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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9606]

RIN 1545-BI13

Use of Controlled Corporations to Avoid the Application of Section 304

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations addressing sales of stock between related corporations. The regulations finalize proposed regulations and remove temporary regulations that apply to certain sales of stock that are recharacterized as contributions and redemptions, but that are structured with a principal purpose of redesignating the issuing corporation or the acquiring corporation. The regulations affect persons treated as receiving distributions in redemption of stock as a result of such transactions.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Date: These regulations apply to acquisitions of stock occurring on or after December 29, 2009.

FOR FURTHER INFORMATION CONTACT: Ryan A. Bowen, (202) 622-3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 30, 2009, the IRS and the Treasury Department published final and temporary regulations and a notice of proposed rulemaking by cross-reference to temporary regulations in the **Federal Register** (74 FR 69021, TD 9477, 2010-1 CB 385; REG-132232-08, 74 FR 69043) (2009 regulations) under section 304. A correction to the 2009 regulations was published in the **Federal Register** on February 26, 2010 (75 FR 8796). The 2009 regulations amended the anti-abuse rule of §1.304-4T, which was published in the **Federal Register** on June 14, 1988 (TD 8209), to address transactions that are subject to section 304 but are structured with a principal purpose of avoiding the application of section 304 to certain corporations. No public hearing on the 2009 regulations was requested or held, and no written comments were received. Accordingly, this Treasury decision adopts the 2009 regulations without change as final regulations and removes the temporary regulations under section 304.

Special Analyses

It has been determined that this Treasury decision 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) and (d) of the Administrative Procedure Act (5 U.S.C. Chapter 6) do not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. Chapter 6), it is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. These regulations primarily will affect large corporations. Thus, the number of affected small entities will not be substantial. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of 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 continues to read in part as follows:

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

Par. 2. Section 1.304-4 is revised to read as follows:

§1.304-4 Special rules for the use of related corporations to avoid the application of section 304.

(a) Scope and purpose. This section applies to determine the amount of a property distribution constituting a dividend (and the source thereof) under section 304(b)(2), for certain transactions involving controlled corporations. The purpose of this section is to prevent the avoidance of the application of section 304 to a controlled corporation.

(b) Amount and source of dividend. For purposes of determining the amount constituting a dividend (and source thereof) under section 304(b)(2), the following rules shall apply:

(1) Deemed acquiring corporation. A corporation (deemed acquiring corporation) shall be treated as acquiring for property the stock of a corporation (issuing corporation) acquired for property by another corporation (acquiring corporation) that is controlled by the deemed acquiring corporation, if a principal purpose for creating, organizing, or funding the acquiring corporation by any means (including through capital contributions or debt) is to avoid the application of section 304 to the deemed acquiring corporation. See paragraph (c) Example 1 of this section for an illustration of this paragraph.

(2) Deemed issuing corporation. The acquiring corporation shall be treated as acquiring for property the stock of a corporation (deemed issuing corporation) controlled by the issuing corporation if, in connection with the acquisition for property of stock of the issuing corporation by the acquiring corporation, the issuing corporation acquired stock of the deemed issuing corporation with a principal purpose of avoiding the application of section 304 to the deemed issuing corporation. See paragraph (c) Example 2 of this section for an illustration of this paragraph.

(c) Examples. The rules of this section are illustrated by the following examples:

Example 1. (i) Facts. P, a domestic corporation, wholly owns CFC1, a controlled foreign corporation with substantial accumulated earnings and profits. CFC1 is organized in Country X, which imposes a high rate of tax on the income of CFC1. P also wholly owns CFC2, a controlled foreign corporation with accumulated earnings and profits of $200x. CFC2 is organized in Country Y, which imposes a low rate of tax on the income of CFC2. P wishes to own all of its foreign corporations in a direct chain and to repatriate the cash of CFC2. In order to avoid having to obtain Country X approval for the acquisition of CFC1 (a Country X corporation) by CFC2 (a Country Y corporation) and to avoid the dividend distribution from CFC2 to P that would result if CFC2 were the acquiring corporation, P causes CFC2 to form CFC3 in Country X and to contribute $100x to CFC3. CFC3 then acquires all of the stock of CFC1 from P for $100x.

(ii) Result. Because a principal purpose for creating, organizing, or funding CFC3 (acquiring corporation) is to avoid the application of section 304 to CFC2 (deemed acquiring corporation), under paragraph (b)(1) of this section, for purposes of determining the amount of the $100x distribution constituting a dividend (and source thereof) under section 304(b)(2), CFC2 shall be treated as acquiring the stock of CFC1 (issuing corporation) from P for $100x. As a result, P receives a $100x distribution out of the earnings and profits of CFC2 to which section 301(c)(1) applies.

Example 2. (i) Facts. P, a domestic corporation, wholly owns CFC1, a controlled foreign corporation with substantial accumulated earnings and profits. The CFC1 stock has a basis of $100x. CFC1 is organized in Country X. P also wholly owns CFC2, a controlled foreign corporation with zero accumulated earnings and profits. CFC2 is organized in Country Y. P wishes to own all of its foreign corporations in a direct chain and to repatriate the cash of CFC2. In order to avoid having to obtain Country X approval for the acquisition of CFC1 (a Country X corporation) by CFC2 (a Country Y corporation) and to avoid a dividend distribution from CFC1 to P, P forms a new corporation (CFC3) in Country X and transfers the stock of CFC1 to CFC3 in exchange for CFC3 stock. P then transfers the stock of CFC3 to CFC2 in exchange for $100x.

(ii) Result. Because a principal purpose for the transfer of the stock of CFC1 (deemed issuing corporation) by P to CFC3 (issuing corporation) is to avoid the application of section 304 to CFC1, under paragraph (b)(2) of this section, for purposes of determining the amount of the $100x distribution constituting a dividend (and source thereof) under section 304(b)(2), CFC2 (acquiring corporation) shall be treated as acquiring the stock of CFC1 from P for $100x . As a result, P receives a $100x distribution out of the earnings and profits of CFC1 to which section 301(c)(1) applies.

(d) Effective/applicability date. This section applies to acquisitions of stock occurring on or after December 29, 2009.

§1.304-4T [Removed]

Par. 3. Section 1.304-4T is removed.

Steven T. Miller
Deputy Commissioner for Services and Enforcement.

Approved: December 12, 2012

Mark J. Mazur
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2012-30967 Filed 12/21/2012 at 8:45 am; Publication Date: 12/24/2012]