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INTERNAL REVENUE SERVICE  
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INTERNAL REVENUE SERVICE NATIONAL OFFICE  
TAXPAYER ADVOCATE ADVICE

MEMORANDUM FOR: DON KURIHARA-NAKASU  
I.R.S. Taxpayer Advocate Service  
Honolulu, Hawaii

FROM: PHILIP GARLETT  
Senior Technical Reviewer, CC:INTL:Br2

This letter is in response to your request for technical assistance concerning the tax treatment of consent dividends paid by a personal holding company to its shareholders.

ISSUE:

Were interest and late payment penalty charges properly imposed when the taxpayer paid the tax under section 565(e) of the Internal Revenue Code with its Form 1120, filed on September 12, 1997 pursuant to an extension to file.

CONCLUSION:

We conclude that the tax under section 565(e) was due on the due date of the Form 1120, without extension. An extension of time to file the Form 1120 and the consent dividend elections is not an extension of the time to pay the required tax.

FACTS:

The taxpayer is a personal holding company that files its tax return on a calendar year basis. On or about September 1, 1997, the taxpayer declared a consent dividend to its shareholders under section 565 of the Internal Revenue Code. All the shareholders signed the proper consents (Form 972 - Consent of Shareholder to Include Specific Amount in Gross income). The taxpayer filed these consents and Form 973 (Corporate Claim for Deduction for Consent Dividends) with its Form 1120 on September 12, 1997, pursuant to an extension to file.

Some of the taxpayer's shareholders are foreign persons. The taxpayer included a payment of 30% percent of the amount of the consent dividends attributable to the foreign shareholders with its Form 1120. Because the taxpayer had already filed its 1996 Form 1042, it filed an amended return to report the consent dividends on September 12, 1997. The Philadelphia Service Center assessed a late payment penalty and interest on the

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amount shown on the amended 1996 Form 1042 from the due date, March 15, 1997, until the date the tax was actually paid. The taxpayer subsequently requested assistance from your office maintaining that the penalty and interest charges were improperly imposed. For the reasons below, we conclude that the assessments were proper.

LAW AND ANALYSIS:

Section 565(a) of the Internal Revenue Code provides that if any person owns consent stock in a corporation on the last day of the taxable year, and that person agrees, in a consent (Form 972) filed with the return of the corporation in accordance with regulations prescribed by the Secretary, to treat as a dividend the amount specified in the consent, the amount specified shall constitute a consent dividend for purposes of section 561 (relating to the deduction for dividends paid). Section 1.565-1(b)(3) of the Income Tax Regulations provides that a consent may be filed at any time not later than the due date of the corporation's income tax return for the taxable year for which the dividends paid deduction is claimed. For purposes of the consent, Revenue Ruling 78-296 concludes that the due date includes any applicable extensions. Rev. Rul. 78-296, 1978-2 CB 183.

Section 565(e) of the Code provides that in the case of a consent dividend which, if paid in money would be subject to the provisions of section 1441 (relating to withholding of tax on nonresident aliens) or 1442 (relating to withholding of tax on foreign corporations), section 565 does not apply unless the consent is accompanied by money in an amount equal to the amount that would be required to be deducted and withheld under sections 1441 or 1442 if the consent dividend had been, on the last day of the taxable year of the corporation, paid to the shareholder in money as a dividend. That is, the corporation cannot take into account the consent dividend paid to a foreign shareholder for the dividends paid deduction unless the election is accompanied by any tax that would have been required to be withheld if the amount of the consent dividend was actually distributed to the shareholder on the last day of the corporation's tax year. Note, however, that the tax is not withheld pursuant to § 1441 but, rather, directed to be paid under § 565. See § 565(e) (tax imposed on consent dividends that "would be" subject to 1441 withholding "if" they were actually paid).

Given the above, the procedure for paying tax relating to consent dividends paid to foreign shareholders is explicitly defined by statute. Code section 565(e) provides that the tax shall accompany the Form 972. Code section 565(a) provides that the Form 972 shall accompany the taxpayer's Form 1120.

Although Rev. Rul. 78-296 permits the consent to be filed by the extended due date, there is no corresponding rule that permits an extension for the payment of tax. Section 6072(b) of the Code provides that the due date for filing a corporate tax return for a calendar year taxpayer is March 15<sup>th</sup>. Section 1.6081-3(a) of the Income Tax Regulations provides that, if certain requirements are met, a corporation is allowed an automatic extension of that time to September 15<sup>th</sup>. Among the requirements is the duty to "make a remittance, on or before the date prescribed for payment, of the amount of the properly estimated unpaid tax

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liability.” § 1.6081-3(a)(3). Therefore, notwithstanding the extension to file, the taxpayer must ensure that its tax liability is fully satisfied by the actual return filing date.

In the present case, the taxpayer remitted the 30% tax on the consent dividends it paid to its foreign shareholders with its extended Form 1120. Because that amount should have been remitted by March 15, 1997, late payment penalties and interest assessments are appropriate from that date forward.

I hope this information assists you in responding to the taxpayer. If you require additional information, please do not hesitate to contact Laurie Hatten-Boyd at (202) 622-3164.

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