

LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Outbound	–	–
Volume	2	Deferral Planning	Level 1 UIL	9412
Part	2.3	Foreign Personal Holding Company Issues	Level 2 UIL	9412.03
Chapter	2.3.2	Interest, Dividends or other FPHCI	Level 3 UIL	9412.03-02
Sub-Chapter	2.3.2.2	Exceptions from FPHCI re: payor	–	–

Unit Name	Receipt of Dividends or Interest from a Related CFC
------------------	---

Document Control Number (DCN)	DPL/9412.03_04(2016)
Date of Last Update	01/05/2016

Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

General Overview

- [Issue and Transaction Overview](#)
- [Transaction and Fact Pattern](#)
- [Effective Tax Rate Overview](#)

[Summary of Potential Issues](#)

[Audit Steps](#)

[Training and Additional Resources](#)

[Glossary of Terms and Acronyms](#)

[Index of Related Issues](#)

Issue and Transaction Overview

Receipt of Dividends or Interest from a Related CFC

Generally, the US shareholder of a foreign corporation is able to defer taxation of the corporation's income until it has been distributed to the shareholder. However, in the case of a controlled foreign corporation ("CFC"), certain types of income are subject to current inclusion ("subpart F inclusion") by the US shareholder under IRC 951. One such type of income is Foreign Personal Holding Company Income (FPHCI), which includes income of a CFC such as dividends, interest, rents, and royalties. The FPHCI rules eliminate the deferral of US tax on income earned by certain foreign corporations from portfolio types of investments, *i.e.*, where the company is merely passively receiving investment income rather than earning active business income. Consequently, many of the exceptions to current inclusion of FPHCI focus on the *recipients* of income (*i.e.*, whether the recipients meet certain criteria).

However, in the case of certain related party transactions, the exceptions from FPHCI focus on the *payor* of the income rather than the recipient. For example, under the FPHCI "look-thru" rule (not to be confused with the foreign tax credit ("FTC") look-thru rules, which are beyond the scope of this Unit), FPHCI does *not* include dividends, interest, rents, and royalties if such income is received or accrued from a related CFC and the income is not attributable to subpart F income or income effectively connected with a US trade or business ("ECI") of the related CFC. The look-thru rule is found in IRC 954(c)(6), and is often referred to as the "954(c)(6) exception", or simply "(c)(6)". This exception allows US shareholders to "reinvest" active foreign earnings of one CFC in a related CFC without current taxation, as long as the underlying income of the *payor* CFC would not otherwise have been subject to current US taxation (*i.e.*, as subpart F income or ECI). Note, however, that the exception is not elective; if the requirements are met, the income is *not* FPHCI.

Another exception that looks to the *payor* of the income for eligibility requirements is the same country exception from FPHCI under IRC 954(c)(3). Under the same country exception, FPHCI does not include dividends and interest received by a CFC from a related CFC payor which is incorporated in the same country as the recipient CFC, and which has a substantial part of its assets used in its trade or business in that same country. Similarly, under this exception, FPHCI does not include rents and royalties received by a CFC from a related CFC for the use or privilege of using property within the same country as the recipient CFC's country of incorporation. However, the FPHCI implications/treatment of rents/royalties are outside the scope of this Unit and will be covered in a separate Unit.

Issue and Transaction Overview (cont'd)

Receipt of Dividends or Interest from a Related CFC

The same country exception was originally enacted in 1962 as a part of the broader subpart F legislation. The Kennedy administration and Congress were concerned with tax haven deferral – the shifting of income earned in one country to a tax haven jurisdiction. Because payments between related parties located in the same country don't shift income to another jurisdiction, such same-country payments were excluded from the definition of FPHCI.

However, before 2006, when the look-thru rules were first enacted, FPHCI still included payments from a CFC in one country to a related CFC in another, even if the income was from an active business. In proposing the look-thru rules, the House Ways and Means Committee said, "Most countries allow their companies to redeploy active foreign earnings with no additional tax burden. The Committee believes that this provision will make US companies and US workers more competitive with respect to such countries. By allowing US companies to reinvest their active foreign earnings where they are most needed without incurring the immediate additional tax that companies based in many other countries never incur, the Committee believes that the provision will enable US companies to make more sales overseas, and thus produce more goods in the United States" (HR Rep. No. 304, 109th Cong., 1st Sess. 45 (2005)).

The look-thru rule was first effective for tax years of CFCs beginning after December 31, 2005, and before January 1, 2009. It has since been extended on multiple occasions, and is currently effective for tax years of CFCs beginning before January 1, 2020. No regulations have been issued to date on the look-thru rule; however, guidance was issued in Notice 2007-9. Consequently, it will be critical for the examiner to review Notice 2007-9 in connection with this issue.

This Unit covers in detail the same country exception and look-thru rules for FPHCI (specifically dividends and interest). It includes a scenario with both an interest and dividend payment, and the issues covered in the Unit compare the treatment of the payments under both the look-thru rule and the same country exception from FPHCI. (As previously noted, the FPHCI implications/treatment of rents/royalties are outside the scope of this Unit and will be covered in a separate Unit.)

Transaction and Fact Pattern

Receipt of Dividends or Interest from a Related CFC

Diagram of Transaction	Facts
<pre>graph TD; USP[USP]; CFC1["CFC1 (Country A)"]; CFC2["CFC2 (Country B)"]; CFC3["CFC3 (Country A)"]; CFC2 -- "\$100 Dividend" --> CFC1; CFC3 -- "\$200 Interest" --> CFC1; CFC3 --- I["\$200 Interest income"]; USP --- CFC1; USP --- CFC3;</pre> <p>The diagram illustrates the transaction flow. At the top is the United States Person (USP). Below USP are three entities: CFC1 (Country A), CFC2 (Country B), and CFC3 (Country A). CFC2 is shown at the bottom left, with an upward arrow labeled "\$100 Dividend" pointing to CFC1. CFC3 is shown to the right of CFC1, with a leftward arrow labeled "\$200 Interest" pointing to CFC1. Below CFC3, the text "\$200 Interest income" is displayed. USP is connected to both CFC1 and CFC3 by lines.</p>	<ul style="list-style-type: none">▪ CFC1 (incorporated in Country A) received \$100 of dividend income from CFC2 (incorporated in Country B) and \$200 of interest income from CFC3 (incorporated in Country A).▪ All of CFC2's earnings are from operations and are not subpart F income or ECI.▪ CFC3 earned \$200 of passive interest income and made a \$200 interest payment to CFC1.

Effective Tax Rate Overview

Receipt of Dividends or Interest from a Related CFC

ETR of Company

- The examiner should review the company's audited financial statements to determine the ETR for the years at issue and compare it to other companies in the same industry. The examiner should look for the total permanently reinvested offshore income (PRI).
- The examiner should consider the tax rates in the countries where the US company has CFCs as compared to the US tax rate. For CFCs in low-tax countries, the examiner should consider whether the taxpayer may be motivated to shift profits to those countries. For CFCs in high-tax countries, the examiner should consider whether the high tax exception (covered in a separate IPS Unit) from Subpart F income may apply and therefore reduce the time spent examining the issue.

ETR Impact of Adjustment

- An inclusion of FPHCI may increase the financial income tax expense of USP resulting in higher ETR.

Summary of Potential Issues

Receipt of Dividends or Interest from a Related CFC

<u>Issue 1</u>	Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).
<u>Issue 2</u>	Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).
<u>Issue 3</u>	Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).
<u>Issue 4</u>	Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

All Issues, Step 1: Initial Factual Development

Receipt of Dividends or Interest from a Related CFC

CFC1 received dividend and interest income from CFC2 and CFC3, respectively, which would generally be characterized as FPHCI, a type of Subpart F income, resulting in a current Subpart F inclusion to USP. However, the income may be excluded from FPHCI under the look-thru rule or same country exception if the CFCs meet certain requirements.

Fact Element	Resources	6103 Protected Resources
<p>The examiner should determine whether the dividend and interest income CFC1 received from CFC2 and CFC3 would normally constitute FPHCI (refer to UIL 9412.03-01 and 9412.03-02 for details). Dividend and Interest income should be identified on Lines 9 and 10 of Form 5471 Schedule M. The taxpayer may have reported Subpart F income on Line 1 of Form 5471 Schedule I.</p>	<ul style="list-style-type: none"> ▪ Form 5471 ▪ Form 5471 Instructions ▪ Global Tax and Legal Organizational Charts ▪ Business descriptions ▪ Information Document Request (IDR) to request details of taxpayer's subpart F calculations and, if applicable, qualifications for the exception claimed 	
<p> DECISION POINT: The examiner should consider the current amount of unrepatriated offshore E&P, as a subpart F inclusion is limited to this amount.</p>	<ul style="list-style-type: none"> ▪ IRC 952(c)(1)(A) 	

Issue 1, Step 2: Review Potential Issues

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>As the name “same country exception” implies, the payor of the income must be created or organized in the same country in which the recipient CFC is incorporated.</p> <p><i>HOWEVER</i>, just because the payor is created or organized in the same country as the recipient CFC does <i>not</i> mean that the income automatically qualifies under the same country exception from FPHCI.</p> <p>The examiner should carefully review <i>all</i> of the criteria for the same country exception from FPHCI discussed on the following slides. During the additional factual development, the examiner should address each of the criteria in turn, and keep in mind that the country in which the payor is organized is merely <i>one</i> of the criteria involved to satisfy the same country exception.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(3) ▪ Treas. Reg. 1.954-2(b)(4) 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The same country exception from FPHCI provides, in relevant part, that FPHCI does <i>not</i> include...</p> <p>Dividends and interest received from a related person [as defined under IRC 954(d)(3)] that (i) is a corporation created or organized in the same country as the CFC, <i>and</i> (ii) uses a substantial part of its assets in a trade or business in that same country.</p> <p>The same country exception does <i>not</i> apply to interest to the extent it reduces the payor's subpart F income or creates or increases a deficit in E&P that reduces the subpart F income of the payor or another CFC.</p> <p>Please note that the terms "trade or business" and "substantial assets test" are defined in the regulations.</p> <p>Note: the CFCs in this transaction do not own flow through entities (i.e. disregarded entities or partnerships); this concept is beyond the scope of this unit.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(3) ▪ IRC 954(d)(3) ▪ Treas. Reg. 1.954-1(f) ▪ Treas. Reg. 1.954-2(b)(4) 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>A person will be considered a <i>related person</i> with respect to a CFC if the person (whether it's an individual, corporation, partnership, trust or estate) controls or is controlled by the CFC (or is controlled by the same persons that control the CFC).</p> <p>Control means direct or indirect ownership of (1) in the case of corporations, stock having <i>more than 50%</i> of the total voting power of all classes of stock entitled to vote or of the total value of stock of the corporation; and (2) in the case of a partnership, trust, or estate, <i>more than 50%</i> (by value) of the capital, profits or beneficial interest in the entity.</p>	<ul style="list-style-type: none"> ▪ IRC 954(d)(3) ▪ Treas. Reg. 1.954-1(f) 	

Issue 1, Step 3: Additional Factual Development

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
The examiner should determine whether CFC3 is a corporation created or organized in the same country as CFC1.	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. ▪ If necessary, the examiner may issue an IDR to request organization documents of CFC1 or CFC3. 	
The examiner should determine whether CFC3 is a <i>related person</i> (see previous slide) with respect to CFC1.	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The examiner should determine whether CFC3 uses a substantial portion of its assets in a trade or business in the same country where CFC1 is created or organized.</p> <p>Note: the CFCs in this transaction do not own flow through entities (i.e. disregarded entities or partnerships); this concept is beyond the scope of this unit.</p>	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. ▪ The examiner may also wish to review VAT returns, insurance agreements, fixed asset reports, foreign income or property tax returns, etc. to determine which assets are used in a trade or business. 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
The examiner should determine whether the interest payment reduces CFC3's subpart F income or creates/increases a deficit in E&P that reduces (or may reduce) the subpart F income of CFC3 or another CFC.	<ul style="list-style-type: none">▪ The examiner should review financial statements and E&P schedules of CFC3. In addition, if necessary, the examiner should consider tracing the interest payment back to its original source to determine if the subpart F income or E&P of another CFC was affected.	

Issue 1, Step 4: Develop Arguments

Receipt of Dividends or Interest from a Related CFC

Issue 1

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The factual development in this transaction indicates CFC3 is a corporation created/organized in the same country as CFC1 and is a related person with respect to CFC1. However, the facts also indicate the interest payment from CFC3 to CFC1 reduces CFC3's subpart F income. As a result, regardless of where CFC3 uses a substantial portion of its assets in a trade or business, the interest would <i>not</i> be excluded from FPHCI under the same country exception.</p> <p>The examiner should calculate the amount of CFC1's FPHCI and USP's subpart F inclusion (see UIL 9412.05 General subpart F Computational Issues), and be sure to consider FTC implications when computing any adjustments on Form 5701 (e.g. some indirect foreign tax credit offset – see UIL 9413) (Note: CFC3's payment of interest to CFC1 reduces CFC3's potential subpart F income to zero, so USP will only have a subpart F inclusion <i>once...</i> from CFC1.)</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(3) ▪ Treas. Reg. 1.954-2(b)(4) & (5) 	

Issue 2, Step 2: Review Potential Issues

Receipt of Dividends or Interest from a Related CFC

Issue 2

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>Applicable for tax years of CFCs beginning after December 31, 2005, and before January 1, 2020, the look-thru rule states that dividends, interest (including factoring income, which is beyond the scope of this Unit), rents, and royalties received or accrued from a CFC that is a related person will not be treated as FPHCI to the extent attributable or properly allocable to income of the related CFC that is neither subpart F income nor ECI.</p> <p>To review the rules for <i>related person</i>, refer to Issue 1 Step 2 Slide 11.</p> <p>The examiner should read Sections 5(a) & (b) of Notice 2007-9, for a detailed discussion of the rules for determining whether interest is allocable or apportionable to subpart F income or ECI, in which case the income would <i>not</i> be excluded from FPHCI under the look-thru rule.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6) ▪ Notice 2007-9 ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) 	

Issue 2, Step 2: Review Potential Issues (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 2

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>In addition, the look-thru rule will <i>not</i> apply to the extent the interest, rent, or royalty creates or increases a deficit in E&P that reduces (or may reduce) the subpart F income of the payor or another CFC.</p> <p>Examiners should note this provision of the look-thru rule is identical to one of the provisions of the same country exception. While the look-thru rule is less stringent in that the payor and recipient need not be incorporated in the same country, <i>neither</i> exception will apply to the extent the income is attributable to subpart F income or creates/increases a deficit in E&P that may reduce subpart F income of the payor.</p> <p>This is a key concept of both the look-thru rule and the same country exception. Generally, subpart F income cannot be converted to non-subpart F income merely by remitting the income to or through another CFC.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6)(B) ▪ Notice 2007-9 ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) ▪ Audit Aid Comparing Look-Thru and Same Country Exceptions from FPHCI 	

Issue 2, Step 3: Additional Factual Development

Receipt of Dividends or Interest from a Related CFC

Issue 2

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
The examiner should determine whether CFC3 is a <i>related person</i> (see slide 11) with respect to CFC1.	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. 	
The examiner should determine whether the interest income is attributable to subpart F income or ECI of CFC3.	<ul style="list-style-type: none"> ▪ The examiner should issue an IDR to request copies of schedules detailing the allocation and apportionment of income to subpart F, non-subpart F, ECI, etc. 	
The examiner should determine whether the interest income creates or increases a deficit in E&P that reduces the subpart F income of CFC3 or another CFC (for further discussion, refer to Notice 2007-9 listed in resources in this Unit).	<ul style="list-style-type: none"> ▪ The examiner should have reviewed this fact element in Issue 1, Step 3. No additional factual development is needed. 	

Issue 2, Step 4: Develop Arguments

Receipt of Dividends or Interest from a Related CFC

Issue 2

Whether interest income received by CFC1 from CFC3 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>Although the factual development in this transaction indicates CFC3 is a related person with respect to CFC1, the facts also indicate the interest income received by CFC1 from CFC3 is attributable to the subpart F income of CFC3. Consequently, the interest income would <i>not</i> be excluded from FPHCI under the look-thru rule.</p> <p>The examiner should calculate the amount of CFC1's FPHCI and USP's subpart F inclusion, and be sure to consider Foreign Tax Credit (FTC) implications when computing any adjustments on Form 5701.</p> <p>(Note Issues 1 and 2 result in the same outcome, regardless of their countries of incorporation, since the income was attributable to subpart F income of CFC3, which was reduced by CFC3's interest payment to CFC1.)</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6) ▪ Notice 2007-9 ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) 	

Issue 3, Step 2: Review Potential Issues

Receipt of Dividends or Interest from a Related CFC

Issue 3

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>To review the rules for the <i>same country exception</i>, refer to Issue 1 Step 2 Slide 9 et seq.</p> <p>The same country exception does not apply to dividends attributable to E&P that accrued while the recipient did not hold the stock (either directly, or indirectly through a chain of corporations that each meet the requirements described in item 1 above) of the payor.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(3) ▪ Treas. Reg. 1.954-2(b)(4) 	
<p> CONSULTATION: While the dividend in the transaction in this unit is an actual dividend received, the examiner should consider whether any dividends are deemed to have been made, for example, under IRC 964(e). If so, the examiner should consider contacting a member of the Organizations and Restructuring IPN to determine the proper characterization of the transaction. Also note that a 964(e) dividend will not qualify for the same country exception, but it <i>may</i> qualify for the look-thru exception for <i>certain</i> transactions, subject to Notice 2014-52 (see also slide 24).</p>	<ul style="list-style-type: none"> ▪ IRC 964(e)(2) ▪ Notice 2014-52 	

Issue 3, Step 3: Additional Factual Development

Receipt of Dividends or Interest from a Related CFC

Issue 3

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The examiner should determine whether CFC2 is a corporation created or organized in the same country as CFC1.</p> <p>Note: since the facts in Issue 3 indicate CFC1 and CFC2 are not incorporated in the same country, the examiner does not need to develop the remaining fact elements for Issue 3. However, the remaining fact elements and references/resources are provided in the event the facts in the examiner's case indicate otherwise.</p>	<ul style="list-style-type: none"> ▪ Based on the information obtained during the initial factual development, CFC1 and CFC2 are not incorporated in the same country. No additional factual development is needed. 	
<p>The examiner should determine whether CFC2 is a <i>related person</i> (see slide 11) with respect to CFC1.</p>	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. 	

Issue 3, Step 3: Additional Factual Development (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 3

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The examiner should determine whether CFC2 uses a substantial portion of its assets in a trade or business in the same country where CFC1 is created or organized.</p>	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. ▪ The examiner may also wish to review VAT returns, insurance agreements, fixed asset reports, foreign income or property tax returns, etc. to determine where assets are used in a trade or business. 	
<p>The examiner should determine whether the dividend is attributable to E&P accrued while CFC1 held stock in CFC2.</p>	<ul style="list-style-type: none"> ▪ The examiner should review Forms 5471 from prior periods (and Schedule J, Schedule O or Form 926 filings) to determine when CFC1 acquired CFC2 stock. 	

Issue 3, Step 4: Develop Arguments

Receipt of Dividends or Interest from a Related CFC

Issue 3

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the same country exception of IRC 954(c)(3).

Fact Element	Resources	6103 Protected Resources
<p>The factual development indicates that CFC1 and CFC2 are not incorporated in the same country. Consequently, the dividend income received by CFC1 from CFC2 would <i>not</i> be excluded from FPHCI under the same country exception, and USP will have a subpart F inclusion with respect to this transaction (unless the look-thru rule applies – See Issue 4).</p> <p>Unless the look-thru rule in Issue 4 applies, the examiner should calculate the amount of CFC1's FPHCI and USP's subpart F inclusion, and be sure to consider Foreign Tax Credit (FTC) implications when computing any adjustments on Form 5701.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(3) ▪ Treas. Reg. 1.954-2(b)(4) 	

Issue 4, Step 2: Review Potential Issues

Receipt of Dividends or Interest from a Related CFC

Issue 4

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>To review the <i>look-thru rule</i>, refer to Issue 2 Step 2 Slide 16.</p> <p>In addition to actual cash dividends, the following are also eligible for the exception:</p> <ul style="list-style-type: none"> ▪ Amounts treated as dividends as a result of a redemption described in IRC 302 or IRC 304 ▪ Gain on sale of a related CFC recharacterized as a dividend under IRC 964(e) (<i>but</i> certain transactions subject to Notice 2014-52 are <i>not</i> eligible for the exception) ▪ Gain recognized in certain reorganizations recharacterized as a boot dividend under IRC 356(a)(2) <p>Not Eligible for the Exception :</p> <ul style="list-style-type: none"> ▪ “All E&P amount” under Treas. Reg. 1.367(b)-3(b)(3)(i) (inbound reorganization of a lower-tier CFC) <p> CONSULTATION: Refer to Issue 3 Step 2 Slide 20</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6) ▪ Notice 2007-9 ▪ IRC 954(d)(3) ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) ▪ Notice 2014-52 	

Issue 4, Step 2: Review Potential Issues (cont'd)

Receipt of Dividends or Interest from a Related CFC

Issue 4

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>In its anti-abuse provisions, Notice 2007-9 lists four types of transactions that will not qualify for the look-thru rule from FPHCI.</p> <ul style="list-style-type: none"> ▪ Amounts that reduce the US tax base, including factoring income ▪ Avoidance of IRC 956 ▪ Use of options or similar interests ▪ Change of character of income through the use of a conduit entity <p>Refer to the notice for additional details regarding the anti-abuse provisions.</p> <p> CONSULTATION: Before applying these anti-abuse provisions, the examiner should consult with counsel</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6) ▪ Notice 2007-9 ▪ IRC 954(d)(3) ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) 	

Issue 4, Step 3: Additional Factual Development

Receipt of Dividends or Interest from a Related CFC

Issue 4

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
The examiner should determine whether CFC2 is a <i>related person</i> (see slide 11) with respect to CFC1.	<ul style="list-style-type: none"> ▪ During the initial factual development, the examiner should have reviewed the Form(s) 5471 and tax and legal organizational charts. 	
The examiner should determine whether the dividend income is attributable to subpart F income or ECI of CFC2.	<ul style="list-style-type: none"> ▪ The examiner should review the Form 5471 Schedule M, transfer pricing study, financial statements, and company website to determine if any of the E&P is made up of subpart F income. ▪ If needed, the examiner may also issue an IDR to request schedules reflecting the makeup of E&P. ▪ If necessary, the examiner may research IDRS to determine whether CFC2 filed Form 1120F to report ECI. 	

Issue 4, Step 4: Develop Arguments

Receipt of Dividends or Interest from a Related CFC

Issue 4

Whether dividend income received by CFC1 from CFC2 may be excluded from FPHCI under the look-thru rule of IRC 954(c)(6).

Fact Element	Resources	6103 Protected Resources
<p>The factual development indicates CFC2 is a related person with respect to CFC1 and the dividend income is not attributable to subpart F income of CFC2. As such, the dividend income is excluded from FPHCI of CFC1 under the look-thru rule, and USP will not have a subpart F inclusion with respect to this transaction.</p> <p>Note the different results in Issues 3 and 4. The facts in both issues indicate the income is <i>not</i> attributable to subpart F income of CFC2. However, in Issue 3 the income <i>is</i> FPHCI (absent the look-thru rule) since CFC2 is not in the same country as CFC1. By contrast, in Issue 4, the income is not FPHCI due to application of the look-thru rule. Refer to the audit aid listed at right for comparison of the look-thru rule and same country exception.</p>	<ul style="list-style-type: none"> ▪ IRC 954(c)(6) ▪ Notice 2007-9 ▪ Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) ▪ Audit Aid Comparing Look-Thru and Same Country Exceptions from FPHCI 	

Training and Additional Resources

Chapter 2.3.2 Interest, Dividends or other FPHCI		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> Refer to 2/26/14 CPE Centra on the DP IPN SharePoint Site 	<ul style="list-style-type: none"> 2014 DP CPE CENTRA - IRC Section 954(c)(6) Look Thru Rules
Issue Toolkits	<ul style="list-style-type: none"> Audit Aid Comparing Look-Thru and Same Country Exceptions from FPHCI 	
White Papers / Guidance	<ul style="list-style-type: none"> Staff of Joint Comm. on Tax'n, 112th Cong., General Explanation of Tax Legislation Enacted in the 112th Congress at 181-183 (Comm. Print 2013) 	
Reference Materials - Treatises	<ul style="list-style-type: none"> Other reading materials 	<ul style="list-style-type: none"> Practical Applications of the CFC Look-Thru Rule Under Notice 2007-9, 36 TMINTLJ 288 Bittker & Lokken Fundamentals of International Taxation 69.4.2, 69.4.3 & 69.4.3A BNA TMFEDPORT No. 6220-1st Section V

Glossary of Terms and Acronyms

Acronym	Definition
CFC	Controlled Foreign Corporation
DP	Deferral Planning
E&P	Earnings and Profits
ECI	Effectively Connected Income (or income effectively connected with the conduct of a trade or business in the United States)
ETR	Effective Tax Rate
FPHCI	Foreign Personal Holding Company Income
FTC	Foreign Tax Credit
IDR	Information Document Request
IPN	International Practice Network
IPS	International Practice Service
IRC	Internal Revenue Code
PE	Permanent Establishment
PRI	Permanently Reinvested (offshore) Income
USP	United States Parent

Index of Related Issues

Issue	Associated UIL(s)	References
Rents and royalties	9412.03-01	
Interest, dividends or other FPHCI	9412.03-02	
General Subpart F Computational Issues	9412.05	
Foreign Tax Credit	9413	
Identification of a US trade or business or permanent establishment (PE)	9421.01	