is not treated as a tax for purposes of determining the amounts of allowable credits other than under section 53 (minimum tax credits) and section 27(a) (foreign tax credits). This generally precludes taxpayers from using credits to offset the tax owed on section 965 dividends by adopting the fiction that no such tax was imposed and, therefore, there is no tax against which the credits could be applied. However, this fiction did not extend to either the foreign tax credit or the minimum tax credit. Thus, taxpayers could claim foreign tax credits against such tax liability subject to additional limitations. Also, taxpayers are permitted to claim minimum tax credits under section 53. See section 9.01 of Notice 2005-64.

In Notice 2005-64, the Service and Treasury clarified how section 965 and the section 53 minimum tax credit interact. The notice recognizes that section 53 credits are plainly available to the recipients of section 965 dividends, but also that all generally-applicable aspects of the credit, including the limit on the credit under section 53(c), continue to apply. Under section 53(c), the minimum tax credit is generally limited to the excess of the taxpayer's regular tax liability minus certain credits over its tentative minimum tax liability. This limitation ensures that the regular tax liability is not reduced by credits below the minimum tax liability. See *also* IRC sections 26, 38, and 45C. Consistent with section 965(e)(1), Notice 2005-64 provides that, in computing the section 53(c) limit, the tax on nondeductible dividends is required to be included in both the regular tax liability and the tentative minimum tax liability. This result is premised on the statutory language of section 965(e)(1) that requires taxes on nondeductible dividends to be treated as taxes for purposes of section 53. Nothing in the statute or its legislative history suggests that this directive applies only to particular aspects of section 53 and statutory analysis generally precludes the use of divergent assumptions in approaching a particular issue. See, e.g., *PNC Fin. Servs. Grp. v. Comm'r*, 503 F.3d 119, 126 (D.C. Cir. 2007) ("Inconsistency is the antithesis of the rule of law.") (quoting *LaShawn A. v. Barry*, 87 F.3d 1389, 1393 (D.C. Cir. 1996) (en banc)). That is precisely what would have occurred if the tax on nondeductible dividends had been included in the regular tax and excluded from the minimum tax in determining the amount of the allowable minimum tax credit under section 53(c). Finally, the inconsistent treatment of nondeductible dividends under section 53 would have resulted in a larger allowance of such credits than if such dividends had been taxable at the lower AMT rates under section 55. As noted above, Congress stated that taxpayers who received dividends under section 965 should not be permitted to reduce their minimum tax obligations and the allowance of excessive section 53 credits would have run counter to that directive. The BNA software used by the Service describes the amounts of AMTI including the nondeductible dividends, and the resulting tentative minimum tax, as the "expanded" AMTI and TMT, respectively.

The ultimate issue that you raised is whether, given that the nondeductible dividend income is included in the section 53(c) computation, the limits that apply in computing the regular tax -- e.g., the taxable income floor in section 965(e)(2)(A) -- also apply in computing the tentative minimum tax component of the limitation. We believe that these limits apply for all purposes of section 53. Section 965(e)(2)(A) unambiguously precludes the reduction of taxable income below the amount of nondeductible dividends. Alternative minimum taxable income is derived from regular taxable income. Section 55(b)(2) defines alternative minimum taxable income as the taxable income of the taxpayer as modified only under sections 56 through 58. Nothing in sections 56 through 58 provides for the elimination of nondeductible section 965 dividends (only the deductible portion of such dividends is described in section 56(g)(4)(C)(vi)). Moreover, longstanding regulations under section 55 provide that restrictions and limitations that apply for regular tax purposes also apply for minimum tax purposes unless expressly overridden: "Except as otherwise expressly provided . . . all Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the alternative minimum taxable income of the taxpayer." Treas. Reg. section 1.55-1(a). See *also Ventas v. U.S.*, 381 F.3d 1156 (Fed. Cir. 2004) (rejecting argument that taxable income should be adjusted to restore compensation deductions not explicitly described in sections 56-58). Nothing in section 965 precludes the application of the taxable income floor in applying the limit on minimum tax credits under section 53(c). The specialized minimum tax provisions adopted by section 965 are limited to the determination of election year AMT under section 55 and expressly do not apply for purposes of section 53. See section 965(e)(1) (flush language). Accordingly, nothing in the statute or any other guidance calls off the application of the taxable income floor or other section 965 limits in applying the minimum tax credit. Finally, the

inconsistent application of these limitations for only selected aspects of the minimum tax credit determination would run afoul of the common sense interpretive principle, noted above, that concepts must be applied consistently within a particular provision. For all these reasons, we conclude that the taxable income floor under section 965(e)(2)(A) applies equally in determining the regular and minimum tax liabilities used to compute the limit on allowable minimum tax credits under section 53(c).

For example, assume that Taxpayer has \$1,000x of regular taxable income in the section 965 election year, including \$600x of nondeductible section 965 dividends. Taxpayer also has alternative minimum taxable income of \$250x (exclusive of the nondeductible dividends) and regular and AMT net operating loss carryovers in the election year of \$1,200x and \$900x, respectively. Taxpayer also has available a minimum tax credit carryover of \$200x. Because available losses exceed the amount of nondeductible dividends, the taxable income floor in section 965(e)(2)(A) prevents losses from reducing taxable income below the amount of nondeductible dividends, or \$600x. The pre-credit regular tax liability of the taxpayer (assuming a 35% rate) would be \$210x (\$1,000x of regular taxable income less allowable losses of \$400x). For section 55 purposes, because the nondeductible dividends are excluded from the minimum tax computation, the AMT net operating loss can be used to reduce or eliminate the AMTI of \$250x, subject to section 56(d). For purposes of computing the minimum tax credit under section 53, however, the \$600x of nondeductible dividends is included in computing the available credits. Under section 53(c), the credit is limited to the excess of the regular tax liability of \$210x over the "expanded" tentative minimum tax. Thus, Taxpayer has \$850x of expanded AMTI and \$900x of available AMT NOLs, but only \$250x of the losses can be deducted under section 965(e)(2)(A). Accordingly, the expanded TMT is \$120x (assuming a minimum tax rate of 20%) and section 53(c) limits the minimum tax credit to \$90x (\$210x less \$120x).

Please let me know if you have any further questions or comments.

Sincerely,