

Notice of Proposed Rulemaking

Consolidated Returns; Intercompany Transactions

REG-131264-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of manufacturer incentive payments between members of a consolidated group. The proposed regulations are necessary to provide additional guidance for a variety of transactions involving manufacturer incentive payments. The regulations will affect corporations filing consolidated returns.

DATES: Written or electronic comments and requests for a public hearing must be received by November 11, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-131264-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-131264-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS and REG-131264-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Frances Kelly, (202) 622-7770; concerning submissions of comments and/or requests for a public hearing,

Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 1502 of the Internal Revenue Code. On July 18, 1995, final regulations (T.D. 8597, 1995-2 C.B. 147) under §1.1502-13, amending the intercompany transaction system of the consolidated return regulations, were published in the **Federal Register** (60 FR 36671). Those final regulations provide rules for taking into account items of income, gain, deduction, and loss of members from intercompany transactions. Their purpose is to clearly reflect the taxable income (and tax liability) of the group by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability.

Accounting for Intercompany Transactions

Under §1.1502-13(b)(1), an intercompany transaction is a transaction between corporations that are members of the same consolidated group immediately after the transaction. For purposes of §1.1502-13, S is the member transferring property or providing services, and B is the member receiving the property or services.

S's income, gain, deduction, and loss from an intercompany transaction, whether directly or indirectly, are its intercompany items, and may include amounts from an intercompany transaction that are not yet taken into account under its separate entity method of accounting. B's income, gain, deduction, and loss from an intercompany transaction, or from property acquired in an intercompany transaction, are its corresponding items. An item is a corresponding item whether it is directly or indirectly from an intercompany transaction (or from property acquired in an intercompany transaction). The recomputed corresponding item is the corresponding item that B would take into account if S and B were divisions of a single corporation and the intercompany

transaction were between those divisions. Although neither S nor B actually takes the recomputed corresponding item into account, it is computed as if B did take it into account.

Matching Rule

In general, under the matching rule of §1.1502–13(c), B takes its corresponding item into account under its separate entity accounting method and S takes its intercompany item into account to reflect the difference for the year between B’s corresponding item taken into account and the recomputed corresponding item. The matching rule determines when the intercompany transaction regulations override the members’ timing of items under their otherwise applicable separate entity methods of accounting.

Manufacturer Incentive Payments

Section 1.1502–13(c)(7)(ii), *Example 13*, illustrates how the matching rule of the intercompany transaction regulations treats manufacturer incentive payments made by one member of a group to another. In this example, B is a manufacturer that sells its products to dealers, and S is a credit company that offers financing, including financing to customers of the dealers. Under B’s incentive program, in Year 1, S purchases the product from an independent dealer for \$100 and leases it to a nonmember. S pays \$90 to the dealer for the product, and assigns to the dealer its \$10 incentive payment from B. Under their separate entity accounting methods, B would deduct the \$10 incentive payment in Year 1 and S would take a \$90 basis in the product. The example assumes that if S and B were divisions of a single corporation, the \$10 payment would not be deductible and S’s basis in the property would be \$100. The example concludes that under the matching rule of §1.1502–13(c), S takes its \$10 intercompany item into account as income in Year 1 to reflect the difference between B’s \$10 corresponding item (the \$10 deduction taken into account by B) and the \$0 recomputed corresponding item. S’s basis in the product is \$100 (rather than the \$90 it would be under S’s separate entity method of accounting) and the additional \$10 of basis in the product is recovered based on

subsequent events (e.g., S’s cost recovery deductions or its sale of the product).

Since §1.1502–13 was issued, it has become clear that the facts and the underlying assumptions in *Example 13* do not provide adequate guidance to address the variety of transactions involving manufacturer incentive payments. Accordingly, the IRS and Treasury Department believe that § 1.1502–13(c)(7)(ii), *Example 13*, should be amended to address certain of these transactions and to clarify the proper treatment of such payments under the intercompany transaction regulations. Therefore, these proposed regulations supplement the fact pattern of *Example 13* with two additional fact patterns involving manufacturer incentive payments.

Proposed Effective Date

The regulations are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rule making will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed

original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is William F. Barry, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.1502–13 also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502–13 is amended by adding paragraph (c)(7)(ii), *Example 13(c)*, (d), and (e), and paragraph (c)(7)(iii) to read as follows:

§1.1502–13 Intercompany transactions.

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(c) * * *

(7) * * * (i) * * *

(ii) * * *

Example 13. * * * (a) * * *

(c) *Deduction for incentive payment on single entity basis.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing, including financing to customers of the independent dealers. During Year 1, B initiates a program of incentive payments. Under B’s program, an independent dealer sells product to a customer under a retail installment sales contract (RISC) in which the customer agrees to pay for the product

over the term of the contract at a below market interest rate. The customer purchases the product from the independent dealer and enters into a RISC. The RISC has a face amount of \$100 but a fair market value of \$90. The independent dealer assigns the RISC to S in exchange for a \$100 payment from S. B pays \$10 to S to compensate S for the \$10 overpayment to the independent dealer. Assume that under their respective separate entity accounting methods, B would deduct the \$10 payment in Year 1, and S would take a \$90 basis in the RISC and would take the \$10 into account over the term of the RISC. Assume that, if S and B were divisions of a single corporation, the \$10 overpayment to the independent dealer would be deductible in Year 1 and the basis of the RISC would be \$90.

(d) *Timing and attributes.* Under paragraph (b)(1) of this section, the incentive payment transaction is an intercompany transaction. Under paragraph (b)(2)(iii) of this section, S has a \$10 intercompany item not yet taken into account under its separate entity method of accounting. Under the matching rule, S takes its intercompany item into account to reflect the difference between B's corresponding item taken into account and the recomputed corresponding item. In Year 1, there is no difference between B's \$10 deduction taken into account and the \$10 recomputed deduction. Accordingly, under the matching rule, S does not take the \$10 incentive payment into account as intercompany income in Year 1. Instead, S takes the \$10 into income over the term of the RISC. S's basis in the RISC is \$90.

(e) *No intercompany transaction.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing to purchasers of goods and services, including the independent dealers. During Year 1, B initiates a program of incentive payments to the independent dealers. Under B's program, S loans \$100 to an independent dealer at a below market interest rate to finance the independent dealer's purchase of product from B. The independent dealer issues a note to S at a below market interest rate. B pays \$10 to S to compensate S for the below market interest rate on the note. Under § 1.1273-2(g)(4), the payment from B to S is treated as a payment from B to the independent dealer and then as a payment from the independent dealer to S. Because the incentive payment is treated as being made by a member of the group to a non-member, the transaction is not an intercompany transaction under paragraph (b)(1) of this section. Therefore, § 1.1502-13 is not applicable.

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(iii) *Effective date.* Section 1.1502-13 (c)(7)(ii), *Example 13(c)*, (d), and (e) are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to exten-

sions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

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Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

(Filed by the Office of the Federal Register on August 12, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2004, 69 F.R. 50112)