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Legal Updates

IRS Extends Period of Temporary Relief to U.S. Shareholders of CFCs

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On December 28, 2009, pursuant to Notice 2010-12, the Internal Revenue Service ("IRS") extended the period of temporary relief to U.S. shareholders of controlled foreign corporations ("CFCs") to facilitate liquidity.

Background

In general, the provisions of the Internal Revenue Code of 1986, as amended ("Code"), applicable to a CFC may result in phantom income inclusion to a U.S. shareholder that owns 10% or more of the voting stock of the CFC under certain circumstances. Section 956 of the Code provides for such an income inclusion when a CFC makes an investment of earnings in "United States property," which includes certain obligations by the CFC to related U.S. persons, unless such obligations are "readily marketable."

The IRS and the U.S. Treasury Department ("Treasury") previously announced in Notice 88-108 that final regulations issued under Section 956 of the Code will exclude an obligation from the purview of Section 956 of the Code where the obligation is collected within 30 days from the time it is incurred. To facilitate liquidity, on October 10, 2008, the IRS and Treasury announced in Notice 2008-91 that they will issue regulations providing that, for purposes of Section 956 of the Code, a CFC may choose to exclude an obligation held by the CFC that would otherwise be an investment in "United States property" if the obligation is collected within 60 days from the time it is incurred. The exclusion does not apply if the CFC holds for 180 or more calendar days during its taxable year obligations that would be an investment in "United States property" without regard to the new 60 day rule. Further, Notice 2009-10 provided that the above-described regulations will apply to the third consecutive tax year of a CFC, if any, that ends after October 3, 2008 and on or before December 3, 2009.

In addition, pursuant to Revenue Procedure 2008-26, the IRS and Treasury provided that the IRS, for purposes of applying Section 956 of the Code for any day of calendar year 2007 or 2008, will not question whether a security is "readily marketable" in determining whether the security constitutes "United States property" if the security is of a type that was readily marketable at any time within three years before May 5, 2008. The Revenue Procedure was aimed at addressing the effect of market

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dislocations in respect of securities that likely would be marketable under “normal” market conditions. In addition, Notice 2009-10 extended the provisions of Revenue Procedure 2008-26 to any day of calendar year 2009.

Notice 2010-12

Notice 2010-12 further extends the relief described above. It provides that the regulations described in Notice 2008-91 will also apply to the taxable year of a CFC that immediately follows the last taxable year of such CFC to which such regulations could apply (without regard to Notice 2010-12). The IRS and Treasury, however, indicate in the notice that they do not anticipate extending the relief to any additional period.

In addition, Notice 2010-12 extends the application of Revenue Procedure 2008-26 to any day during calendar year 2010.