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**Tax Committee Comments and Recommendations, no. 2:  
Comments on Proposed Regulations Under Section 902 of the  
Internal Revenue Code Regarding Domestic Corporations  
Receiving Dividends from Foreign Corporations, Submitted to the  
IRS - Nov. 5, 1964**

American Institute of Certified Public Accountants. Committee on Federal Taxation

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TAX COMMITTEE COMMENTS AND RECOMMENDATIONS

Comments on Proposed Regulations  
Under Section 902 of the Internal Revenue Code  
Regarding Domestic Corporations Receiving Dividends from Foreign Corporations

Submitted to the IRS - Nov. 5, 1964

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COMMITTEE ON FEDERAL TAXATION  
of the  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Proposed Regulations Regarding Domestic  
Corporations Receiving Dividends from Foreign Corporations

Section

1

1.902-3(f)           The one sentence of this paragraph refers the reader to Section 316 for the definition of a dividend. If this reference is an attempt to incorporate all of Section 316 into Section 902, it ignores the holding of the Tax Court in Steel Improvement & Forge Co., 36 T.C. 265, 279, reversed on another issue 11 AFTR 2d 953 (6th Cir., 1963). It was held in Steel that for purposes of Section 902 a dividend does not come out of the full current year's profits but only out of profits accumulated up to the date of payment of the dividend.

2

1.902-4(b)(2)       There appears to be no statutory authority for the provision that if a foreign corporation is not a less developed country corporation for the first year beginning after December 31, 1962, it shall not be considered as being a less developed country corporation for any taxable year beginning before January 1, 1963, "even though such foreign corporation would have been able to meet the tests of Section 902(d)(1) or (2) for such prior taxable year. The provision should be deleted.

3

1.902-5(b)(1)       The proposed regulations provide that the pre-1963 profits distributed by a second tier corporation to a first tier corporation, must be reduced by a stipulated proportion when the first tier corporation makes distributions to a domestic parent. This provision does not appear to be supported by the statute, nor does it appear to represent the intention of Congress. Moreover, it is inconsistent

with Regulations Section 1.963-4(b)(3)(i) which provides that "If any foreign corporation included in the chain or group for the taxable year receives a distribution for such year from another foreign corporation in the chain or group and in turn makes a distribution for the taxable year, the distribution so made shall first be allocated to the earnings and profits, to the extent thereof, attributable to the distribution so received."

The Senate Committee Report states: "Dividends received by a foreign corporation from its subsidiary before January 1, 1965, which are paid out of the subsidiary's profits from before 1963, are to be treated as paid out of the first foreign corporation's profits from before 1963 if it in turn pays the dividends to the domestic corporation before January 1, 1965." It appears that it was intended that dividends paid by a first tier corporation to a domestic parent are out of the first tier corporation's accumulated profits attributable to the second tier corporations pre-1963 profits to the extent that the first tier corporation has such profits; that is, the second tier corporation's distribution out of pre-1963 profits flows through to the domestic parent to the extent that the first tier corporation makes distributions to the domestic parent.

It is recommended that Proposed Regulations Section 1.902-5(b)(1) should be amended as follows: "For purposes of paragraph (a)(2)(iii) of this section, a first-tier corporation's distribution made out of its accumulated profits for a taxable year beginning after December 31, 1962, shall be considered to be made first out of its accumulated profits for such year which are attributable to a distribution received from its second-tier corporation's profits accumulated in a taxable year beginning before January 1, 1963, but limited to an amount which equals the amount of the distribution (reduced as provided in subparagraph (2) of this paragraph) received from such second-tier corporation's profits accumulated in such year beginning before January 1, 1963."

If the suggested amendment is adopted, conforming amendments should be made in Proposed Regulations Sections 1.902-5(b)(2) and 1.902-5(e), Example 2.