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# IRC 956 Deemed Dividend Reduced for US Shareholders of CFCs that are Corporations under Recently Proposed Regulations. Deemed Dividend Rules are Retained, however, for US Shareholders Other than Corporations.

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On October 31, 2018, the Internal Revenue Service (the "IRS") and the Treasury Department issued proposed regulations (the "Proposed Regulations") that reduce (and in some circumstances eliminate) the tax imposed on a deemed dividend inclusion under Section 956 of the Internal Revenue Code (the "Code") for US shareholders of a "controlled foreign corporation" (a "CFC") that are domestic corporations. The Proposed Regulations address an inconsistency between Section 956 of the Code, which imposes a tax on dividends that are "deemed" to be received by US shareholders from CFCs, and the "participation exemption system" adopted under the Tax Cuts and Jobs Act (the "TCJA"), which provides an exemption for dividends actually received from certain foreign corporations.

Section 956 of the Code generally requires US persons that own 10% or more (by vote or value) of the stock of a CFC (a "10% US Shareholder") to include in their gross income, on a current basis, among other things, their pro rata share of such CFC's "investment in US property." Generally, a guarantee by a CFC of an obligation of a US person, including for this purpose a loan or other debt instrument, as well as a pledge of 66.66% or more of the voting stock of a CFC as collateral security for an obligation of a US person, is considered an investment in US property and triggers a "deemed dividend" to the 10% US Shareholders in an amount equal, in general, to the lesser of the principal amount of the loan and the total untaxed earnings and profits of the CFC.

The TCJA established a broad participation exemption system pursuant to which a corporate US shareholder that owns 10% or more of a foreign corporation (a "10% US Corporate Shareholder"), other than a passive foreign investment company, is allowed a 100% dividends received deduction in an amount equal to the foreign source portion of any dividend received from such foreign corporation. As a result, foreign source earnings of a foreign corporation that are repatriated to a 10% US Corporate Shareholder as a dividend are effectively exempt from tax. A deemed dividend, however, under Section 956 of the Code was not eligible for the 100% dividends received deduction.

The Proposed Regulations provide that the amount otherwise includible in US taxable income by a US shareholder that is a corporation under Section 956 of the Code is reduced to the extent that the US corporate shareholder would be allowed a deduction under the participation exemption system if the amount had been received as a distribution from the CFC. The Proposed Regulations effectively provide an offsetting deduction for deemed dividends that is comparable to the deduction available to 10% US Corporate Shareholders for dividends actually received from a foreign corporation.

The Proposed Regulations **will not** eliminate the deemed dividend inclusion in all instances where the borrower is a corporation and do not change the treatment of US shareholders that are not corporations. As a result, the deemed dividend rules under Section 956 of the Code remain in effect for US shareholders of a CFC other than domestic corporations (such as individuals).

The rules are proposed to be effective for taxable years of a CFC beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register. Taxpayers, however, generally are permitted to rely on the proposed regulations prior to finalization.

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