

LB&I Concept Unit

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Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

[General Overview](#)

[Detailed Explanation of the Concept](#)

[Index of Referenced Resources](#)

[Training and Additional Resources](#)

[Glossary of Terms and Acronyms](#)

[Index of Related Practice Units](#)

Section 245A Dividend Received Deduction Overview

The Tax Cuts and Jobs Act (TCJA) transitioned the United States from a primarily deferral-based international tax system to a participation exemption system coupled with immediate taxation of certain offshore earnings. This transition was implemented through several interlocking provisions of the Code - Sections 245A, 951A and 965. All three provisions have different effective dates and thus TCJA created periods in which some but not all of them apply. The new system also operates alongside the pre-Act subpart F regime that taxes certain offshore earnings using a longstanding rule for attributing pro rata shares of a foreign corporation's earnings to its U.S. shareholders.

Section 245A allows an exemption for certain foreign income of a domestic corporation that is a U.S. Shareholder (within the meaning of IRC Section 951(b)) by means of a 100 percent dividends received deduction ("DRD") for the foreign source portion of dividends received from "Specified 10-percent owned Foreign Corporations" ("SFCs"). The 100 percent DRD is only available to domestic C corporations that are neither real estate investment trusts nor regulated investment companies. The corporate shareholder must satisfy the one-year holding period requirement in Section 246(c).

Under this participation exemption system, Foreign Tax Credit (FTC) or Foreign Tax Deduction is not allowed for foreign taxes, including withholding taxes, paid or accrued with respect to any dividend that is benefiting from the 100% deduction.

Section 245A is effective for distributions made after December 31, 2017.

Section 245A DRD is generally intended to be available only with respect to distributions of residual untaxed foreign-source earnings and profits (E&P) remaining after application of Section 951 (subpart F income) and Section 951A (Global Intangible Low-Taxed Income (GILTI)).

Section 245A Dividend Received Deduction Overview

IRS issued Treasury Regulations Section 1.245A-5 that limit the Section 245A DRD available for certain dividends received from current or former controlled foreign corporations (CFCs). The Treasury Regulations address situations where Section 245A could apply to distributions of E&P not previously taxed by the subpart F or GILTI regimes. These situations arise because of the different effective dates of Section 965 and Section 951A or change in ownership of a CFC.

These situations cause unanticipated interactions between Section 245A and the rules for including subpart F income and GILTI. The Treasury Regulations also limit the application of the Section 954(c)(6) exception with respect to certain dividends paid by a lower-tier CFC to an upper-tier CFC. Under the Section 954(c)(6) exception, certain dividends paid to a CFC by a related CFC are excluded from Foreign Personal Holding Company Income (FPHCI) treatment and are not included in the distributee-CFC's subpart F income as long as such dividends are not attributable or properly allocable to the distributor-CFC's subpart F income or Effectively Connected Income (ECI).

IRS issued final regulations Section 1.245A(e)-1 special rules for hybrid dividends that address the implementation of Section 245A with respect to hybrid dividends. Section 245A(e) includes rules that disallow the Section 245A DRD with respect to hybrid dividends. If a U.S. shareholder receives a hybrid dividend, then the U.S. shareholder is not allowed the Section 245A DRD for that dividend and Section 245A(d) applies to disallow FTCs and Foreign Tax Credit deductions.



CAUTION: This concept unit provides a general overview of Section 245A along with the released Treasury Regulations. This concept unit does not provide a comprehensive overview of every rule of the law and regulations.

Detailed Explanation of the Concept

Section 245A Dividend Received Deduction Overview

Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation</u></p> <ul style="list-style-type: none"> ▪ IRC Section 245A allows 100 percent DRD for the foreign source portion of a dividend received by a domestic corporate U.S. shareholder (a "Section 245A shareholder") from an SFC. ▪ Treas. Reg. 1.245A-5 limits the amounts of DRD to the portion of the dividends received by Section 245A shareholder from an SFC that exceeds ineligible amounts. ▪ Section 245A shareholder is a domestic corporate U.S. shareholder of an SFC that directly or indirectly owns stock of the SFC. ▪ A SFC is: <ul style="list-style-type: none"> – A Controlled Foreign Corporation (CFC) with a domestic U.S. corporate shareholder, other than a Real Estate Investment Trust (REIT) or Regulated investment Company (RIC). <ul style="list-style-type: none"> ▪ A CFC is any foreign corporation in which more than 50% of the total value of the stock is owned directly, indirectly or constructively by U.S. shareholders on any day during the taxable year of the corporation; or – Any Foreign Corporation (FC) which has a corporate U.S. shareholder. This means that a non-CFC is not a SFC unless one of the shareholders is a U.S. corporation that owns at least 10% of the foreign corporation. 	<ul style="list-style-type: none"> ▪ IRC 245A(a) ▪ Treas. Reg. 1.245A-5(b) ▪ Treas. Reg. 1.245A-5(i)(21) ▪ IRC 245A(b) ▪ Treas. Reg. 1.245A-5(i)(22)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <ul style="list-style-type: none"> ▪ A SFC does not include a Passive Foreign Investment Company (PFIC). <ul style="list-style-type: none"> – An FC is a PFIC if 75% of the corporation's gross income is passive income or the average percentage of the corporation's assets which produce or which are held to produce passive income is at least 50%. ▪ Ineligible Amounts: Treas. Reg. 1.245A-5 limits the amount of the Section 245A deduction in certain situations in which the deduction would effectively eliminate from the U.S. tax system subpart F income or income subject to tax under the GILTI regime of Section 951A. ▪ A dividend otherwise eligible for a deduction under Section 245A is deductible only to the extent that it exceeds the Ineligible Amount. ▪ The Ineligible Amount is the sum of: <ul style="list-style-type: none"> – 50 percent of the Extraordinary Disposition Amount (ED Amount); and – 100 percent of the Extraordinary Reduction Amount (ER Amount). 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(b)(2) ▪ Treas. Reg. 1.245A-5(b)(2) ▪ Treas. Reg. 1.245A-5(b)(2)(i) ▪ Treas. Reg. 1.245A-5(b)(2)(ii)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis

Resources

IRC Section 245A Dividend Received Deduction's Limitation (cont'd)

Extraordinary Disposition

- An Extraordinary Disposition (ED) is a disposition by an SFC that:
 1. Is of Specified Property;
 2. Occurs during the SFC's Disqualified Period and on a date when the SFC was a CFC;
 3. Occurs outside the ordinary course of the SFC's activities; and
 4. Is to a related party.
- Specified Property is any property to the extent that gain recognized with respect to the property during the disqualified period is not described in one of the following five categories of gross income disregarded in computing tested income under Section 951A GILTI regime.
 1. U.S. source Effectively Connected Income (ECI);
 2. Subpart F income;
 3. Gross income excluded from SFC's Foreign Base Company Income (FBCI) and Insurance Income;
 4. Dividends received from a related person;
 5. Foreign Oil and Gas Extraction Income (FOGEI).
- The Disqualified Period begins on January 1, 2018, and ends at the close of the SFC's taxable year, if any, that began before 2018 and ended after 2017.
- The extraordinary disposition rule applies only to corporations with a taxable year other than the calendar year, only for the year that included the start of 2018, and only for dispositions occurring in 2018.

- Treas. Reg. 1.245A-5(c)(3)(ii)
- Treas. Reg. 1.245A-5(c)(3)(iii)
- Treas. Reg. 1.245A-5(c)(3)(iv)
- Treas. Reg. 1.245A-5(i)(1)
- Treas. Reg. 1.245A-5(i)(19)
- Treas. Reg. 1.245A-5(i)(2)
- Treas. Reg. 1.245A-5(c)(3)(iii)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>Extraordinary Disposition (cont'd)</u></p> <ul style="list-style-type: none"> ▪ Whether a disposition occurs outside the ordinary course of the SFC's activities is a facts and circumstances determination considering whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency. ▪ Per se occurring outside the ordinary course of a SFC's activities if: <ol style="list-style-type: none"> 1. It is undertaken with a principal purpose of generating E&P during the disqualified period; or 2. It is a disposition of intangible property described in Section 367(d)(4). ▪ A related party is a related party within the meaning of Section 267(b) or section 707(b). ▪ De minimis exception to ED: <ul style="list-style-type: none"> – No dispositions by an SFC are considered to be an ED if they do not exceed the lesser of \$50 million or 5 percent of the gross value of the SFC's property. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(c)(3)(ii)(B) ▪ Treas. Reg. 1.245A-5(c)(3)(ii)(C) ▪ Treas. Reg. 1.245A-5(i)(19) ▪ Treas. Reg. 1.245A-5(c)(3)(ii)(E)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>First Component of Ineligible Amount - ED Amount</u></p> <ul style="list-style-type: none"> ▪ Extraordinary Disposition Amount (ED Amount): <ul style="list-style-type: none"> – The portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the section 245A shareholder's Extraordinary Disposition Account (ED Account). ▪ Extraordinary Disposition Account (ED Account): <ul style="list-style-type: none"> – The balance of the ED account is equal to: <ul style="list-style-type: none"> ▪ The section 245A shareholder's pro rata share of the SFC's ED E&P MINUS the section 245A shareholder's prior ED Amounts, if any. ▪ Extraordinary Disposition E&P is the sum of the net gain recognized by the SFC from its extraordinary disposition(s) of specified property. ▪ Dividends are considered: <ul style="list-style-type: none"> – First to be paid out of the Section 245A shareholder's Non-Extraordinary Disposition E&P; and – Next paid out of the Section 245A shareholder's ED Account to the extent of the account's balance. 	<ul style="list-style-type: none"> ▪ Treas. Reg.1.245A-5(b)(2) ▪ Treas. Reg.1.245A-5(c)(1) ▪ Treas. Reg.1.245A-5(c)(2) ▪ Treas. Reg.1.245A-5(c)(3)(i)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>First Component of Ineligible Amount - ED Amount (cont'd)</u></p> <ul style="list-style-type: none">▪ Non-Extraordinary Disposition E&P is the excess of:<ol style="list-style-type: none">1. The product of:<ol style="list-style-type: none">A. The SFC's Section 959(c)(3) E&P determined as of the end of the SFC's taxable year taking into account certain distributions made by the SFC during the taxable year; andB. The Section 245A shareholder's stock ownership percentage immediately after the distribution; OVER2. The balance of the Section 245A shareholder's ED account with respect to the SFC immediately before the distribution.	<ul style="list-style-type: none">▪ Treas. Reg. 1.245A-5(c)(3)(i)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u> <u>Successor Rules for ED Accounts</u> <ol style="list-style-type: none">1. Section 245A shareholder that acquires stock of an SFC from another Section 245A shareholder with an ED Account;2. Certain Section 381 transactions;3. Certain distributions involving Section 355 or Section 356; and4. Certain transfers of stock of lower-tier CFCs by upper-tier CFCs where Section 245A shareholder ceases to be Section 245A shareholder with respect to the lower-tier CFC.	<ul style="list-style-type: none">▪ Treas. Reg. 1.245A-5(c)(4)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis

Resources

IRC Section 245A Dividend Received Deduction's Limitation (cont'd)

Second Component of Ineligible Amount - ER Amount

- An Extraordinary Reduction (ER) occurs when either of two sets of conditions are satisfied:
 1. During a taxable year, the controlling Section 245A shareholder transfers, in the aggregate, more than 10 percent of the value of the stock of the CFC that the Section 245A shareholder owns at the beginning of the CFC's taxable year.
 2. One or more transactions reduce the percentage of the CFC's stock owned by the controlling Section 245A shareholder on the last day of the CFC's taxable year to less than 90 percent of the shareholder's initial percentage of such stock.
 - Initial Percentage is that owned by the controlling Section 245A shareholder on either of two dates:
 - The day on which the shareholder owns its highest percentage of the stock; or
 - The day before the first day on which stock was transferred in the preceding taxable year as part of a plan to reduce the shareholder's percentage.
- A controlling Section 245A shareholder has an ER Amount if:
 1. It receives a dividend from a CFC during a taxable year of the CFC ending after December 31, 2017; and
 2. An extraordinary reduction occurs with respect to the controlling Section 245A shareholder's ownership of the CFC.

- Treas. Reg. 1.245A-5(c)(2)
- Treas. Reg. 1.245A-5(e)(1)
- Treas. Reg. 1.245A-5(e)(2)(i)
- Treas. Reg. 1.245A-5(e)(1)
- Treas. Reg. 1.245A-5(i)(21)
- Treas. Reg. 1.245A-5(g)(3)
- Treas. Reg. 1.245A-5(i)(2)
- Treas. Reg. 1.245A-5(i)(19)
- Treas. Reg. 1.245A-5(i)(2)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>Second Component of Ineligible Amount - ER Amount (cont'd)</u></p> <ul style="list-style-type: none"> ▪ If the prior conditions are met, then Section 245A shareholder's ER Amount is the lesser of: <ol style="list-style-type: none"> 1. The amount of the dividend; or 2. The amount equal to the sum of: <ul style="list-style-type: none"> ▪ The controlling section 245A shareholder's pre-reduction pro rata share of the CFC's subpart F income and tested income for the taxable year, reduced (but not below zero) by the prior ER Amount. ▪ Controlling Section 245A shareholder's pre-reduction pro rata share: the percentage of the CFC's subpart F income or tested income that corresponds to the controlling Section 245A shareholder's stock ownership percentage in the CFC immediately before the ER and without regard to section 951(a)(2)(B) and Treas. Reg. 1.951-1(b)(1)(ii) to the extent that such subpart F income and tested income is not already included in the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income. ▪ De minimis amounts: No amount is considered an ER Amount with respect to a controlling Section 245A shareholder of the CFC if the sum of the CFC's subpart F income and tested income for the taxable year does not exceed the lesser of \$50 million or 5 percent of the CFC's total income for the taxable year. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(b)(2) ▪ Treas. Reg. 1.245A-5(g)(6) ▪ Treas. Reg. 1.245A-5(e)(1) ▪ Treas. Reg. 1.245A-5(e)(2)(ii) ▪ Treas. Reg. 1.245A-5(i)(29) ▪ Treas. Reg. 1.245A-5(e)(3)(ii)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>Application of Section 954(c)(6) Exception and Tiered ER Amounts</u></p> <ul style="list-style-type: none"> ▪ The look-through rule under Section 954(c)(6) provides that dividends, interest, rents and royalties that one CFC receives or accrues from a related CFC are not treated as Foreign Personal Holding Income to the extent attributable or allocable to income of the related CFC which is neither subpart F income nor treated as effectively connected with a U.S. trade or business. ▪ The treasury regulations limit the application of the Section 954(c)(6) exception with respect to certain dividends paid by a lower-tier CFC to an upper-tier CFC when an extraordinary reduction occurs with respect to the lower-tier CFC. <ul style="list-style-type: none"> – As a result of the limitation, only the portion of the dividend exceeding the lower-tier CFC's tiered extraordinary reduction amount is eligible for the section 954(c)(6) exception. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(f) ▪ IRC 954(c)(6)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis

Resources

IRC Section 245A Dividend Received Deduction's Limitation (cont'd)

Application of Section 954(c)(6) Exception and Tiered ER Amounts (cont'd)

- A lower-tier CFC's tiered ER Amount equals:
 - Upper-tier CFC's ownership percentage (by value) in the lower-tier CFC immediately before the extraordinary reduction MULTIPLIED BY the sum of the lower-tier CFC's subpart F income and tested income for the taxable year, THEN this amount is reduced by:
 1. Pro rata share of the lower-tier CFC's subpart F income and tested income for the taxable year that is taken into account by U.S. tax residents and attributable to the shares of the lower-tier CFC owned by the upper-tier CFC;
 2. The amount included in an upper-tier CFC's subpart F income resulting from prior dividends paid by the lower-tier CFC giving rise to tiered extraordinary reduction amounts or the application of Section 245A(e);
 3. Certain prior Extraordinary Reduction Amounts with respect to the lower-tier CFC arising in cases where the lower-tier CFC was a first-tier CFC at some point in the taxable year and paid a dividend to one or more controlling Section 245A shareholders at that time; and
 4. Subpart F income and tested income taken into account by a U.S. tax resident as a result of an issuance of stock directly by the lower-tier CFC during the taxable year.

- Treas. Reg. 1.245A-5(f)
- IRC 954(c)(6)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u> <u>Miscellaneous Provisions</u> <u>Election to Close CFC's Taxable Year</u> If each controlling Section 245A shareholder elects, and each U.S. tax resident agrees, to close the CFC's taxable year for all purposes of the code on the date of an Extraordinary Reduction, then no amount is considered an ER amount or tiered-ER amount and the electing shareholder(s) is (are) not required to reduce the Section 245A deduction (if applicable).	

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A Dividend Received Deduction's Limitation (cont'd)</u></p> <p><u>Miscellaneous Provisions (cont'd)</u></p> <p><u>Anti-Abuse Rule</u></p> <p>The treasury regulations grant broad authority to the Commissioner to make appropriate adjustments if a transaction is engaged in with a principal purpose of avoiding the purposes Treas. Reg. 1.245A-5.</p> <ul style="list-style-type: none"> ▪ The treasury regulations provide special rules for: <ul style="list-style-type: none"> – Source of Dividends; – IRC Section 964(e) inclusions as dividends; – Stock ownership and stock transfer; – Priority rules between Treas. Reg. 1.245A-5 and IRC Section 245A(e); – Ordering multiple dividends; – Partner's distributive share of a domestic partnership's pro rata share of subpart F income. ▪ Applicability Dates: Treas. Reg. 1.245A-5 applies to distributions occurring after December 31, 2017. Note that temporary regulations were issued in June 2019 along with proposed regulations that were finalized in August 2020. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(e)(3)(i) ▪ Treas. Reg. 1.245A-5(h) ▪ Treas. Reg. 1.245A-5(g) ▪ Treas. Reg. 1.245A-5(k)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends</u></p> <p><u>Hybrid Dividends</u></p> <ul style="list-style-type: none"> ▪ The Section 245A DRD does not apply to hybrid dividends. ▪ A hybrid dividend is an amount received from a controlled foreign corporation for which the distributing corporation received a deduction or other tax benefit under an income, war profits, or excess profits tax imposed by a foreign country or a U.S. possession. ▪ A hybrid deduction of a CFC includes a deduction, exemption, exclusion, credit, or other tax benefit to the extent equivalent to a deduction, for which: <ol style="list-style-type: none"> 1. The deduction or other tax benefit is allowed to the CFC; and 2. The deduction or other tax benefit relates to or results from an amount paid, accrued, or distributed with respect to an instrument issued by the CFC and treated as stock for U.S. tax purposes, or is a deduction allowed to the CFC with respect to equity (e.g., a notional interest deduction). ▪ Absent section 245A(e), a hybrid dividend without the restriction would have given rise to a DRD under Section 245A(a). ▪ A dividend is subject first to the Hybrid Dividend rules of Section 245A(e) and, to the extent the dividend is not a hybrid dividend, then to Treas. Reg. 1.245A-5. ▪ Foreign tax credits and/or foreign tax deductions associated with hybrid dividends are disallowed. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A(e)-1(b)(1) ▪ Treas. Reg. 1.245A(e)-1(b)(2) ▪ Treas. Reg. 1.245A(e)-1(d)(2) ▪ Treas. Reg. 1.245A-5(g)(4)(i)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends (cont'd)</u></p> <p><u>Hybrid Deduction Account (HDA)</u></p> <ul style="list-style-type: none"> ▪ A Hybrid Deduction Account (HDA) must be created and maintained for each share of the Controlled Foreign Corporation's stock. <ul style="list-style-type: none"> – The amount that the U.S. shareholder receives that would otherwise be eligible for a DRD absent 245A(e) is a hybrid dividend to the extent of the U.S. shareholder's HDA for all of the shares of stock it holds in the CFC, generally determined as of the close of the CFC's taxable year. ▪ Hybrid deduction is generally allocated to a share of CFC stock to the extent that the hybrid deduction relates to an amount paid, accrued, or distributed by the CFC with respect to the share. ▪ Hybrid Deduction with respect to equity is allocated to a share of CFC stock based on the PRODUCT of: <ul style="list-style-type: none"> – The amount of the deduction allowed for all of the CFC equity; and – A fraction, the numerator of which is the value of the share of CFC stock and the denominator of which is the value of all shares of stock of the CFC. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A(e)-1(d)(1) ▪ Treas. Reg. 1.245A(e)-1(d)(3) ▪ Treas. Reg. 1.245A(e)-1(d)(6)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends (cont'd)</u></p> <p><u>Hybrid Deduction Account (HDA) (cont'd)</u></p> <ul style="list-style-type: none"> ▪ HDA must be adjusted with respect to a share of stock of a CFC as of the close of the CFC's taxable year. ▪ The HDA must be: <ul style="list-style-type: none"> – INCREASED BY the amount of hybrid deductions of the CFC allocable to the share for the taxable year. – DECREASED BY three categories of income included in gross income of the domestic corporation: <ol style="list-style-type: none"> 1. Adjusted Subpart F inclusion; 2. Adjusted GILTI inclusion; 3. Investment in U.S. property (IRC Section 956). – DECREASED BY the amount of hybrid deductions in the account that gave rise to a hybrid dividend or tiered dividend during the taxable year. <ul style="list-style-type: none"> ▪ If there is more than one HDA with respect to its CFC stock, then a pro rata amount in each account is considered to have given rise to the hybrid dividend or tiered hybrid dividend, based on the amounts in the accounts before this decrease. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A(e)-1(d)(4)(i)(A) ▪ Treas. Reg. 1.245A(e)-1(d)(4)(i)(B) ▪ Treas. Reg. 1.245A(e)-1(d)(4)(ii) ▪ Treas. Reg. 1.245A(e)-1(h)(2)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends (cont'd)</u></p> <p><u>Hybrid Deduction Account (HDA) (cont'd)</u></p> <p><u>Acquisition of HDA Rules</u></p> <ul style="list-style-type: none"> ▪ If stock in the CFC is acquired by one specified owner from another, the HDA of the share travels with the stock. <ul style="list-style-type: none"> – Specified owner of a CFC is either: <ul style="list-style-type: none"> ▪ A domestic corporation that is a U.S. shareholder , which owns directly, indirectly, or constructively at least 10% of the value or voting power of the CFC; or ▪ An upper-tier CFC that would be a U.S. shareholder of the CFC if it were a domestic corporation. ▪ If a share is transferred to a holder other than a specified owner, the HDA connected to that share disappears. ▪ Carryover of the HDA from one share of stock to another may occur in reorganizations (including recapitalizations) and in Section 332 liquidations. ▪ If a shareholder exchanges CFC stock for stock of another CFC in a Section 354 or Section 356 exchange pursuant to a Section 381(a)(2) transaction in which the target CFC is the transferor, the shareholder's HDA either: <ul style="list-style-type: none"> – Is attributed to the received CFC stock, if the shareholder is a specified owner of the acquiring CFC immediately after the exchange; or – Is eliminated and not thereafter taken into account by any person, if the shareholder is not a specified owner of the acquiring CFC immediately after the exchange. 	
	<ul style="list-style-type: none"> ▪ Treas. Reg.1.245A(e)-1(d)(4)(ii)(A)(1) ▪ Treas. Reg.1.245A(e)-1(d)(4)(ii)(A)(2) ▪ Treas. Reg.1.245A(e)-1(d)(4)(ii)(B)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends (cont'd)</u></p> <p><u>Hybrid Deduction Account (HDA) (cont'd)</u></p> <ul style="list-style-type: none">▪ HDA must be maintained in the functional currency of the CFC.<ul style="list-style-type: none">– The amount of any deduction or other tax benefit allowed to a CFC is determined by taking into account any foreign currency gains or losses.▪ If a CFC's functional currency is other than the functional currency of a U.S. shareholder or upper-tier CFC that receives an amount from the CFC, then:<ul style="list-style-type: none">– The sum of the U.S. shareholder's or upper-tier CFC's HDA with respect to each share of stock of the CFC is translated into the functional currency of the U.S. shareholder or upper-tier CFC based on the spot rate as of the date of the dividend.	<ul style="list-style-type: none">▪ Treas. Reg. 1.245A(e)-1(d)(6)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis	Resources
<p><u>IRC Section 245A(e) Hybrid Dividends (cont'd)</u></p> <p><u>Tiered Hybrid Dividends</u></p> <ul style="list-style-type: none"> ▪ Tiered Hybrid Dividend is an amount received by a CFC from another CFC to the extent that the amount would be a hybrid dividend under the regulations if the receiving CFC were a domestic corporation. <ul style="list-style-type: none"> – However, the regulations carve out of the above treatment any Previously Taxed Earning & Profits (PTEP) distributions described in Section 959(b), which prevents repeat taxation of a lower-tier CFC's earnings that have already been included in the gross income of the U.S. shareholder. ▪ If an upper-tier CFC receives a tiered hybrid dividend from a lower-tier CFC, and a domestic corporation is a U.S. shareholder of both CFCs, then: <ul style="list-style-type: none"> – The tiered hybrid dividend is treated as subpart F income of the receiving CFC for the taxable year in which such dividend is received; – The U.S. shareholder must include in gross income an amount equal to its pro rata share of the subpart F income inclusion; and – Foreign tax credits and foreign tax deductions attributable to the amount included in the U.S. shareholder's gross income are disallowed. ▪ Section 964 dividends (gain on the sale of stock by a CFC): <ul style="list-style-type: none"> – If a dividend described under Section 964(e)(1) is a tiered hybrid dividend, then the domestic corporation that is a U.S. shareholder of both CFCs is not permitted the Section 245A DRD with respect to such dividend. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A(e)-1(c)(2) ▪ Treas. Reg. 1.245A(e)-1(b)(2) ▪ Treas. Reg. 1.245A(e)-1(c)(4)

Detailed Explanation of the Concept (cont'd)

Section 245A Dividend Received Deduction Overview

Analysis

Resources

IRC Section 245A Interaction with Other Sections

Constructive Distributions from CFC under IRC Section 956

- IRC Section 245A created a disparity between the taxation of actual repatriations of previously untaxed foreign earnings and deemed repatriations under Section 956.
- U.S. shareholder of a CFC may be taxed on the shareholder's Section 956 amount which in turn reflects the foreign corporation's investments in U.S. property.
 - A corporate U.S. shareholder's Section 956 inclusion is not eligible for a Section 245A DRD because it is not actually a dividend.
 - However, the corporate U.S. shareholder would be eligible for a deduction under Section 245A for any actual dividends paid by the foreign corporation.
- In response to this disparity, the regulations allow the U.S. corporate shareholder to reduce the Section 956 amount.
 - The reduction is the amount that would be deductible by the corporate shareholder under Section 245A upon a hypothetical distribution from CFC in an amount equal to the amount otherwise determined under Section 956.

- Treas. Reg. 1.956-1(a)(2)

Analysis

IRC Section 245A Interaction with Other Sections (cont'd)

- IRC Section 964(e) treats as dividends some gains on sales or exchanges of foreign corporation stock by a CFC.
- If a CFC sells or exchanges stock of a lower-tier CFC and the selling CFC held the stock for one year or more, Section 964(e)(4) provides that:
 1. Any amount treated as a dividend under Section 964(e)(1) is treated as subpart F income of the selling CFC for purposes of Section 951(a)(1)(A) to the extent of the foreign-source portion (within the meaning of Section 245A(c)) of the dividend;
 2. Any U.S. shareholder with respect to the selling CFC must include in gross income its pro rata share of such subpart F income for such shareholder's taxable year with or within which such taxable year of the CFC ends; and
 3. The U.S. shareholder that includes its pro rata share of such subpart F income in its gross income is allowed a Section 245A DRD as if such subpart F income were a dividend.

- IRC 964(e)(4)(A)
- Treas. Reg. 1.245A-5(g)(2)

If a domestic corporation sells or exchanges stock in a foreign corporation that was held for at least one year, any amount treated as a dividend under Section 1248 is also treated as a dividend for Section 245A DRD.

- Treas. Reg. 1.245A-5(g)(1)

Detailed Explanation of the Concept (cont'd) 21

Section 245A Dividend Received Deduction Overview	
Analysis	Resources
<p><u>IRC Section 245A and International Information Returns</u></p> <p><u>Forms 5471</u></p> <ul style="list-style-type: none">▪ If a corporation pays or receives a Hybrid Dividend or Tiered Hybrid Dividend for which a deduction is disallowed under section 245A, then Form 5471 must contain information about the disallowance.▪ If a dividend subject to Treas. Reg. Section 1.245A-5 is paid, and gives rise to any of the following, then a taxpayer is required to disclose such information on Form 5471:<ol style="list-style-type: none">1. An Ineligible Amount;2. A Tiered Extraordinary Disposition amount; or3. A Tiered Extraordinary Reduction amount.	<ul style="list-style-type: none">▪ Treas. Reg. 1.6038-2(f)(14)▪ Treas. Reg. 1.6038-2(f)(16)

Index of Referenced Resources

Section 245A Dividend Received Deduction Overview

IRC 245A(a)

IRC 245A(b)

IRC 954(c)(6)

IRC 964(e)(4)(A)

Treas. Reg. 1.245A-5(b)

Treas. Reg. 1.245A-5(b)(2)

Treas. Reg. 1.245A-5(b)(2)(i)

Treas. Reg. 1.245A-5(b)(2)(ii)

Treas. Reg. 1.245A-5(c)(1)

Treas. Reg. 1.245A-5(c)(2)

Treas. Reg. 1.245A-5(c)(3)(i)

Treas. Reg. 1.245A-5(c)(3)(ii)

Treas. Reg. 1.245A-5(c)(3)(iii)

Treas. Reg. 1.245A-5(c)(3)(iv)

Treas. Reg. 1.245A-5(c)(4)

Treas. Reg. 1.245A-5(e)(1)

Treas. Reg. 1.245A-5(e)(2)

Index of Referenced Resources (cont'd)

Section 245A Dividend Received Deduction Overview

Treas. Reg. 1.245A-5(e)(3)

Treas. Reg. 1.245A-5(f)

Treas. Reg. 1.245A-5(g)(3)

Treas. Reg. 1.245A-5(g)(6)

Treas. Reg. 1.245A-5(h)

Treas. Reg. 1.245A-5(i)(1)

Treas. Reg. 1.245A-5(i)(2)

Treas. Reg. 1.245A-5(i)(3)

Treas. Reg. 1.245A-5(i)(19)

Treas. Reg. 1.245A-5(i)(21)

Treas. Reg. 1.245A-5(i)(22)

Treas. Reg. 1.245A-5(i)(29)

Treas. Reg. 1.245A-5(k)

Treas. Reg. 1.956-1(a)(2)

Treas. Reg. 1.6038-2(f)(14)

Treas. Reg. 1.6038-2(f)(16)

Training and Additional Resources

Section 245A Dividend Received Deduction Overview

Type of Resource	Description(s)
Training Courses	<ul style="list-style-type: none"> ▪ <i>Dividend Received Deduction (DRD) and Other Miscellaneous Tax Reform Provisions</i> - ITM Course Number 72175r ▪ <i>TCJA Anti-Hybrid Rules – Sections 245A(e) and 267A</i> - ITM Course Number 72181r
Guidance	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A-5(b) - Extraordinary Disposition - General Rule ▪ Treas. Reg. 1.245A-5(b)(2) - Ineligible Amount ▪ Treas. Reg. 1.245A-5(c)(1) - Extraordinary Disposition Amount ▪ Treas. Reg. 1.245A-5(c)(3)(ii) - Extraordinary Disposition ▪ Treas. Reg. 1.245A-5(c)(3)(i) - Extraordinary Disposition Account ▪ Treas. Reg. 1.245A-5(c)(4) - Successor Rules ▪ Treas. Reg. 1.245A-5(d) - Section 954(c)(6) and Tiered Extraordinary Disposition Amounts ▪ Treas. Reg. 1.245A-5(e)(1) - Extraordinary Reduction Amount ▪ Treas. Reg. 1.245A-5(e)(2)(i) - Extraordinary Reduction ▪ Treas. Reg. 1.245A-5(e)(2)(ii) - Pro Rata Share of CFC's Subpart F and GILTI- Pre-Reduction ▪ Treas. Reg. 1.245A-5(e)(3)(i) - Election to Close CFC's Taxable Year ▪ Treas. Reg. 1.245A-5(e)(3)(ii) - De Minimis Exception ▪ Treas. Reg. 1.245A-5(f) - Tiered Extraordinary Reduction Amounts and Section 954(c)(6) ▪ Treas. Reg. 1.245A-5(g) - Special Rules ▪ Treas. Reg. 1.245A(e)-1(b)(1) - Hybrid Dividends - General Rule ▪ Treas. Reg. 1.245A(e)-1(b)(2) - Hybrid Dividends ▪ Treas. Reg. 1.245A(e)-1(b)(3) - Dividends from Lower-Tier Foreign Corporation ▪ Treas. Reg. 1.245A(e)-1(c) - Tiered Hybrid Dividends ▪ Treas. Reg. 1.245A(e)-1(d)(1) - Hybrid Deduction Accounts ▪ Treas. Reg. 1.245A(e)-1(d)(4)(i)(A) - Maintenance of Hybrid Deduction Accounts ▪ Treas. Reg. 1.245A(e)-1(d)(4)(i)(B) - Maintenance of Hybrid Deduction Accounts

Training and Additional Resources (cont'd)

Section 245A Dividend Received Deduction Overview

Type of Resource	Description(s)
Guidance (cont'd)	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.245A(e)-1(d)(4)(iii) - Acquisition of Hybrid Deduction Accounts ▪ Treas. Reg. 1.245A-5(g)(2) - Deemed Dividends – Section 964(e)(4) ▪ Treas. Reg. 1.245A-5(g)(4)(i) - Priority Rules ▪ Treas. Reg. 1.245A-5(h) - Anti-Abuse Rule ▪ Treas. Reg. 1.245A-5(k) - Applicability Date ▪ Treas. Reg. 1.956-1(a)(2) - Investment of Earnings in U.S. Property – Section 956 ▪ Treas. Reg. 1.245A(e)-1(d)(6) - Foreign Currency Rules ▪ Treas. Reg. 1.6038-2(f)(14) - Forms 5471 Reporting Requirement ▪ Treas. Reg. 1.6038-2(f)(16) - Forms 5471 Reporting Requirement ▪ Treas. Reg. 1.6038-2(m)(2) - Forms 5471 Reporting Requirement
Reference Materials	<ul style="list-style-type: none"> ▪ <i>Kuntz & Peroni - U.S. Int'l Tax</i> Para B6.02A: Dividends-Received Deduction Under Section 245A

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporations
DRD	Dividends Received Deduction
E&P	Earnings and Profits
ECI	Effectively Connected Income
ED	Extraordinary Disposition
ED Account	Extraordinary Disposition Account
ED Amount	Extraordinary Disposition Amount
ER Amount	Extraordinary Reduction Amount
FBCI	Foreign Base Company Income
FC	Foreign Corporation
FOGEI	Foreign Oil and Gas Extraction Income
FPHCI	Foreign Personal Holding Company Income
GILTI	Global Intangible Low-Taxed Income
HDA	Hybrid Deduction Account
PFIC	Passive Foreign Investment Company
PTEP	Previously Taxed Earning & Profits
REIT	Real Estate Investment Trust

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
RIC	Regulated Investment Company
SFC	Specified Foreign Corporation
TCJA	The Tax Cuts and Jobs Act

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
	None at this time.