

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-135005-07]

RIN 1545-BG94

Clarification of Controlled Group Qualification Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation to clarify which corporations are included in a controlled group of corporations. The regulation clarifies that a corporation that satisfies the controlled group rules for stock ownership and qualification is a member of such group, without regard to its status as a component member.

DATES: Written or electronic comments and request for a public hearing must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-135005-07), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-135005-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-135005-07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Grid Glycer (202) 622-7930; concerning submissions of comments, Oluwafunmilayo Taylor (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 1563(a) defines four types of controlled groups of corporations. This definition is relevant for purposes of allocating certain tax benefits under section 1561, as well as other provisions of the Internal Revenue Code that incorporate the concept of a controlled group of corporations. In order for a corporation to be included in one of these controlled groups under section 1563(a), it must satisfy the stock ownership test for that type of group. In addition, other rules in section 1563 may also apply in order to determine whether a corporation satisfies the applicable stock ownership test. For example, section 1563(c) excludes certain stock of a corporation (for example, nonvoting stock that is limited and preferred as to dividends) from the definition of stock, section 1563(d) determines when to take into account the stock owned by a corporation, and section 1563(e) determines when stock of a corporation is constructively owned.

Section 1563(b) describes which corporations are “component members” of a section 1563(a) controlled group of corporations for purposes of section 1561 and section 1563, in part by excluding certain corporations under section 1563(b)(2). For example, certain special purpose corporations, such as tax-exempt corporations, are treated as excluded members and not as component members. See sections

1563(b)(2)(B) through 1563(b)(2)(E). Notwithstanding that a corporation is not a “component member,” however, the IRS has consistently taken the position that the determination of whether a corporation is included in a controlled group under section 1563(a) is determined without applying section 1563(b).

Explanation of Provisions

The Treasury Department and the IRS propose to amend §1.1563-1 to clarify that an excluded member of a controlled group, such as a corporation described in sections 1563(b)(2)(B) through 1563(b)(2)(E), is nevertheless a member of the group. Specifically, the proposal will add paragraph (a)(1)(ii) to §1.1563-1 and an Example to §1.1563-1(b)(4).

Section 1563 was originally promulgated to limit the use of the tax benefit items described in section 1561 by the component members of a controlled group as defined in section 1563. S. Rep. No. 88-830 at 150 (1964), 1964-1 (Part 2) CB 502, 654. However, since then, certain other statutory and regulatory provisions have referenced the controlled group rules of section 1563 for other purposes. Some of these provisions adjust the definition of a controlled group to state that certain provisions of section 1563 do not apply.

For example, section 41(f)(1)(A)(i) provides that, in determining the amount of the credit for increasing research activities under section 41, all members of the same controlled group shall be treated as a single taxpayer. Section 41(f)(5)(B) provides that the term “controlled group of corporations” has the same meaning given to such term by section 1563(a), except that the determination shall be made without regard to

subsections (a)(4) and (e)(3)(C) of section 1563. The effect of not applying section 1563(a)(4) is to treat two or more life insurance companies, which would otherwise be treated as members of a separate life insurance controlled group, each as a member of a controlled group described in section 1563(a)(1)-(3) (Section 1563(e)(3)(B) deals with an application of the constructive ownership rules; however, because that application is not relevant to the issue being addressed in this preamble, it will not be further discussed.). However, section 41(f)(5) and similar provisions make no reference to subsection (b) of section 1563. Section 1563(b), among other things, defines which corporations are “component members” and “excluded members” for purposes of section 1561 and section 1563. Nevertheless, some taxpayers have argued that a corporation that is an “excluded member” within the meaning of section 1563(b)(2) cannot, as a consequence, be a “member” of a section 1563(a) controlled group generally. This line of argument tends to equate a corporation’s membership generally with such corporation’s status as a component member.

The Treasury Department and the IRS disagree with such arguments and believe that an excluded member under section 1563(b)(2), while not a component member of a controlled group under section 1563(b)(1), is nevertheless a member of a controlled group under section 1563(a). See also §1.414(b)-1(a).

This position is supported by the clear language of the statute. Section 1563(b)(2) provides, in the introductory text, that a “corporation which is a member of a controlled group of corporations . . . shall be treated as an excluded member of such group . . .”. Moreover, this position is also supported by the legislative history for

sections 1561 and 1563, which states that “the determination of the corporations included within a parent-subsidary controlled group, or a brother-sister controlled group, is made without regard to the type of corporation involved.” S. Rep. No. 88-830 at 152 (1964), 1964-1 (Part 2) CB 505, 656; see also H.R. Rep. 88-749 at A201-202 (1963), 1964-1 (Part 2) CB 248, 449-450 (providing examples where an “excluded member” is treated as a member of a controlled group of corporations). Compare section 1504(a)(1)(A) (affiliated group comprised of includible corporations only). Therefore, this proposed regulation clarifies that a corporation identified in section 1563(b)(2) as an excluded member of a controlled group is nevertheless a member of such group for purposes of section 1563(a). Accordingly, a corporation whose stock is held by such an excluded member may be treated as a component member of the controlled group of corporations.

Finally, this proposed regulation further illustrates that an excluded member of a controlled group is treated as a member of such group by adding an example demonstrating that a controlled group can consist solely of excluded members.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation and because this regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before this proposed regulation is adopted as a final regulation, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed regulation and how it can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of this regulation is Grid Glycer of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in its development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as

follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1563-1 is amended by:

1. Redesignating paragraph (a)(1)(ii) as paragraph (a)(1)(iii) and adding paragraph (a)(1)(ii).

2. Adding Example 4 to paragraph (b)(4).

3. Adding a sentence at the end of paragraph (e).

The additions to read as follows:

§1.1563-1 Definition of controlled group of corporations and component members and related concepts.

(a) * * *

(1) * * *

(ii) Special rules. In determining whether a corporation is included in a controlled group of corporations, section 1563(b) shall not be taken into account. For rules defining a component member of a controlled group of corporations, including rules defining an excluded member and an additional member, see section 1563(b) and paragraph (b) of this section.

* * * * *

(b) * * *

(4) * * *

Example 4. Individual A owns all of the stock of corporations X, Y and Z. Each of these corporations is an S corporation. X, Y, and Z are each members of a brother-

sister controlled group, even though each such corporation is treated as an excluded member of such group. See §1.1563-1(b)(2)(ii)(C).

* * * * *

(e) * * * Paragraph (a)(1)(ii) of this section applies to taxable years beginning on or after the date of publication in the **Federal Register** of the Treasury decision adopting these rules as final regulations.

Linda E. Stiff
Deputy Commissioner for Services and Enforcement

[FR Doc. 2009-23396 Filed 09/28/2009 at 8:45 am;

Publication Date: 09/29/2009]