

amount specified in a consent is larger than the amount of earnings subject to the accumulated earnings tax imposed by part I of subchapter G, such excess is not a consent dividend under paragraph (a) of this section and will not be included in the gross income of the shareholder.

(3) Except as provided in section 565(b), §1.565-2 and paragraph (c)(2) of this section, once a shareholder's consent is filed, the full amount specified in such consent must be included in the shareholder's gross income as a taxable dividend, and the ground upon which a deduction for consent dividends is denied the corporation does not affect the taxability of a shareholder whose consent has been filed for the amount specified in the consent. For example, although described in part I, II, or III of subchapter G, or part I or II of subchapter M, chapter 1 of the Code, the corporation's taxable income (as adjusted under section 535(b), 545(b), 556(b), 852(b)(2), or 857(b)(2), as appropriate) may be less than the total of the consent dividends.

(4) A shareholder who is a non-resident alien or a foreign corporation is taxable on the full amount of the consent dividend that otherwise qualifies under this section even though that payment has not been made as required by section 565(e) and §1.565-5.

(5) Income of a foreign corporation is not subject to the tax on accumulated earnings under part I of subchapter G, chapter 1 of the Code except to the extent of U.S. source income, adjusted as permitted under section 535. See section 535 (b) and (d) and §1.535-1(b). Therefore, foreign source earnings (other than those distributions subject to resourcing under section 535(d)) of a foreign corporation that is not described in paragraph (a)(2) of this section cannot qualify for consent dividend treatment. Accordingly, a consent dividend made by a foreign corporation described in paragraph (a)(1) of this section shall not be effective with respect to all of the corporation's earnings, but shall relate solely to earnings which would have been, in the absence

of the consent dividend, subject to the accumulated earnings tax.

[T.D. 8244, 54 FR 10538, Mar. 14, 1989, as amended by T.D. 9100, 68 FR 70705, Dec. 19, 2003]

§ 1.565-1T General rule (temporary).

(a) through (b)(2) [Reserved]. For further guidance, see §1.565-1(a) through (b)(2).

(b)(3) A consent may be filed at any time not later than the due date of the corporation's income tax return for the taxable year for which the dividends paid deduction is claimed. With such return, and not later than the due date thereof, the corporation must file Forms 972 for each consenting shareholder, and a return on Form 973 showing by classes the stock outstanding on the first and last days of the taxable year, the dividend rights of such stock, distributions made during the taxable year to shareholders, and giving all the other information required by the form. For taxable years beginning before January 1, 2003, the Form 973 filed with the corporation's income tax return shall contain or be verified by a written declaration that is made under the penalties of perjury and the Forms 972 filed with the return must be duly executed by the consenting shareholders. For taxable years beginning after December 31, 2002, the Form 973 filed with the corporation's income tax return shall be verified by signing the return and the Forms 972 filed with the return must be duly executed by the consenting shareholders or, if unsigned, must contain the same information as the duly executed originals. If the corporation submits unsigned Forms 972 with its return for a taxable year beginning after December 31, 2002, the duly executed originals are records that the corporation must retain and keep available for inspection in the manner required by §1.6001-1(e).

(c) [Reserved]. For further guidance, see §1.565-1(c).

[T.D. 9100, 68 FR 70705, Dec. 19, 2003]

§ 1.565-2 Limitations.

(a) *General rule.* Amounts specified in consents filed by shareholders or other

beneficial owners of a corporation described in § 1.565-1(a) are not treated as consent dividends to the extent that—

(1) They would constitute a preferential dividend or

(2) They would not constitute a dividend (as defined in section 316),

if distributed in money to shareholders on the last day of the taxable year of the corporation. If any portion of any amount specified in a consent filed by a shareholder of a corporation described in the preceding sentence is not treated as a consent dividend under section 565(b) and this section, it is disregarded for all tax purposes. For example, it is not taxable to the consenting shareholder, and paragraph (c) of § 1.565-1 is not applicable to this portion of the amount specified in the consent.

(b) *Preferential Distribution.* (1) A preferential distribution is an actual distribution, or a consent distribution, or a combination of the two, which involves a preference to one or more shares of stock as compared with other shares of the same class or to one class of stock as compared with any other class of stock. See section 562(c) and § 1.562-2.

(2) The application of section 565 (b) (1) and § 1.565-2 (b) may be illustrated by the following examples:

Example 1. The X Corporation, a personal holding company, which makes its income tax returns on the calendar year basis, has 200 shares of stock outstanding, owned by A and B in equal amounts. On December 15, 1987, the corporation distributes \$600 to B and \$100 to A. As a part of the same distribution, A executes a consent to include \$500 in his gross income as a taxable dividend although such amount is not distributed to him. The X Corporation, assuming the other requirements of section 565 have been complied with, is entitled to a consent dividends deduction of \$500. Although the consent dividend is deemed to have been paid on December 31, 1987, the last day of the taxable year of the corporation, the total amount of all distributions constitutes a single nonpreferential distribution of \$1200.

Example 2. The Y corporation, a personal holding company, which makes its income tax returns on the calendar year basis, has one class of consent stock outstanding, owned in equal amounts by A, B, and C. If A and B each receive a distribution in cash of \$5,000 and C consents to include \$3,000 in gross income as a taxable dividend, the combined actual and consent distribution of

\$13,000 is preferential. See section 562 (c) and § 1.562-2 (a). Similarly, if no one receives a distribution in cash, but A and B each consents to include \$5,000 as a taxable dividend in gross income and C agrees to include only \$3,000, the entire consent distribution is preferential.

Example 3. The Z Corporation, which makes its income tax returns on the calendar year basis and is subject, for the taxable year in question, to the accumulated earnings tax, has only two classes of stock outstanding, each class being consent stock and consisting of 500 shares. Class A, with a par value of \$40 per share, is entitled to two-thirds of any distribution of earnings and profits. Class B, with a par value of \$20 per share, is entitled to one-third of any distribution of earnings and profits. On December 15, 1987, there is distributed on the class B stock \$2 per share, or \$1,000, and shareholders of the class A stock consent to include in gross income amounts equal to \$2 per share, or \$1,000. The entire distribution of \$2,000 is preferential, inasmuch as the class B stock has received more than its pro rata share of the combined amounts of the actual distributions and the consent distributions.

(c) *Section 316 Limitation.* (1) An additional limitation under section 565 (b) is that the amounts specified in consents which may be treated as consent dividends cannot exceed the amounts which would constitute a dividend (as defined in section 316) if the corporation had distributed the total specified amounts in money to shareholders on the last day of the taxable year of the corporation. If only a portion of such total would constitute a dividend, then only a corresponding portion of each specified amount is treated as a consent dividend.

(2) The application of section 565 (b) (2) and § 1.565-2 (c) may be illustrated by the following example:

Example. The X Corporation, a corporation described in § 1.565-(a) (1) or (2), which makes its income tax returns on the calendar year basis, has only one class of stock outstanding, owned in equal amounts by A and B. It makes no distributions during the taxable year 1987. Its earnings and profits for the calendar year 1987 amount to \$8,000, there being at the beginning of such year no accumulated earnings or profits. A and B execute proper consents to include \$5,000 each in their gross income as a dividend received by them on December 31, 1987. The sum of the amounts specified in the consents executed by A and B is \$10,000, but if \$10,000

had actually been distributed by the X corporation on December 31, 1987, only \$8,000 would have constituted a dividend under section 316 (a). The amount which could be considered as consent dividends in computing the dividends paid deduction for purposes of the accumulated earnings tax is limited to \$8,000, or \$4,000 of the \$5,000 specified in each consent. The remaining \$1,000 in each consent is disregarded for all tax purposes. (In the case of a personal holding company, see also the example in § 1.565-3(b).)

[T.D. 8244, 54 FR 10539, Mar. 14, 1989]

§ 1.565-3 Effect of consent.

(a) *General Rule.* The amount of the consent dividend that is described in paragraph (a) of § 1.565-1 shall be considered, for all purposes of the Code, as if it were distributed in money by the corporation to the shareholder on the last day of the taxable year of the corporation, received by the shareholder on such day, and immediately contributed by the shareholder as paid-in capital to the corporation on such day. Thus, the amount of the consent dividend will be treated by the shareholder as a dividend. The shareholder will be entitled to the dividends received deduction under section 243 or 245 with respect to such consent dividend. The basis of the shareholder's consent stock in a corporation will be increased by the amount thus treated in his hands as a dividend which he is considered as having contributed to the corporation as paid-in capital. The amount of the current dividend will also be treated as a dividend received from sources within the United States in the same manner as if the dividend had been paid in money to the shareholders. Among other effects of the consent dividend, the earnings and profits of the corporation will be decreased by the amount of the consent dividends. Moreover, if the shareholder is a corporation, its accumulated earnings and profits will be increased by the amount of the consent dividend with respect to which it makes a consent.

(b) *Example.* The application of section 565 (c) may be illustrated by the following example:

Example. Corporation A, a personal holding company and a calendar year taxpayer, has one shareholder, individual B, whose consent to include \$10,000 in his gross income for the

calendar year 1987 has been timely filed. A has \$8,000 of earnings and profits at the beginning of 1987. A has \$10,000 of undistributed personal holding company income (determined without regard to distributions under section 316(b)(2)) for 1987. B must include \$10,000 in his gross income as a taxable income and is treated as having immediately contributed \$10,000 to A as paid-in capital. See section 316(b)(2).

[T.D. 8244, 54 FR 10540, Mar. 14, 1989]

§ 1.565-4 Consent dividends and other distributions.

Section 565(d) provides a rule applicable where a distribution is made in part in consent dividends and in part in money or other property. With respect to such a distribution the entire amount specified in the consents and the amount of such money or other property shall be considered together. Thus, if as a part of the same distribution consents are filed by some of the shareholders and cash is distributed to other shareholders, for example, those who may be unwilling to sign consents, the total amount of the cash and the amounts specified in the consents will be viewed as a single distribution to determine the tax effects of such distribution. For example, the total of such amounts must be considered to determine whether the distribution (including the amounts specified in the consents) is preferential and whether any part of such distribution would not be dividends if the total amounts specified in the consents were distributed in cash. See paragraph (b)(2) of § 1.565-2 for examples illustrating the treatment of distributions which consist in part of consent dividends and in part of other property.

§ 1.565-5 Nonresident aliens and foreign corporations.

(a) *Withholding.* In the event that a corporation makes a consent dividend, as described in § 1.565-1 (a), to a shareholder that is subject to a withholding tax under section 1441 or 1442 on a distribution of cash or other property, the corporation must remit an amount of tax equal to the withholding tax that would be imposed under section 1441 or 1442 if an actual cash distribution equal to the consent dividend had been paid to the shareholder on the last day of the corporation's taxable year. Such