



NEW IRC SECTION 954(c)(6)

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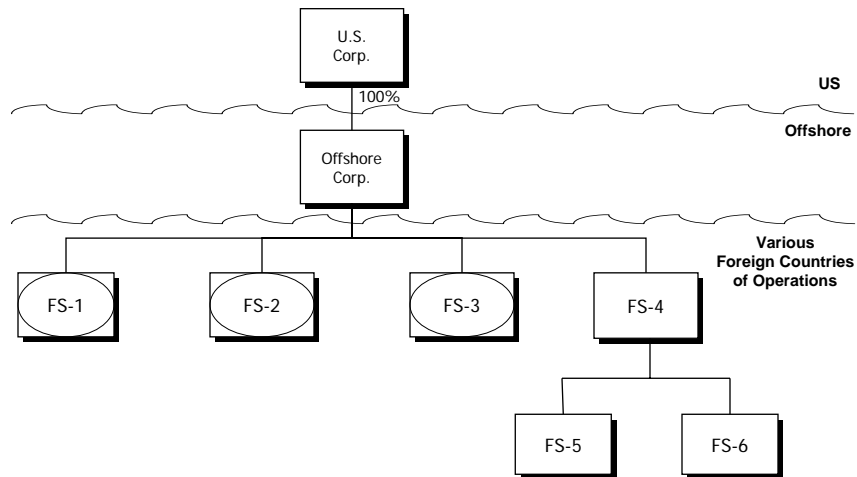
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New IRC Section 954(c)(6)

- IRC § 954(c)(1): Dividends, interest, rents and royalties generally treated as Subpart F income of a controlled foreign corporation (CFC) taxable to its United States shareholders when earned.
- IRC § 954(c)(3)(A)(i): Exception for dividends and interest received from a related corporation organized in, and using a substantial part of its assets in a trade or business in, the same foreign country as the CFC.
- IRC § 954(c)(3)(A)(ii): Exception for rents and royalties received from a related corporation for the use of property in the foreign country in which the CFC is organized.

Example 1



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New IRC Section 954(c)(6)

- IRC § 954(c)(6), added by the Tax Increase Prevention and Reconciliation Act of 2005:

. . . “dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under . . . section 904(d)(3)) to income of the related person which is neither subpart F income nor [effectively connected income]”

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New IRC Section 954(c)(6)

- Exclusion applies to taxable years of foreign corporations beginning after 12-31-05 and before 1-1-09, i.e., for calendar years 2006, 2007 and 2008.
- House Committee Report: “Most countries allow their companies to redeploy active foreign earnings with no additional tax burden. . . . [T]his provision will make U.S. companies and U.S. workers more competitive with respect to such countries . . . [and] will enable U.S. companies to make more sales overseas, and thus produce more goods in the United States.”

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Notice 2007-9

- The payor-CFC and the payee-CFC need be related only when the particular dividend, interest, rent or royalty is received or accrued. Compare IRC § 954(c)(3)(C).
- “Dividends” include amounts treated as dividends under IRC §§ 302, 304, 356(a)(2) and 964(e), but do not include all earnings and profits inclusions under Reg. § 1.367(b)-3(b)(3)(i).
- Earnings and profits of distributing CFC need not be accumulated while the corporation is a CFC or a related person (or during the period IRC § 954(c)(6) is in effect).

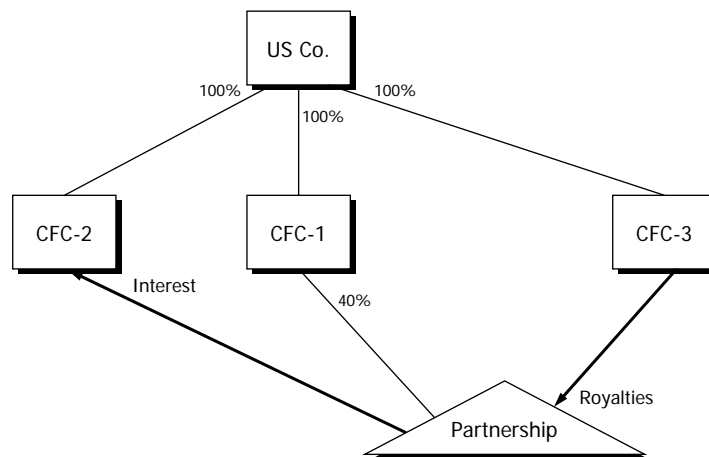
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Notice 2007-9 (continued)


- Interest, rents or royalties received or accrued **from** a partnership with a CFC-partner are treated as received or accrued from a CFC to the extent the CFC-partner is treated as the payor under Reg. § 1.954-2(b)(4) or (5).
- Dividends, interest, rents or royalties received **by** a partnership with a CFC-partner are treated as received or accrued by a CFC to the extent provided in Reg. §§ 1.702-1(a)(8)(ii), 1.952-1(g) and 1.954-1(g) (the *Brown Group* regulations).

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Example 2




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Notice 2007-9 (continued)

- Interest, rents and royalties are not eligible for the exception to the extent the corresponding deduction (i) is allocated to and therefore reduces the related CFC-payor's Subpart F income, or (ii) creates (or increases) a deficit that may reduce Subpart F income of the related CFC-payor or another CFC under IRC § 952(c). Compare IRC § 954(c)(3)(B).
- Interest, rents and royalties are not eligible for the exception to the extent the corresponding deduction (i) is allocated to effectively connected income of the related CFC-payor, or (ii) creates (or increases) a net operating loss carryover that is effectively connected with a U.S. trade or business.

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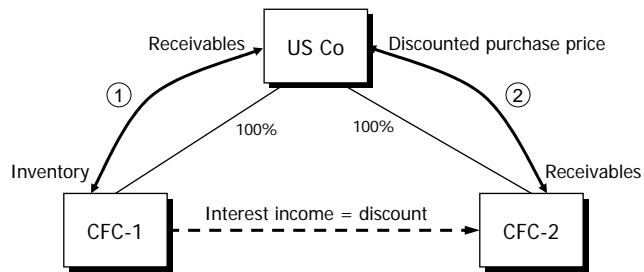


Notice 2007-9 (continued)

- Anti-abuse rule #1: IRC § 954(c)(6) is not available where the net effect of a transaction is the creation of a deduction or loss of a U.S. taxpayer without a corresponding Subpart F income inclusion of the CFC-recipient, where the inclusion would have resulted absent IRC § 954(c)(6).

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Example 3



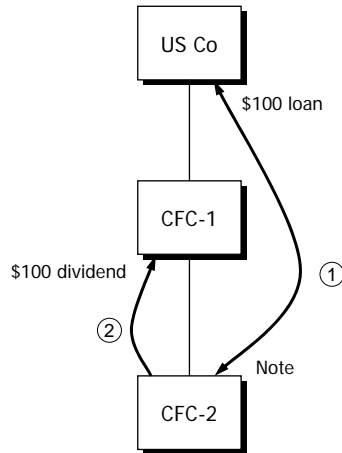
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Notice 2007-9 (continued)

- Anti-abuse rule #2: A dividend that reduces the applicable earnings of a CFC and therefore an income inclusion under IRC § 956 is not eligible for the exception. See Reg. § 1.956-1T(b)(4).

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Example 4



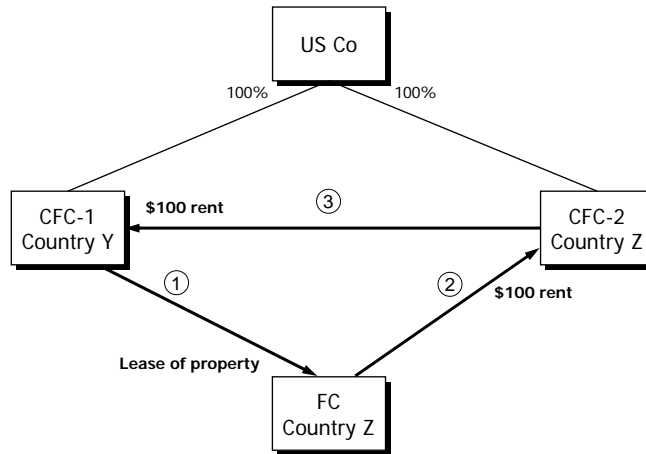
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Notice 2007-9 (continued)

- Anti-abuse rule #3: Options or similar interests can not be used to cause a foreign payor corporation to become a CFC-payor if a principal purpose is to qualify for the exception.
- Anti-abuse rule #4: A conduit entity can not be used to change the character of the underlying income of a transaction to income that qualifies for the exception, if a principal purpose is to qualify for the exception.

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Example 5



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New IRC Section 954(c)(6)

■ Other Issues:

- Are distributions of previously taxed earnings (under IRC § 959) treated as paid first, so that a distribution of the remaining earnings and profits would qualify for the exception?
- How does IRC § 954(c)(6) interact with the exceptions for same-country income and high-taxed income (IRC §§ 954(c)(3) and 954(b)(4))?

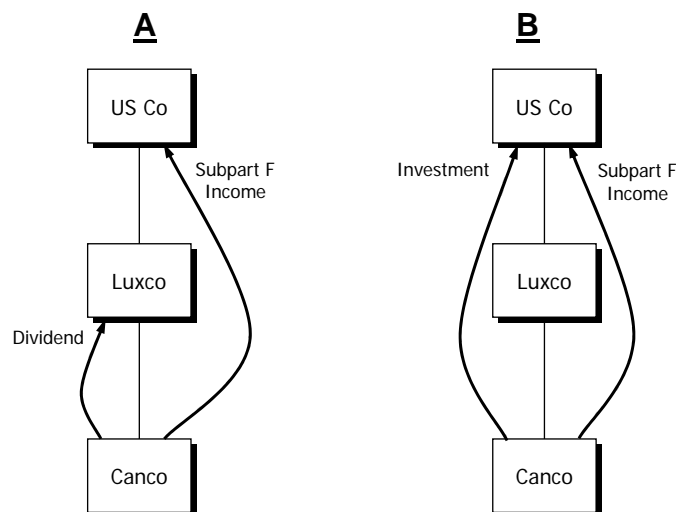
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Observations

- Will a CFC replace a disregarded entity (DRE) as the preferred vehicle for operations?
 - Multiple CFCs may permit better foreign tax credit management by avoiding “blending” of rates, but may result in more reliance on IRC § 956.
 - Incorporation of a DRE in its country of operations may avoid foreign base company services income and foreign base company sales income.
 - Consider selective conversion of DREs to CFCs, treated as foreign-to-foreign transfers under IRC § 351. Consider effect of any branch terminations under IRC § 987. Note that IRC § 381 tax attributes remain with the CFC.

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Example 6A & 6B



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Observations (continued)

- Dividend income under IRC § 304 from cross-chain sales may no longer result in Subpart F income.
- A sale by an upper-tier CFC of the stock of a lower-tier CFC may no longer produce Subpart F income to the extent of the gain treated as dividend income under IRC § 964(e). In some cases this could replace the “check-and-sell” technique.
- The exception for dividends permits the removal of earnings from low-tax countries, while the exception for interest, rents and royalties permits the shifting of earnings from high-tax to low-tax countries.

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Observations (continued)

- Generally, interest paid between CFCs either (i) reduces the CFC-payor’s Subpart F income and results in Subpart F income to the CFC-payee in the same amount, or (ii) neither reduces the CFC-payor’s Subpart F income nor results in Subpart F income to the CFC-payee.
- An election to treat a DRE owned by a CFC as a corporation will result in a deemed transfer of its assets under IRC § 351. Any note from the DRE to its CFC-owner would be treated as “boot” under IRC § 351(b), but the resulting gain should not be Subpart F income if attributable to active business assets, although the gain would increase the CFC’s earnings and profits.

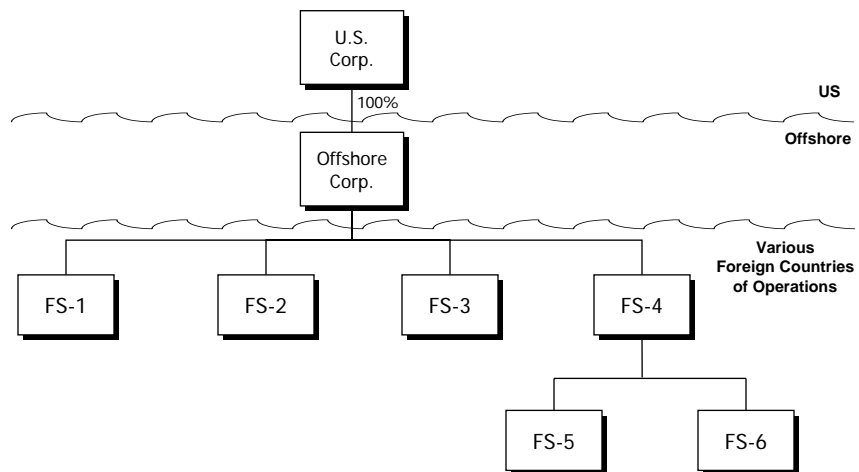
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New IRC Section 954(c)(6)

- What happens in 2009?
 - Will Congress extend the exclusion for ___ years?
 - Can the CFCs be reconverted to DREs?
 - Any tax consequences to the reconversions (generally IRC §§ 332/337 transactions)?

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Example 7



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Canadian Observations

- Canada tightening ITA 95(2)(a)(ii) (Budget 2007) - US relaxing
- Payments to a Partnership with US members (reverse hybrid): look through to US members (despite OECD partnership report)
- US entities used hybrids in the past to achieve the same result (e.g., Alberta/Nova Scotia ULC)
 - Now easier (to avoid old statutes)

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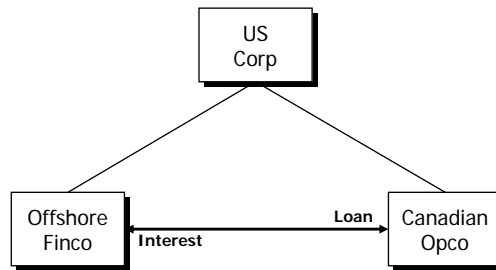


Canadian Observations

- Applies to Dividends: means can hold Latin/other CFAs in Canadian Holdcos and get exempt surplus dividends.
- Likely no capital gains tax once Budget is thought through:
 - But Budget 2007 means no interest deduction
 - Deemed dividends (IRC § 304) constructive dividends.
 - ITA 15 (1) benefits are a problem.
- Interest income from Canada to offshore FINCO (CFA of US parent)
 - Double dip? Thin capitalization limits apply since NAL with US parent
 - Treaty shopping? N/A! if US percent is zero WHT

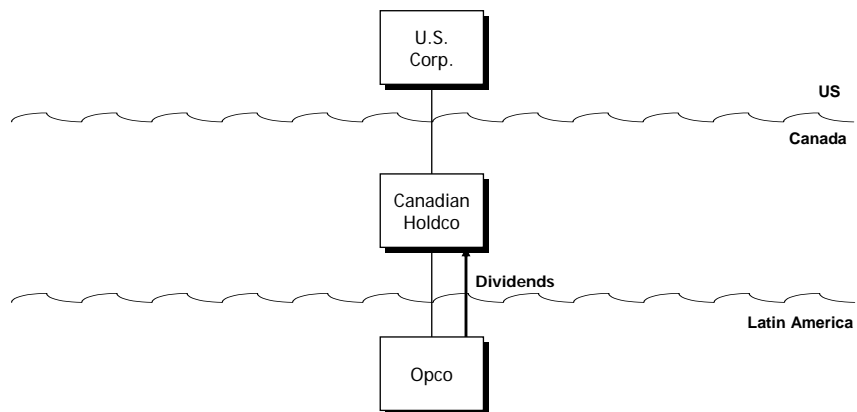
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Example 8



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Example 9



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