Acquirer, a domestic corporation, owns, through disregarded entities, 100 percent of the stock of US Sub, a domestic corporation. US Sub acquired all of the stock of Target, a domestic corporation, for cash in a taxable transaction (the "Target Acquisition") effected through a reverse subsidiary cash merger.

After the Target Acquisition, pursuant to a series of transactions the following occurred for U.S. tax purposes: (a) Target converted to a foreign corporation ("Foreign NewCo") in a transaction that qualified as a reorganization within the meaning of section 368(a)(1)(F) (the "Outbound Reorganization"); (b) Foreign NewCo transferred a portion of its assets and liabilities to US NewCo, a newly formed domestic corporation, in exchange for all the US NewCo stock (the "Contribution"), and (c) US Sub distributed its assets to Acquirer in a complete liquidation qualifying under section 332.

As a consequence of the Outbound Reorganization, Foreign NewCo succeeded to the Target tax attributes enumerated in section 381(c), including earnings and profits of Target (the "Target E&P"). Following the Contribution, US NewCo is expected to generate earnings and profits. US NewCo may distribute such earnings and profits as a dividend to its 100 percent owner, Foreign NewCo. Foreign NewCo may distribute its earnings and profits, including earnings and profits attributable to any dividends it receives from US NewCo, to its 100 percent owner, Acquirer.

Foreign NewCo is a controlled foreign corporation ("CFC"). Dividends received by Foreign NewCo from US NewCo are included in Foreign NewCo's gross income and constitute foreign personal holding company income, a type of subpart F income, pursuant to section 954(c)(1)(A).
Treas. Reg. § 1.952-2(a) provides, in general, that the gross income of a foreign corporation for any taxable year shall be determined by treating such foreign corporation as a domestic corporation taxable under section 11 and by applying the principles of section 61 and the regulations thereunder. Treas. Reg. § 1.952-2(b)(i) provides, in general, that the taxable income of a foreign corporation for any taxable year shall, subject to the special rules of Treas. Reg. § 1.952-2(c), be determined by treating such foreign corporation as a domestic corporation taxable under section 11 and by applying the principles of section 63. Section 63(a) provides that, except as provided in section 63(b), for purposes of subtitle A of the Code, the term “taxable income” means gross income minus the deductions allowed by sections 1 through 1400 (other than the standard deduction).

Section 243(a) provides that in the case of a corporation there shall be allowed as a deduction an amount equal to a certain percentage of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter. Section 243(c) provides that in the case of any dividend received from a 20-percent owned corporation, the appropriate percentage is 80 percent. For this purpose, the term “20-percent owned corporation” means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. Also, for this purpose, stock described in section 1504(a)(4) shall not be taken into account.

Section 245(a)(1) provides that in the case of dividends received by a corporation from a qualified 10-percent owned foreign corporation, there shall be allowed as a deduction an amount equal to the percent (specified in section 243 for the taxable year) of the U.S.-source portion of such dividends. Section 245(a)(2) provides that a “qualified 10-percent owned foreign corporation” is any foreign corporation (other than a passive foreign investment company) if at least 10 percent of the stock of such corporation (by vote and value) is owned by the taxpayer. Section 245(a)(3) provides that the U.S.-source portion of any dividend is an amount which bears the same ratio to such dividends as the post-1986 undistributed U.S. earnings bears to the total post-1986 undistributed earnings. Section 245(a)(4) provides that the term “post-1986 undistributed earnings” has the meaning given to such term by section 902(c)(1). Section 245(a)(5) provides that post-1986 undistributed U.S. earnings includes the portion of the post-1986 undistributed earnings attributable to any dividend received (directly or through a wholly owned foreign corporation) from a domestic corporation at least 80 percent of the stock of which (by vote and value) is owned (directly or through such wholly owned foreign corporation) by the qualified 10-percent owned foreign corporation. Earnings and profits of a corporation are not decreased by an amount allowed as a deduction for dividends received. Weyerhaeuser v. Commissioner, 33 BTA 594 (1935).

The Target E&P succeeded to by Foreign NewCo pursuant to section 381 as a result of the Outbound Reorganization shall not be included in Foreign NewCo's post-1986 undistributed earnings, pre-1987 accumulated profits, or pre-1987 section 960 earnings and profits. For purposes of calculating Foreign NewCo's net foreign base company income, subject to applicable limitations, including those provided under section 246, Foreign NewCo shall be allowed as a deduction an amount equal to 80 percent of the amount received as dividends from US NewCo. Subject to applicable limitations, including those provided under section 246, Acquirer shall be allowed as a deduction an amount equal to 80 percent of the U.S.-source portion of dividends received from Foreign NewCo.

The post-1986 undistributed U.S. earnings taken into account in computing the U.S.-source portion of the dividends received from Foreign NewCo includes the portion of the post-1986 undistributed earnings attributable to dividends received from US NewCo.

Foreign NewCo's earnings and profits and Acquirer's earnings and profits shall not be decreased by the respective dividends received deductions.

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