THE §245A D.R.D. MEETS THE I.R.S.: ONLY *LOPER BRIGHT* MIGHT PROVIDE RELIEF

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INTRODUCTION

In Chief Counsel Advice ("C.C.A.") Memo. 202436010, the I.R.S. concluded that the dividends-received deduction ("D.R.D.") under Code §245A is not available to controlled foreign corporations ("C.F.C.'s"). The I.R.S.'s position drew heavily on the plain language of the relevant statute. The emphasis on the statute's plain language is not a new legal principle, but the timing of the memorandum is interesting given it was released a few months after *Loper Bright Enterprises v. Raimondo*,[1] a landmark Supreme Court case decided in June 2024. *Loper Bright* struck down the long-standing *Chevron* doctrine,[2] under which courts were directed to defer to a Federal agency's reasonable interpretation of ambiguous statutory provisions. In *Loper Bright*, the Supreme Court reasserted the judiciary's responsibility to interpret the law and held that the *Chevron* doctrine gave too much interpretive power to Federal agencies. In the tax context, this has led practitioners to speculate about *Loper Bright*'s effect on Treasury Regulations. The speculation is partly fueled by a lack of clarity on what tests and standards will be used under *Loper Bright* to determine the validity of regulations promulgated by Federal agencies.

D.R.D.

As the name suggests, a D.R.D. is a deduction that a corporate shareholder can claim when receiving dividends if certain conditions are met. The general purpose behind the D.R.D. is to reduce the tax burden on income that is being shifted from one corporation to another but is staying within corporate solution. The Code §245A D.R.D. applies to the foreign-source portion of a dividend received by a U.S. corporate shareholder from a foreign corporation. To qualify for the deduction, the recipient must hold at least 10% of the distributing corporation's shares measured either by vote or by value.[3] Additionally, the recipient must have held the stock for more than 365 days in the two-year period beginning one year before the ex-dividend date.[4] If the recipient qualifies for the Code §245A requirements, the D.R.D. provides a deduction equal to 100% of the foreign-source portion of the dividend.

This D.R.D. was enacted in 2017 as part of the U.S.'s partial shift to a territorial tax system.

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1 603 U.S. 369 (2024).

2 Named after *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

3 Code §951(b).

4 Code §246(c)(5).

By the statute's plain language, the Code §245A D.R.D. is available only to domestic corporations. However, practitioners have found several clues that this D.R.D. should also be available to C.F.C.'s that receive a dividend from a 10%-owned foreign corporation. A C.F.C. is a foreign corporation in which more than 50% of the corporation's stock, measured by vote or by value, is owned by U.S. shareholders each of whom own at least 10% of the corporation's stock, measured by vote or by value.[5]

Because computation of income can yield different results under U.S. rules compared to foreign rules, Treas. Reg. §1.952-2 requires that a C.F.C. calculate its income for U.S. income tax purposes by using U.S. rules. Notably, a C.F.C. is directed to calculate its gross income and taxable income as though it were a domestic corporation. Certain exceptions and special rules are laid out, such as those relating to insurance income, but Code §245A is not among those exclusions.

Other statutory rules might infer the availability of the D.R.D. Paragraph (e)(2) of Code §245A applies to a C.F.C. that receives a hybrid dividend from its foreign subsidiary that is also a C.F.C. with respect to the upper-tier C.F.C.'s U.S. shareholders. The upper-tier C.F.C. is not entitled to claim the D.R.D. to offset Subpart F income. As a result, a U.S. shareholder holding directly or indirectly a ≥10% interest in the upper-tier C.F.C. is taxed in the U.S. on its share of the Subpart F income of that C.F.C.

Notably, a hybrid dividend is a dividend for which a Code §245A D.R.D. would be allowed but for paragraph (e) and for which the lower-tier C.F.C. payor received a deduction or other tax benefit in a foreign country.[6] An example of a hybrid dividend is an amount paid by a corporation that the U.S. views as a dividend for a shareholder, but the foreign country of residence of the payor views as a deductible expense, such as interest paid on a debt instrument.[7]

This definition of hybrid dividend implies a dividend that would, in principle, be eligible for the Code §245A D.R.D. were it not for paragraph (e). Paragraph (e)(2) indicates that a C.F.C. can receive a Code §245A-eligible-dividend. If a C.F.C. can never claim the Code §245A D.R.D., the hybrid dividend rule would be superfluous as no dividend received by a C.F.C. could ever qualify for the D.R.D., whether hybrid or not hybrid.

Code §964(e)(4) also deals with structures involving a C.F.C. owning a foreign subsidiary. This provision applies where a C.F.C. sells stock in the foreign subsidiary and, under rules similar to Code §1248, is required to treat the gain as a dividend to the extent of the earnings and profits of the foreign subsidiary.[8] This deemed dividend is also included in the C.F.C.'s U.S. shareholders' income as Subpart F income. However, a U.S. shareholder who would have been eligible to claim the Code §245A D.R.D. had the shareholder received an actual dividend can apply the Code §245A D.R.D. to this Subpart F inclusion. Therefore, the C.F.C. is effectively allowed a Code §245A D.R.D. on the deemed dividend. It would seem logical to allow the D.R.D. for actual dividends. However, the language is limited to such deemed dividends and does not extend to actual dividends.

5 Code §§957(a), 951(b).

6 Code §245A(e)(4).

7 For this purpose, any limitation on the deduction claimed for the payment is irrelevant.

8 Code §1248 recharacterizes certain sales of foreign corporate stock by U.S. shareholders as dividends.

LEGISLATIVE HISTORY

The legislative history behind Code §245A is ambiguous. A footnote in the House of Representative's Conference Report,[9] describing U.S. corporations eligible for the Code §245A D.R.D., supports the availability of the D.R.D. for C.F.C.'s:

> [U.S. corporations eligible for the §245A D.R.D. include] a controlled foreign corporation treated as a domestic corporation for purposes of computing the taxable income thereof. See Treas. Reg. Sec. 1.952-2(b)(1). Therefore, a C.F.C. receiving a dividend from a 10-percent owned foreign corporation that constitutes subpart F income may be eligible for the D.R.D. with respect to such income.

The Joint Committee on Taxation's Bluebook, which explains the new law after its enactment, offers a different viewpoint:

> A corporate U.S. shareholder of a C.F.C. receiving a dividend from a 10-percent owned foreign corporation shall be allowed a D.R.D. with respect to the subpart F inclusion attributable to such dividend in the same manner as a dividend would be allowed under section 245A.[10]

The Bluebook thus suggests that while Congress intended to extend Code §964(e)(4) treatment to actual dividends received by a C.F.C., and therefore mimic the effect of a Code §245A D.R.D., Congress's intent did not go as far as to actually allow the D.R.D. to the C.F.C.

THE I.R.S. POSITION

C.C.A. 202436010 holds that the statute's unambiguous language means that "the analysis of the issue ends there* * *." It further states:

> In fact, the reading of section 245A(a) to allow a section 245A D.R.D. for a C.F.C. would render the use of the word "domestic" in the statute surplusage, and under a "cardinal principle of statutory construction," statutes are to be interpreted to give effect to every word of the statute.[11] The use of the word "domestic" in section 245A(a) contrasts with the language of sections 243(a) and 245(a), each of which allows a deduction for a dividend received by a "corporation" without specifying that the corporation needed to be domestic. Thus, unlike section 245A(a), sections 243(a) and 245(a) provide dividends received deductions to both domestic and foreign corporations. Had Congress wanted to provide a section 245A D.R.D. to both domestic and foreign corporations, it could have used language analogous to sections 243 and 245. Instead, section 245A(a) specifically requires a *domestic* corporation that is a United States shareholder, and that word must be given its plain meaning.

9 H.R. Rep. No. 115-466 (2917).

10 But the Bluebook notes that a "technical correction may be necessary to reflect this intent."

11 Citing *Williams v. Taylor*, 529 U.S. 362 (2000).

The C.C.A. also considers and rejects the specific arguments above. It argues, relying on regulatory definitions, that the Subpart F inclusion required under Code §245A(e)(2) does not imply that the D.R.D. would otherwise apply. Instead, it suggests that this provision operates by treating the C.F.C. as a domestic corporation for this purpose and then determining whether the D.R.D. would be available to the deemed domestic corporation. Arguably, however, the I.R.S.'s regulatory interpretation of Code §245A(e)(2) also departs from statutory language, as the statute's plain language does not treat a C.F.C. as a domestic corporation for purposes of defining a hybrid dividend.

VARIAN

The first court case to discuss the impact of *Loper Bright* in a tax context was *Varian Medical Systems v. Commr.*,[12] where the Tax Court examined another issue related to the Code §245A D.R.D.: the interaction of the D.R.D. with the Code §78 gross-up. The Code §78 gross-up applies to a U.S. corporation that claims a foreign tax credit for foreign taxes paid by certain 10%-owned foreign subsidiaries. It requires such a corporation to treat as a dividend the amount of foreign tax paid by the C.F.C. with respect to the included income. Without the gross-up, a taxpayer could effectively claim a double benefit of a foreign tax credit and a deduction for foreign tax paid. However, Code §78 states that the grossed-up amount is not treated as a dividend for purposes of Code §245 D.R.D.[13] In other words, the gross-up dividend cannot be reduced or eliminated by a Code §245 D.R.D. When Code §245A was enacted, this rule's scope was extended to cover the Code 245A D.R.D.

"The C.C.A. . . . argues, relying on regulatory definitions, that the Subpart F inclusion required under Code §245A(e)(2) does not imply that the D.R.D. would otherwise apply."

However, there was a timing issue as to effective dates of the provisions in play in the case. Code §245A applies to distributions made after December 31, 2017. The revised version of Code §78, which takes into account the Code §245A D.R.D., applies to tax years beginning after December 31, 2017. For a calendar-year taxpayer, both provisions applied to the 2018 tax year, and there was no timing mismatch. But for a fiscal-year taxpayer, revised Code §78 seemed not to apply until its new tax year began in 2018. This meant that the Code §245A D.R.D. was theoretically applicable to the gross-up until the new tax year began sometime in 2018.

That was the taxpayer's situation and its position in *Varian*. The taxpayer's tax year began on September 29, 2017. This meant that its first tax year to which revised Code §78 applied to – *i.e.*, the first tax year beginning after December 31, 2017 – did not begin until September 29, 2018. But since Code §245A D.R.D. is available for all post-2017 distributions without regard to the tax year, the taxpayer applied the D.R.D. to its gross-up for its 2017–18 tax year.

The I.R.S. argued that the Code §245A D.R.D. only applies to actual dividends distributed out of a corporation's earnings and profits. The court found several objections to this. No such limitation exists in the statutory language, and the definition of "dividend" implies that when a dividend is deemed made, it is also deemed to be distributed, satisfying the I.R.S.'s purported requirement. The I.R.S. pointed out that

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12 163 T.C. No. 4 (2024).

13 This D.R.D. is similar to the Code §245A D.R.D. but applies to the U.S.-source portion of the dividend rather than the foreign-source portion.

some other Code provisions that create deemed dividends, such as Code §1248,[14] specify that Code §245A applies to the deemed dividend. This would imply that by default, Code §245A does not apply to deemed dividends. But the court explained that Code §78, unlike those other provisions, creates a deemed dividend "for purposes of this title [*i.e.*, the Code]." It concluded:

> Saying that an amount will be treated in a particular manner "for purposes of this title" (*i.e.*, the Code) is equivalent to listing every section in the Code and saying that the amount will be so treated for purposes of each section. Thus, Congress did not need to say more to bring a section 78 dividend within the scope of section 245A.

After rejecting the definitional argument of the I.R.S., the court turned to the I.R.S.'s regulatory argument. In 2019, the I.R.S., having taken note of the mismatch issue with Code §§245A and 78, amended Treas. Reg. §1.78-1(a) to read as follows:

> A section 78 dividend is treated as a dividend for all purposes of the Code, except that it is not treated as a dividend for purposes of section 245 or 245A, and does not increase the earnings and profits of the domestic corporation or decrease the earnings and profits of the foreign corporation.

This regulation disallows the application of the Code §245A D.R.D. to a gross-up. But it also contradicts the statute. For the court, that was a non-starter:

> But, as we have already observed, the plain text of the statutes provides for the deduction. As the Supreme Court has said, "self-serving regulations never 'justify departing from the statute's clear text.'" *Niz-Chavez v. Garland*, 593 U.S. 155, 141 S. Ct. 1474, 1485, 209 L. Ed. 2d 433 (2021) (quoting *Pereira v. Sessions*, 585 U.S. 198, 138 S. Ct. 2105, 2118, 201 L. Ed. 2d 433 (2018)); see also *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 328, 134 S. Ct. 2427, 189 L. Ed. 2d 372 (2014) ("[T]he need to rewrite clear provisions of the statute should have alerted [the Government] that it had taken a wrong interpretive turn."); *Koshland v. Helvering*, 298 U.S. 441, 447, 56 S. Ct. 767, 80 L. Ed. 1268, 1936-1 C.B. 219 (1936) ("[W]here . . . the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation."); *Abdo v. Commissioner*, No. 5514-20, 162 T.C., slip op. at 21 (Apr. 2, 2024) (reviewed) ("Respondent's regulation . . . cannot change the result dictated by an unambiguous statute." (citing *Niz-Chavez*, 141 S. Ct. at 1485)).

IMPACT OF *LOPER BRIGHT*?

Although the I.R.S. adopted its *Varian* position before *Loper Bright* was decided, the court asked the I.R.S. for its views on the impact of *Loper Bright* on the case. But it seems unlikely that it made a difference. The statutes here were unambiguous with respect to their effective dates. The court noted that "even under *Chevron*, '[i]f

[14] Code §1248 recharacterizes gain on the sale of C.F.C. stock as a dividend to the extent of untaxed E&P in the C.F.C.

the intent of Congress is clear, that is the end of the matter,' [*Chevron*, 467 U.S. at 842,]* * *"[15]

Therefore, *Varian* did not provide much clarity regarding the impact of *Loper Bright*. But under the *Loper Bright* framework, courts may place greater emphasis on uncovering the unambiguous meaning of a statute. *Loper Bright* holds that "statutes, no matter how impenetrable, do – in fact, must – have a single, best meaning." The single, best meaning here was easy to find. That will not necessarily be the case with other statutes.

FEDEX AND DELEGATIONS OF AUTHORITY

Loper Bright was also cited by the Western District of Tennessee in *FedEx Corp. and Subsidiaries v. United States*.[16] *FedEx* provides a little more guidance on the application of *Loper Bright*.

The *FedEx* case concerned the "transition tax," also known as the Code §965 tax, enacted in 2017. Under Code §965, certain U.S. shareholders of certain foreign corporations were required to pay a one-time tax on the foreign corporation's deferred (and therefore untaxed) foreign earnings. A U.S. shareholder subject to the transition tax and with applicable interests in multiple foreign corporations was allowed to offset the taxable foreign earnings from profitable foreign subsidiaries with losses from unprofitable foreign subsidiaries.[17]

The case concerned FedEx's claim for foreign tax credit for foreign taxes paid by its subsidiaries on the earnings offset by losses, which the court referred to as "offset earnings." Under former Code §902, a U.S. corporation that received a dividend from a foreign subsidiary was deemed to have paid the foreign tax paid by the subsidiary on the income giving rise to earnings and profits from which the dividend was paid. In this way, a U.S. corporation owning sufficient shares in a foreign corporation could actually claim a credit, thereby reducing the U.S. tax on the dividend. Where the U.S. corporation reported a Subpart F inclusion instead of a dividend, Code §960 deemed the Subpart F inclusion to be a dividend for purposes of Code §902. This meant that a U.S. shareholder of a C.F.C. could, in principle, also claim foreign tax credit for the Subpart F income inclusion, assuming sufficient ownership was held in the foreign corporation.

The I.R.S. previously issued a regulation that disallowed foreign tax credits for dividends paid from offset earnings.[18] The general policy behind the foreign tax credit is to reduce or eliminate double taxation on a specific item of income that would otherwise arise because both the foreign country and the U.S. could tax the same income. The foreign country could tax the income as earned and the U.S. could tax the resulting earnings and profits as distributed.[19] Since offset earnings are not

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15 Citing *Loper Bright*.

16 No. 2:20-cv-02794 (2025).

17 Code §965(b)(1).

18 Treas. Reg. §1.965-5(c)(1)(ii).

19 In addition, the foreign country could impose withholding tax on dividend distributions paid by the foreign corporation.

taxed by the U.S., the I.R.S. was concerned that allowing foreign tax credit would completely eliminate taxation on applicable income.

This regulation was held invalid by the *FedEx* court in 2023, which granted summary judgment to FedEx on that issue. FedEx's victory rested on the interaction of the following statutory language.

- Code §960(a)(1), as mentioned earlier, allows a U.S. shareholder of a C.F.C. to claim foreign tax credit for foreign tax paid by the C.F.C. on income that is included in the U.S. shareholder's income as Subpart F income.
- When this income is actually repatriated to the U.S. shareholder, Code §959 provides that the U.S. will not tax the income again, since it was already taxed under the Subpart F regime, and Code §965(b)(4)(A) extends this treatment to offset earnings, ensuring that the offset earnings are not taxed when repatriated. Correspondingly, Code §960(a)(2) provides that on a repatriation under Code §959, the U.S. shareholder cannot claim foreign tax credit on foreign tax that was already credited under Code §960(a)(1), as would otherwise have been allowed under the general rule of former Code §902.
- Finally, Code §960(a)(3) provides that if repatriated earnings are excluded from income under Code §959, the repatriated earnings will be treated as a dividend for purposes of Code §902 to take into account foreign tax that was not previously credited under Code §960(a)(1). Therefore, any foreign tax paid by the C.F.C. for which the U.S. shareholder did not previously receive a credit is credited under this paragraph.

FedEx's argument was as follows:

- FedEx's repatriated offset earnings are excluded from income under Code §959, per Code §965(b)(4)(A).
- FedEx's C.F.C. paid foreign tax on the offset earnings that was not previously credited under Code §960(a)(1).
- Therefore, Code §960(a)(3) allows a credit to be taken.

The government argued that Code §965(b)(4)(A) requires the offset earnings to be treated as though they have been previously included in income under Subpart F, even though they were not. Code §960(a)(1) specifically provides that for amounts previously included under Subpart F, the U.S. shareholder is deemed to have paid the associated foreign taxes. And Code §960(a)(2) provides that taxes previously deemed paid under Code §960(a)(1) will not be credited.

But FedEx prevailed because Code §965(b)(4)(A) is limited to purposes of applying Code §959. The court agreed that the government incorrectly applied the deemed prior inclusion under Code §965(b)(4)(A) to Code §960(a), contradicting that provision's plain language. The court found the government's construction of the statutes to be inconsistent and too complex compared to FedEx's interpretation. It held that the regulation disallowing the foreign tax credit was invalid.

Loper Bright

Earlier this year, the court revisited the issue and asked the parties for observations in light of *Loper Bright*.

Even under *Loper Bright*, the Supreme Court acknowledged that delegation to an agency can still be possible:

> [Some statutes] expressly delegate to an agency the authority to give meaning to a particular statutory term. * * *Others empower an agency to prescribe rules to fill up the details of a statutory scheme, or to regulate subject to the limits imposed by a term or phrase that leaves agencies with flexibility, such as 'appropriate' or 'reasonable.'

The government noted that Code §965(o) authorizes the Department of the Treasury to issue regulations "as may be necessary or appropriate," including "regulations or other guidance to prevent the avoidance of the purposes of this section…" The government then invoked Treas. Reg. §1.965-5(c)(1)(i), also referred to as the "regulatory haircut rule."[20]

To incentivize compliance with the transition tax, Congress included a deduction in Code §965(c) that effectively reduced the transition tax rate to 15.5% for earnings embodied in cash and cash equivalents and 8% for earnings embodied in all other assets. Under the haircut rule, the foreign taxes paid on the portion of income that for which this deduction is allowed are not allowed to be credited. This rule aims to prevent a taxpayer from claiming a double benefit of the Code §965(c) deduction and foreign tax credit on the same portion of an item of income. The government argued that even if it could not fully deny FedEx foreign tax credit, it could use the haircut rule to reduce FedEx's foreign tax credit.

"Under the haircut rule, the foreign taxes paid on the portion of income that for which this deduction is allowed are not allowed to be credited."

However, the haircut rule only applies to amounts for which the Code §965(c) deduction is allowed. And the Code §965(c) deduction, in turn, only applies to amounts that are included in income under Subpart F. As part of the court's previous grant of partial summary judgment, it held that offset earnings are not included in Subpart F income. Therefore, the deduction could not apply to offset earnings, and the haircut rule does not apply to income if there is no Code §965(c) deduction. The court found that offset earnings were outside the scope of the haircut rule, partly because of statutory definitions.

The court agreed that delegations of authority can still be respected under *Loper Bright*, but cautioned that such delegations did not give the I.R.S. complete freedom in writing regulations:

> *Loper Bright* holds that, when assessing the legality of agency regulations, courts must independently interpret the governing statutes, and sometimes the "best reading of a statute is that it delegates discretionary authority to an agency." 144 S.Ct. at 2263. The Supreme Court elaborated that, when a statute delegates regulatory authority to an agency, courts must "recogniz[e] constitutional delegations, fi[x] the boundaries of the delegated authority, and ensur[e] that the agency has engaged in reasoned decisionmaking within those boundaries."

Here, the court refused to accept the application of the regulatory haircut rule because it would have been against the plain meaning of the relevant statutes, as

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20 There is also a parallel "statutory haircut rule" in Code §965(g)(1). The court dismissed the application of the statutory rule for similar reasons as the regulatory one.

previously litigated. The court concluded that "[p]romulgating a regulation that contradicts statutory language is outside the boundaries of the authority delegated to the I.R.S."

The court therefore outlined a few more contours of the *Loper Bright* framework. Delegations of authority do not necessarily give the I.R.S. *carte blanche* to issue regulations. Instead, courts are required to evaluate the delegation of authority itself to determine its boundaries. And regulations issued under a delegation of authority are invalid to the extent they contradict a statute's language.

CONCLUSION

The currently pending budget resolution bill in Congress contains many tax provisions that grant rulemaking authority to the Treasury Department on various subjects, including tax-free tips, deductions for state and local taxes, and amortization of R&D expenses. These provisions were clearly added with *Loper Bright* in mind. The *FedEx* court's scrutiny of the delegation in Code §965(o) suggests that lawmakers will need to be particularly clear and specific when granting authority to write regulations. The effect, as is generally the case under *Loper Bright*, will likely be less discretion given to the I.R.S.