

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

TD 9153

RIN 1545-BD43

Clarification of Definitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations providing clarification of the definitions of a corporation and a domestic entity in circumstances where the business entity is considered to be created or organized in more than one jurisdiction. These regulations will affect business entities that are created or organized under the laws of more than one jurisdiction. The final regulations consist of technical revisions to reflect the issuance of the temporary regulations and to correct a cross-reference in §301.7701-3. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective August 12, 2004.

Applicability Dates: For the dates of applicability of these regulations, see §301.7701-2T(f) and §301.7701-5T(c).

FOR FURTHER INFORMATION CONTACT: Thomas Beem, (202) 622-3860 (not a toll-free number).

## SUPPLEMENTARY INFORMATION:

### **Background**

Several jurisdictions have recently enacted provisions (generally referred to as either continuance or domestication statutes) that make it possible for a business entity to be treated as created or organized under the laws of more than one jurisdiction at the same time (a dually chartered entity). A dually chartered entity and the interest holders in the entity must determine for Federal tax purposes (1) the entity's classification (e.g., corporation or partnership) and (2) whether the entity is foreign or domestic. The regulations contained in this document are intended to clarify the rules for these determinations.

Section 7701(a)(3) of the Internal Revenue Code of 1986 (Code) provides that the term corporation includes associations, joint stock companies, and insurance companies. The definition of a corporation under the tax statutes has not changed since the Revenue Act of 1918, Public Law 65-254 (40 Stat. 1057, section 1). Final regulations (TD 8697) providing rules for the classification of business entities were published in the Federal Register on December 18, 1996 (61 FR 66584 (1996)). Those entity classification rules identify certain entities that are always treated as corporations and are not eligible to elect their entity classification.

Section 7701(a)(4) of the Code provides that the term domestic when applied to a corporation or partnership means "created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations." Section 7701(a)(5) of the Code provides that the term foreign when applied to a corporation or partnership means a "corporation or partnership that is not domestic." This definition is significantly different than the definition of foreign entity that preceded it. The Revenue Act of 1918 used the term foreign to mean a corporation or partnership "created or organized outside the United States." Thus, under that definition, a dually chartered entity that was organized in the United States and in a foreign jurisdiction would have met the definitions of both a domestic entity and a foreign entity, creating uncertainty as to

the entity's status. The Revenue Act of 1924, Public Law 68-176 (43 Stat. 253) eliminated that potential for uncertainty by providing the definition of a foreign entity that is currently reflected in section 7701(a)(5). This definition of a foreign entity as "a corporation or partnership that is not domestic" makes it impossible for an entity to meet the definitions of both a domestic entity and a foreign entity for Federal tax purposes at the same time. As a result, a dually chartered entity that is organized both in the United States and in a foreign jurisdiction is a domestic entity.

Final regulations providing further guidance on the definitions of domestic and foreign business entities were published in the Federal Register on November 17, 1960 (25 FR 10928 (1960)).

### **Explanation of Provisions**

Under the existing rules, the characterization of a business entity for Federal tax purposes is established in two separate and independent steps. The first involves a determination of whether the entity is a corporation or a non-corporate entity (e.g., a partnership). The second involves a determination of whether the entity is foreign or domestic.

The determination of whether a business entity is classified as a corporation is made by applying the definition in §301.7701-2(b). If the entity is not a corporation under that definition, then it is a partnership if it has more than one owner and it is a disregarded entity if it has only a single owner. The temporary regulations in this document clarify that this same definition applies to dually chartered entities. Thus, to determine whether a dually chartered entity is a corporation, it must first be determined if the entity's organization in any of the jurisdictions in which it is organized would cause it to be treated as a corporation under the rules of §301.7701-2(b). If the entity would be treated as a corporation as a result of its formation in any of the jurisdictions in which it is organized, it is treated as a corporation for Federal tax purposes even though its organization in the other jurisdiction or jurisdictions would not have caused it to be treated as a corporation.

Once the classification of a business entity has been determined, a determination will generally need to be made regarding whether it is a domestic or foreign entity. It is a domestic entity if it is created or organized in the United States or under the laws of the United States or of any state. It is a foreign entity only if it is not domestic. The temporary regulations in this document revise §301.7701-5 to clarify that a dually chartered entity is domestic if it is organized as any form of entity in the United States, regardless of how it is organized in any foreign jurisdiction. An entity that is classified as a corporation because of its form of organization in a foreign country is considered a domestic corporation if it is also organized as some form of entity in the United States, regardless of what form the entity takes in the United States (e.g., corporation, limited liability company, or partnership).

These temporary regulations also remove from §301.7701-5 the definitions of resident foreign corporation, nonresident foreign corporation, resident partnership and nonresident partnership because these terms have become obsolete due to statutory changes since the final regulations were published in 1960.

These regulations clarify current law and do not change the outcome that would result under a proper application of the existing rules as they apply to dually chartered entities. For example, the temporary regulations are consistent with the result in Rev. Rul. 88-25 (1988-1 C.B. 116). These regulations are also not intended to affect the result under existing rules regarding whether an organization is a separate entity for Federal tax purposes (e.g., whether, in a particular case, two sets of organizational documents constitute different facets of a single entity or the foundations of two separate entities). In addition, if a business entity undertakes a continuance, domestication, or other transaction that, upon application of these rules, changes its entity classification or changes its foreign or domestic status, the tax effects of that transaction are determined under the regular tax principles that apply to such changes. Finally, the regulations contained in this document do not determine an entity's place of residence for the purpose of applying the provisions of a tax treaty.

Section 7701(a)(4) of the Code provides regulatory authority to define a domestic partnership other than based on where the partnership is created or organized. The Treasury and the IRS are continuing to explore whether, and under what circumstances, a different definition may be appropriate. If any change to the definition of a domestic partnership were to be proposed, it would apply only to partnerships created or organized after the issuance of regulations or other guidance substantially describing the change in definition.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the notice of proposed rulemaking published in the proposed rules section in this issue of the **Federal Register**. Pursuant to section 7806(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

### **Drafting Information**

The principal author of these regulations is Thomas Beem of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 301**

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and Recordkeeping requirements.

### **Amendments to the Regulations**

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 -- PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §301.7701-1, paragraph (d) is revised to read as follows:

§301.7701-1 Classification of organizations for federal tax purposes.

\* \* \* \* \*

(d) Domestic and foreign business entities. [Reserved]. For further guidance, see §301.7701-1T.

\* \* \* \* \*

Par 3. Section 301.7701-1T is added to read as follows:

§301.7701-1T Classification of organizations for federal tax purposes (temporary).

(a) through (c) [Reserved]. For further guidance, see §301.7701-1(a) through (c).

(d) Domestic and foreign entities. See §301.7701-5T for the rules that determine whether a business entity is domestic or foreign.

(e) through (f) [Reserved].

Par. 4. In §301.7701-2, paragraph (b)(9) is added to read as follows:

§301.7701-2 Business entities; definitions.

\* \* \* \* \*

(b) \* \* \*

(9) [Reserved]. For further guidance, see §301.7701-2T(b)(9).

\* \* \* \* \*

Par. 5. Section 301.7701-2T is added to read as follows:

§301.7701-2T Business entities; definitions (temporary).

(a) through (b)(8) [Reserved] For further guidance, see §301.7701-2 (a) through (b)(8).

(b)(9) Entities with multiple charters. (i) An entity created or organized under the laws of more than one jurisdiction if the rules of this section would treat it as a corporation as a result of its formation in any one of the jurisdictions in which it is created or organized. (The

determination of a business entity's classification is made independently of the determination whether the entity is domestic or foreign. See §301.7701-5T for the rules that determine whether a business entity is domestic or foreign.)

(ii) Examples. The following examples illustrate the rule of this paragraph (b)(9):

Example 1. (i) Facts. X is an entity with a single owner organized under the laws of Country A as an entity that is specifically mentioned in paragraph (b)(8)(i) of this section. Under the rules of this section, such an entity generally is a corporation for Federal tax purposes. Several years after its formation, X files a certificate of domestication in State B as a limited liability company (LLC). Under the laws of State B, X is considered to be created or organized in State B as a LLC upon the filing of the certificate of domestication and is therefore subject to the laws of State B. Under the rules of this section and §301.7701-3, a LLC with a single owner organized only in State B is disregarded as an entity separate from its owner for Federal tax purposes (absent an election to be treated as an association). Neither Country A nor State B law requires X to terminate its charter in Country A as a result of the domestication, and in fact X does not terminate its charter in Country A. Consequently, X is now organized in more than one jurisdiction.

(ii) Result. X remains organized under the laws of Country A as an entity that is specifically mentioned in §301.7701-2(b)(8)(i), and as such, it is an entity that generally is treated as a corporation under the rules of this section. Therefore, X is a corporation for Federal tax purposes because the rules of this section would treat X as a corporation as a result of its formation in one of the jurisdictions in which it is created or organized.

Example 2. (i) Facts. Y is an entity that is incorporated under the laws of State A and that has two shareholders. Under the rules of this section, an entity incorporated under the laws of State A is a corporation for Federal tax purposes. Several years after its formation, Y files a certificate of continuance in Country B as an unlimited company. Under the laws of Country B, upon filing a certificate of continuance, Y is treated as organized in Country B. Under the rules of this section and §301.7701-3, an unlimited company organized only in Country B that has more than one owner is treated as a partnership for Federal tax purposes (absent an election to be treated as an association). Neither State A nor Country B law requires Y to terminate its charter in State A as a result of the continuance, and in fact Y does not terminate its charter in State A. Consequently, Y is now organized in more than one jurisdiction.

(ii) Result. Y remains organized in State A as a corporation, an entity that is treated as a corporation under the rules of this section. Therefore, Y is a corporation for Federal tax purposes because the rules of this section would treat Y as a corporation as a result of its formation in one of the jurisdictions in which it is created or organized.

Example 3. (i) Facts. Z is an entity that has more than one owner and that is recognized under the laws of Country A as an unlimited company organized in Country A. Under the rules of this section and §301.7701-3, an unlimited company organized only in Country A with more than one owner is treated as a partnership for Federal tax purposes (absent an election to be treated as an association). At the time Z was formed, it was also organized as a public limited company under the laws of Country B. Under the rules of this section, a public limited company organized only in Country B generally is treated as a corporation for Federal tax purposes.

(ii) Result. Z is organized in Country B as a public limited company, an entity that generally is treated as a corporation under the rules of this section. Therefore, Z is a corporation for Federal tax purposes because the rules of this section would treat Z as a corporation as a result of its formation in one of the jurisdictions in which it is created or organized.

(c) through (e) [Reserved]. For further guidance, see §301.7701-2(c) through (e).

(f) Special effective date. The rules of this section apply as of August 12, 2004, to all business entities existing on or after that date.

Par. 6. In §301.7701-3, the last sentence of paragraph (b)(3)(i) is revised to read as follows:

§301.7701-3 Classification of certain business entities.

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \* (i) \* \* \* For special rules regarding the classification of such entities prior to the effective date of this section, see paragraph (h)(2) of this section.

\* \* \* \* \*

Par. 7. Section 301.7701-5 is revised to read as follows:

§301.7701-5 Domestic and foreign business entities. [Reserved]. For further guidance, see §301.7701-5T.

Par. 8. Section 301.7701-5T is added to read as follows:

§301.7701-5T Domestic and foreign business entities (temporary)

(a) Domestic and foreign entities. A business entity (including an entity that is disregarded as separate from its owner) is domestic if it is created or organized as any type of entity (including, but not limited to, a corporation, unincorporated association, general partnership, limited partnership, and limited liability company) in the United States, or under the law of the United States or of any State. Accordingly, a business entity that is created or organized both in the United States and in a foreign jurisdiction is a domestic entity. A business entity (including an entity that is disregarded as separate from its owner) is foreign if it is not domestic. (The determination of whether an entity is domestic is made independently of the determination of its



classification for Federal tax purposes. See §§301.7701-2, 301.7701-2T, and 301.7701-3 for the rules governing the classification of entities.)

(b) Examples. The following examples illustrate the rules of this section:

Example 1. (i) Facts. Y is an entity that is created or organized under the laws of Country A as a public limited company. It is also an entity that is organized as a limited liability company (LLC) under the laws of State B. Y has been classified as a corporation for Federal tax purposes under the rules of §§301.7701-2, 301.7701-2T, and 301.7701-3.

(ii) Result. Y is a domestic corporation because it is an entity that is classified as a corporation and it is organized as an entity under the laws of State B.

Example 2. (i) Facts. P is an entity with more than one owner organized under the laws of Country A as an unlimited company. It is also an entity that is organized as a general partnership under the laws of State B. P has been classified as a partnership for Federal tax purposes under the rules of §§301.7701-2, 301.7701-2T, and 301.7701-3.

(ii) Result. P is a domestic partnership because it is an entity that is classified as a partnership and it is organized as an entity under the laws of State B.

(c) Effective date. The rules of this section apply as of August 12, 2004,

to all business entities existing on or after that date.

Mark E. Matthews  
Deputy Commissioner for Services and Enforcement.

Approved: July 21, 2004

Gregory Jenner  
Acting Assistant Secretary of the Treasury.