

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:NER:PEN:PHI:TL-N-6104-99

DABreen

NOV - 3 1999

date:

to: Francis J. Koneski, Case Manager, Group 1804
Pennsylvania District, King of Prussia Post of Duty

from: Assistant District Counsel, Pennsylvania District, Philadelphia

subject: [REDACTED] and Dividend Received Deduction Issue

This memorandum is in response to an inquiry from Team Coordinator Gene Maguire to Senior Attorney David A. Breen.

Facts

[REDACTED] (hereafter the "Parent" or "P") designs, manufactures, and distributes engineered products and services for the [REDACTED] markets [REDACTED]. Parent files a consolidated return with a year ending on [REDACTED]. On [REDACTED] Parent acquired [REDACTED] (hereinafter "Subsidiary" or "S") by purchasing [REDACTED] of its [REDACTED] shares of outstanding common stock. Parent reflected the beginning balance of Subsidiary's retained earnings as an "Other increase in stockholders' equity" section of the balance sheet.

Between [REDACTED] and [REDACTED] "S" paid a \$[REDACTED] cash dividend to "P". During calendar year [REDACTED] "S" paid a \$[REDACTED] cash dividend to "P". Parent and subsidiary filed consolidated income tax returns for tax years [REDACTED] and [REDACTED]. Parent eliminated these dividends in full from consolidated taxable income on its consolidated income tax returns for [REDACTED] and [REDACTED].

Issue

May "P" eliminate the entire amount of dividends from "S", its wholly owned subsidiary in [REDACTED] and [REDACTED]?

Conclusion

The intercompany dividend is eliminated in arriving at consolidated taxable income under Income Tax Regulation § 1.1502-14(a)(1).

Discussion and Legal Analysis

The team coordinator's position is that the [REDACTED] dividend received deduction under I.R.C. § 243(a)(3) is not available to "P", because the distributions to "P" from "S" are not qualifying distributions and that Parent did not comply with the election requirements thereunder. The agent proposes to allow Parent the 80% dividend received deduction pursuant to I.R.C. § 243(a)(1).

Parent's position is that the dividends are completely eliminated from consolidated taxable income pursuant to Treas. Reg. § 1.1502-14(a)(1) which states that dividend distributions between members of a consolidated group are "eliminated" from the computation of consolidated taxable income. Parent argues that the dividend received deduction provisions are inapplicable because the consolidated return regulations cover the subject transaction.

A corporation is entitled to a special deduction for dividends received from a domestic corporation that is subject to income tax. The amount of the deduction is 80% of dividends received if 20% or more of the stock is owned by the receiving corporation. I.R.C. § 243(a). For dividends received from a member of an affiliated group, a corporation can generally deduct 100% of the dividends received. I.R.C. § 243(a)(3). "Affiliated group" has essentially the same meaning as it does under I.R.C. § 1504(a).

Internal Revenue Code § 243 and the regulations thereunder deal with dividends paid by one corporation to another in a nonconsolidated setting. However, treatment of intercompany transfers by companies filing a consolidated return is determined by reference to the consolidated return regulations.

Income Tax Regulation § 1.1502-14(a) states that dividends distributed by one member to another member during a consolidated return year shall be eliminated. It adds that "dividend" means a distribution which is described in I.R.C. § 301(c)(1) other than a distribution described in I.R.C. § 243(c)(1).

The Team Coordinator states in Form 5701, Notice of Proposed Adjustment:

The term "affiliated group" is defined as ownership of 80% or more of the voting stock. Members of a consolidated group must meet the definition of an affiliated group, therefore, the section 243 rules in regard to the dividend received deduction apply to an entity whether the parent elects the consolidated status or the single entity status.

The agent is partially correct. However, as previously stated, because the entities filed a consolidated income tax return, the issue is not the amount of dividend received deduction allowed under I.R.C. § 243 or Reg. § 1.1502-26, but rather, the elimination of the intercompany transfer under Reg. § 1.1502-14(a)(1) in arriving at consolidated taxable income.

Summary

For the reasons set forth above, we recommend that the elimination of the intercompany transfers of \$ [REDACTED] and \$ [REDACTED] in arriving at consolidated taxable income for tax years [REDACTED] and [REDACTED] be accepted as filed.

This concludes our advice and recommendation. Please feel free to call Senior Attorney David A. Breen at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory ten day post review. To assure that National Office has sufficient time to review our advice, we request that you refrain from taking any action with respect to this issue prior to November 1, 1999.

JOSEPH M. ABELE
Assistant District Counsel

cc via email:

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