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Notice 2010-41, Internal Revenue Service, (May 14, 2010)

Notice 2010-41, I.R.B. 2010-22, May 14, 2010.

Controlled foreign corporations: Gross income of U.S. shareholders: Stock ownership rules: Tax-avoidance transactions: Domestic and foreign corporations, resident and nonresident persons: Partnerships: Subpart F income partnership blocker transactions.–

The Treasury Department and the IRS intend to issue regulations providing that, under certain circumstances, an otherwise domestic partnership will be classified as foreign solely for purposes of identifying the U.S. shareholders of a controlled foreign corporation (CFC) that are required to include in gross income the amounts determined under Code Sec. 951(a) with respect to the CFC. This treatment applies to Subpart F income partnership blocker transactions, which were identified as transactions of interest in Notice 2009-7, 2009-1 CB 312, and were added to the list of transactions of interest in Notice 2009-55, I.R.B. 2010-31, 170. Notice 2009-7 will continue to apply, as appropriate.

SECTION 1. OVERVIEW

The Treasury Department and Internal Revenue Service (IRS) intend to issue regulations that will classify certain domestic partnerships as foreign for purposes of identifying the United States shareholders (as defined in § 951(b) of the Internal Revenue Code (Code)) of a controlled foreign corporation (as defined in § 957(a)) that are required to include in gross income the amounts specified under § 951(a) of such controlled foreign corporation. The regulations to be issued pursuant to this notice shall apply to taxable years of a domestic partnership ending on or after May 14, 2010.

SECTION 2. TRANSACTION AT ISSUE

On December 29, 2008, the Treasury Department and the IRS issued Notice 2009-7, 2009-1 C.B. 312, identifying the following transaction (and substantially similar transactions) as a transaction of interest for purposes of § 1.6011-4(b)(6) and §§ 6111 and 6112 of the Code. A United States taxpayer (Taxpayer) wholly owns two controlled foreign corporations (CFC1 and CFC2), each of which owns 50 percent of another controlled foreign corporation (CFC3) through a domestic partnership. CFC3 has amounts described in § 951(a)(1). Taxpayer takes the position that it does not have an income inclusion under § 951(a) with respect to CFC3 because the domestic partnership is the first United States person in the chain of ownership of CFC3. As stated in Notice 2009-7, the Treasury Department and IRS believe that Taxpayer's position is contrary to the purpose and intent of § 951 of the Code.

SECTION 3. BACKGROUND

Section 951(a) provides that if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during any taxable year, then each United States shareholder (as

defined in § 951(b)) of such corporation that owns, within the meaning of § 958(a), stock in the corporation on the last day in such year on which it is a CFC must include in gross income its pro rata share of the corporation's subpart F income (as defined in § 952) as well as any amount determined under § 956 with respect to such shareholder. See also § 951(a)(1)(A)(ii) and (iii) for other required inclusions.

Section 951(b) defines a United States shareholder, with respect to any foreign corporation, as a United States person (as defined in § 957(c)) that owns (within the meaning of § 958(a)) or is considered as owning under § 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. With certain modifications, § 957(c) defines a United States person by reference to § 7701(a)(30). Section 7701(a)(30)(B) defines a United States person to include a domestic partnership. Section 7701(a)(5) defines the term foreign when applied to a corporation or partnership as a corporation or partnership that is not domestic. Section 7701(a)(4) provides that the term domestic when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations. However, § 7701(a) provides that any general definition included therein does not apply where such definition is manifestly incompatible with the intent of the relevant Code provision.

SECTION 4. REGULATIONS CONCERNING THE DEFINITION OF A FOREIGN PARTNERSHIP UNDER SECTION 7701

If the general definition of a United States person provided by § 7701(a)(30)(B) (which incorporates the general definition of a domestic partnership under § 7701(a)(4)) applies to the facts described above in Section 2 (and in Notice 2009-7), the domestic partnership is the United States shareholder required to include in gross income the amounts determined under § 951(a) with respect to CFC3. However, the domestic partnership's gross income inclusion may have little or no tax consequences, depending on the treatment of each partner's (CFC1 and CFC2) distributive share of such income. As stated in Notice 2009-7, the Treasury Department and the IRS believe that the Taxpayer's position in the transaction described therein is contrary to the purpose and intent of § 951. Therefore, consistent with § 7701(a), the Treasury Department and the IRS have determined that the general definition of a domestic partnership under § 7701(a)(4), in the case of certain partnerships owned wholly or partly by foreign corporations, is manifestly incompatible with the intent of § 951.

SECTION 4.01. DOMESTIC PARTNERSHIP TREATED AS FOREIGN FOR CERTAIN PURPOSES

The Treasury Department and the IRS intend to issue regulations that, under certain circumstances, will classify an otherwise domestic partnership as foreign solely for purposes of identifying the United States shareholders of a CFC required to include in gross income the amounts determined under § 951(a) with respect to such CFC.

Specifically, the regulations to be issued shall treat a domestic partnership as foreign for this purpose if the following conditions are satisfied:

1. The partnership is a United States shareholder of a foreign corporation that is a CFC (within the meaning of § 957(a) or 953(c)); and
2. If the partnership were treated as foreign,
 - a. That foreign corporation would continue to be a CFC; and
 - b. At least one United States shareholder of the CFC,
 - i. Would be treated under § 958(a) as indirectly owning stock of the CFC owned by the partnership that is indirectly owned by a foreign corporation; and
 - ii. Would be required to include an amount in gross income under § 951(a) with respect to the CFC.

The regulations to be issued will provide similar results in the case of tiered-partnership structures.

SECTION 4.02. SCOPE OF TREATMENT AS A FOREIGN PARTNERSHIP

The regulations to be issued shall classify a domestic partnership described in § 4.01 of this notice as foreign solely for purposes of identifying the United States shareholders of a CFC required to include in gross income the amounts determined under § 951(a) with respect to such CFC. Therefore, a domestic partnership to which the regulations to be issued apply shall continue to be classified as domestic for all other purposes of the Code. For example, the regulations to be issued shall not otherwise affect the classification of the partnership as domestic for purposes of determining the source of income and expenses, the definition of “United States property” under § 956(c)(1)(C), and the application of § 1248(a). Similarly, the partnership remains a domestic partnership for purposes of determining its information reporting obligations, including the filing of a Form 1065, U.S. Return of Partnership Income, and Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations.

The following demonstrates the application of the regulations described in this Notice to the facts described above in Section 2. Under the regulations to be issued, the domestic partnership described in Notice 2009-7 and in Section 2 above would be treated as foreign because the partnership would be a United States shareholder of a foreign corporation that is a CFC (CFC3) if the regulations to be issued did not apply; and if the domestic partnership were treated as foreign, (1) CFC3 would continue to be a CFC, and (2) under § 958(a) Taxpayer (a United States shareholder of CFC3) would be treated as indirectly owning the stock of CFC3 owned by the partnership that is indirectly owned by CFC1 and CFC2, and would be required to include in gross income the amounts determined under § 951(a) with respect to CFC3. The result would be the same if the Taxpayer were a partner in the partnership (in addition to CFC1 and CFC2), or also owned directly stock of CFC3.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Notice 2009-7 shall continue to apply, as appropriate.

SECTION 6. EFFECTIVE DATE

The regulations to be issued as described in this notice shall apply to taxable years of a domestic partnership ending on or after May 14, 2010. No inference is intended as to the treatment of a domestic partnership for any taxable year ending before May 14, 2010. As stated in Notice 2009-7, the IRS may challenge the positions taken by taxpayers with respect to such transactions, including under the provisions of subpart F and subchapter K of the Code, or under judicial doctrines including the sham transaction, substance over form, and economic substance doctrines.

SECTION 7. DRAFTING INFORMATION

For further information regarding this notice, contact Susan E. Massey at (202) 622-3840 (not a toll-free call).