Treatment of Foreign Stapled Entity Under Section 269B as Domestic for Purposes of Sections 904(i) and 864(e)

Notice 2003–50

This notice modifies Notice 89–94, 1989–2 C.B. 416.

Section 269B provides that, except as provided in regulations, if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation will be treated as a domestic corporation for U.S. income tax purposes. Section 269B(a)(1). Two entities are stapled entities if more than 50 percent in value of the beneficial ownership in each of such entities consists of stapled interests. Section 269B(c)(2). Interests are stapled interests if, by reason of form of ownership, restrictions on transfer, or other terms and conditions, in connection with the transfer of one of the interests the other interest is also transferred or required to be transferred. Section 269B(c)(3).

Notice 89–94 announced that regulations issued under section 269B will provide that a stapled foreign corporation, treated as a domestic corporation under section 269B(a)(1), will nevertheless be treated as a foreign corporation for purposes of the definition of an includible corporation under section 1504(b). Thus, losses of a stapled foreign corporation will not be allowed to offset income of any member of an affiliated group, unless a valid section 1504(d) election is in effect with respect to the stapled foreign corporation.

Section 904(i) provides that if two or more domestic corporations would be members of the same affiliated group if (i) section 1504(b) were applied without regard to the exceptions contained therein, and (ii) the constructive ownership rules of section 1563(e) applied for purposes of section 1504(a), the Secretary is authorized to issue regulations that provide for resourcing the income of any of such domestic corporations or for modifications to the consolidated return regulations to the extent that such resourcing or modifications are necessary to prevent the avoidance of the provisions of this subpart (sections 901 to 908). Section 904(i) was enacted to prevent a consolidated group of corporations from manipulating its foreign tax credit limitation by utilizing techniques to disaffiliate a subsidiary. *See* H.R. Rep. No. 101–247, at 1292–93 (1989).

The regulations under section 904(i) provide that two includible corporations that are "affiliates" (as defined in § 1.904(i)–1(b)(1)) must consistently elect either to credit or to deduct foreign income taxes paid or accrued (or deemed paid) for the taxable year and require the affiliates to determine their foreign tax credit limitations on a combined basis. § 1.904(i)–1(a), (d). In order to be an "affiliate" under § 1.904(i)–1(b), a corporation must be an includible corporation under section 1504(b). See § 1.904(i)–1(b)(1)(i) and –1(b)(2).

Section 864(e)(1) requires the members of an affiliated group to allocate and apportion interest expense as if all members of the group were a single corporation. Section 864(e)(5) provides that, except for certain financial institutions, the term "affiliated group" has the same meaning as in section 1504 (determined without regard to section 1504(b)(4)). Section 864(e)(1) was enacted because Congress was concerned that the separate company approach for allocating and apportioning expenses did not reflect economic reality. Instead, consideration of the expenses of an entire group of corporations that file a consolidated income tax return is a more appropriate approach. In addition, Congress wanted to prevent an affiliated group from manipulating its foreign tax credit limitation by adjusting the location of borrowing within the affiliated group. H.R. Rep. No. 99–426, at 374–75 (1985); S. Rep. No. 99–313, at 346–47 (1986).

Sections 1.861–11 and 1.861–11T contain rules for allocating and apportioning interest expense of an affiliated group. For purposes of these rules, the definition of an "affiliated corporation" is expanded to include any "includible corporation" (as defined in section 1504(b) without regard to section 1504(b)(4)) if 80 percent of the vote or value of all the stock is owned directly or indirectly by an includible corporation or by members of an affiliated group. § 1.861–11T(d)(6). This expanded definition was intended to prevent taxpayers from avoiding application of section 864(e)(1) through disaffiliation of one member or the creation of two affiliated groups.

Treasury and the IRS are aware that certain taxpayers have imposed transfer restrictions on the stock of an 80 percent or greater owned foreign corporation and taken the position that such stock is stapled to the stock of an 80 percent or greater owned domestic corporation. If the interests of the corporations are treated as stapled for purposes of section 269B, then although the foreign corporation generally is treated as a domestic corporation, Notice 89–94 announced that regulations will be issued that would treat it as a foreign corporation for purposes of the definition of an includible corporation under section 1504(b) and therefore not an includible corporation.

This notice announces that regulations issued under section 269B will provide that a foreign corporation that is stapled to a domestic corporation will be treated as a domestic corporation for purposes of the definition of an includible corporation under section 1504(b) when applying §§ 1.904(i)–1 and 1.861–11T(d)(6). The provisions of the regulations described in the preceding sentence will be effective for taxable years beginning after July 22, 2003. In the case of structures completed on or after July 22, 2003, such provisions will be effective for taxable years including July 22, 2003.

The IRS will continue to apply principles of existing law to determine whether interests are stapled for purposes of section 269B. For example, under a substance-over-form analysis, restrictions on transferability of ownership interests may be disregarded for tax purposes if the interests are held by the same person or related persons. Finally, Treasury and the IRS are considering issuing further guidance under section 269B, including guidance on situations where the interests of two or more entities are held by the same person or related persons.

EFFECT ON OTHER NOTICES

Notice 89–94, 1989–2 C.B. 416, is modified.

DRAFTING INFORMATION

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