

# International Tax Reform Proposals:

## Considerations for Calendar-Year Multinational Corporations

*“Given the uncertainty of the extension and the fact that any retroactive extension could create unusual effective tax rate impacts during the interim reporting periods, calendar-year multinational companies may wish to consider making an I.R.C. § 898(c)(2) election.”*

On October 13, 2009, the *Wall Street Journal* published an article concerning President Obama’s international tax reform proposals. The article, *Obama Administration Shelves Plan to Change How U.S. Treats Overseas Profits*, stated that President Obama’s international reform proposals have been postponed for 2009. However, many tax practitioners believe that the Obama administration will reconsider some form of these proposals in 2010.

While keeping a close watch on these international tax reform proposals, many multinational corporations have explored alternatives in light of the sunset of I.R.C. § 954(c)(6) which allows multinational corporations, amongst other things, to use earnings from foreign operations to fund foreign expansion.<sup>1</sup> Section 954(c)(6) is scheduled to expire on December 31, 2009, for calendar-year companies.<sup>2</sup>

For the past few years, multinational corporations relied on Section 954(c)(6) to defer U.S. federal income taxation of otherwise Subpart F income from certain related-party interest, dividends, rents, and royalty payments between controlled foreign corporations. Prior to the announcement of President Obama’s international tax reform proposals in May 2009, many multinational corporations researched alternative structures in an effort to maintain the benefits of Section 954(c)(6) post-sunset. With the announcement of President Obama’s international tax reform proposals, however, several multinational companies instead decided to take a “wait-and-see” approach.

While multinational companies continue to hope that I.R.C. § 954(c)(6) will be extended an additional year for calendar-year companies,<sup>3</sup> it is also expected that the extension would not become law until 2010 and the effective date would be retroactive to January 1, 2010. Given the uncertainty of the extension and the fact that any retroactive extension could create unusual effective tax rate impacts during the interim reporting periods, calendar-year multinational companies may wish to

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<sup>1</sup> I.R.C. § 954(c)(6)(A) states:

In general. For purposes of this subsection, 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 rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including such regulations as may be necessary or appropriate to prevent the abuse of the purposes of this paragraph.

<sup>2</sup> “Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2010, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.” I.R.C. § 954(c)(6)(C).

<sup>3</sup> In the proposal originally released in May 2009, President Obama included a provision to extend I.R.C. § 954(c)(6) for an additional year. One explanation for the extension is that it would allow corporations to structure their operations once (for the sunset of I.R.C. § 954(c)(6) and the advent of President Obama’s international tax reform proposals) instead of twice because the sunset date of Section 954(c)(6) and the advent of President Obama’s proposals were expected to match in this instance.

consider making an I.R.C. § 898(c)(2) election, ending the wholly owned foreign corporations' fiscal year sooner.

*“Absent the election, upon sunset of Section 954(c)(6), taxation of the passive income may have a negative impact on the effective tax rate for calendar-year SEC filers in the first quarter of 2010.”*

Generally, controlled foreign corporations must adopt the same tax year end as their majority U.S. shareholder.<sup>4</sup> Thus, in most cases of calendar-year U.S. corporations, their wholly-owned controlled foreign corporations must also have December 31 year ends. If a controlled foreign corporation makes an election under Section 898(c)(2), then it may choose a tax year ending one month earlier than its U.S. majority shareholder or a November 30 year end for a calendar-year corporation.

The impact of choosing a November 30, 2009 year end is that I.R.C. § 954(c)(6) would sunset for the U.S. shareholder on November 30, 2010, instead of December 31, 2009.<sup>5</sup> Thus, this election could potentially extend Section 954(c)(6) by eleven months and provide calendar-year multinational corporations more time to consider alternative structures.

Corporations considering a Section 898(c)(2) election should be aware that the election requires a closing of the books for Form 5471 reporting purposes as of November 30, 2009.<sup>6</sup> In addition, the election may create some complexity in how the foreign taxes accrued or paid (presumably on a calendar-year basis for local country tax purposes) are allocated between the November 30, 2009, and November 30, 2010, year ends. Corporations should also note that the election does not change the accounting period for the controlled foreign corporation for non-U.S. tax purposes.

Revenue Procedure 2006-45 describes the rules for making a Section 898(c)(2) election. Generally, controlled foreign corporations making this election must do so no earlier than December 1, 2009, and no later than the due date (including extensions) for the U.S. shareholder's federal income tax return (March 15, 2010, or September 15, 2010, in the case of extended tax returns).

Filing the election in 2009 or by the due date may provide corporations with a better way to manage the deferral of U.S. federal income taxation in the event Section 954(c)(6) is not extended or is extended on a retroactive basis. Absent the election, upon sunset of Section 954(c)(6), taxation of the passive income may have a negative impact on the effective tax rate for calendar-year SEC filers in the first quarter of 2010. The negative impact may reverse if I.R.C. § 954(c)(6) is retroactively extended in 2010.

Taxpayers should also be aware that under the guidance from Rev. Proc. 2006-45, once they make an election under I.R.C. § 898(c)(2), it cannot be generally revoked for a 48-month period.

<sup>4</sup> See I.R.C. § 898(c)(1).

<sup>5</sup> See I.R.C. § 954(c)(6)(C). If the controlled foreign corporation's taxable year ended November 30, 2009, its subsequent twelve-month taxable year would begin December 1, 2009, and end November 30, 2010. In this case, I.R.C. § 954(c)(6) would sunset on November 30, 2010.

<sup>6</sup> See Rev. Proc. 2007-64, 2007-2 C.B. 818.

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