Dover Corp. v. Commissioner, 122 T. C. 324 (U. S. Tax Court 2004)

In Dover Corp. v. Commissioner, the U. S. Tax Court ruled that a deemed asset sale following a check-the-box election to treat a foreign subsidiary as a disregarded entity did not generate foreign personal holding company income (FPHCI). This decision clarified the interaction between the check-the-box regulations and the FPHCI rules, impacting how multinational corporations structure their foreign operations to manage tax liabilities effectively.

Parties

Dover Corporation and its subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent).

Facts

Dover Corporation, a U. S. company, controlled two United Kingdom corporations, Dover U. K. Holdings Limited (Dover UK) and its wholly owned subsidiary, Hammond & Champness Limited (H&C). H&C was engaged in the business of installing and servicing elevators. In 1997, Dover UK sold the stock of H&C to Thyssen Industrie Holdings U. K. PLC, an unrelated third party. Prior to the sale, Dover requested and was granted an extension to retroactively elect to treat H&C as a disregarded entity under the check-the-box regulations, effective immediately before the stock sale. This election resulted in a deemed liquidation of H&C into Dover UK under Section 332, followed by a deemed sale of H&C's assets.

Procedural History

The IRS issued a notice of deficiency to Dover Corporation for the 1996 and 1997 tax years, asserting that the deemed sale of H&C's assets generated FPHCI taxable to Dover. Dover challenged this determination in the U. S. Tax Court. The case was submitted for decision without trial under Tax Court Rule 122. The court's decision was entered for the petitioner.

Issue(s)

Whether the gain from Dover UK's deemed sale of H&C's assets immediately following H&C's election to be treated as a disregarded entity constitutes foreign personal holding company income (FPHCI) under Section 954(c)(1)(B)(iii)?

Rule(s) of Law

Section 954(c)(1)(B)(iii) of the Internal Revenue Code defines FPHCI as including gains from the sale of property "which does not give rise to any income. " Treasury Regulation Section 1. 954-2(e)(3)(ii) through (iv) excludes from this definition tangible property, real property, and intangible property used in the seller's trade or business. The check-the-box regulations under Section 301. 7701-3 allow an eligible

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entity to elect its classification for federal tax purposes, and such an election to change from an association to a disregarded entity results in a deemed liquidation under Section 332.

Holding

The court held that Dover UK's gain on the deemed sale of H&C's assets did not constitute FPHCI under Section 954(c)(1)(B)(iii). The court found that the assets were used in Dover UK's trade or business, as required by Section 1. 954-2(e)(3)(ii) through (iv), because the check-the-box election resulted in a deemed Section 332 liquidation, attributing H&C's business history to Dover UK.

Reasoning

The court's reasoning centered on the interaction between the check-the-box regulations and the FPHCI rules. It relied on the principle from Revenue Ruling 75-223 and subsequent IRS guidance that, in a Section 332 liquidation, the parent corporation is viewed as if it had always operated the liquidated subsidiary's business. This principle was deemed applicable to the check-the-box election, resulting in H&C's assets being treated as used in Dover UK's business at the time of the deemed sale. The court rejected the IRS's argument based on Acro Manufacturing Co. v. Commissioner, finding it inconsistent with the IRS's own revenue rulings and administrative guidance. The court also noted that the IRS had the authority to amend the regulations to address perceived abuses but had not done so.

Disposition

The court entered a decision for the petitioner under Tax Court Rule 155.

Significance/Impact

The Dover Corp. decision is significant for its clarification of the tax consequences of check-the-box elections in the context of FPHCI. It underscores the importance of IRS administrative guidance in interpreting the tax code and highlights the potential for taxpayers to rely on such guidance in structuring transactions. The decision has implications for multinational corporations seeking to manage their tax liabilities through the use of disregarded entities in foreign jurisdictions. It also illustrates the tension between taxpayer flexibility under the check-the-box regulations and the IRS's efforts to prevent perceived tax abuses, a tension that has led to ongoing debates about the need for regulatory amendments.

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