APPEALS

INDUSTRY SPECIALIZATION PROGRAM

COORDINATED ISSUE PAPER

INDUSTRY: MAQUILADORA

ISSUE: SECTION 1504(d)

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SETTLEMENT GUIDELINES

Maquiladora –Section 1504(d)

STATEMENT OF ISSUE

Whether a U.S. corporation that formed a Mexican subsidiary to benefit from the Maquiladora program may elect to include the Mexican subsidiary in the consolidated return group under section 1504(d)?

EXAMINATION DIVISION POSITION

U.S. corporations may not include foreign corporations in their consolidated return group as a general rule. Under section 1504(d), however, a domestic corporation may elect to include wholly-owned Mexican or Canadian subsidiaries in their consolidated return group, if those subsidiaries are "maintained solely for the purpose of complying with the laws of such country as to title and operation of property." To include a Mexican subsidiary in a consolidated return group could be beneficial since it would allow the affiliated group to offset its income by the Mexican subsidiary start up costs or operating losses.

Examination argues that the U.S. corporation cannot include the Mexican subsidiary in its consolidated return group because the corporation formed the subsidiary to secure benefits under the Maquiladora program and not solely for the purpose required by the statute under section 1504(d). Exam argues the subsidiary was not "maintained solely for the purpose of complying with the laws of Mexico as to title and operation of property." Exam argues that the Maquiladora program benefits are not "property" under section 1504(d) and thus the corporation cannot elect to include the Mexican subsidiary in its consolidated return group. They cite as their authority the case of Kohler Co. and Subsidiaries v. U.S., 124 F3d 1451 (Fed. Cir. 1997) and Rev. Rul. 71-523.

In Kohler Co. and Subsidiaries v. U.S., the Court affirmed the lower court's determination that the U.S. taxpayer was not required by Canadian law to incorporate in Canada to purchase a Canadian factory and carry on a Canadian manufacturing business. Rather, the taxpayer incorporated in Canada to speed up, rather than ensure, the Canadian authority's approval of that purchase. More importantly, the taxpayer incorporated in Canada in order to qualify for a Canadian grant. Exam argues that Kohler supports the view that certain rights such as "economic benefits" conferred by Maquiladora status are not "property" for purposes of section 1504(d).

Revenue Ruling 71-523, 1971-2 C.B. 326, involved a Canadian entity incorporated to apply for a grant under the Canadian Program for Advancement of Industrial Technology. Under Canadian law, the grant was only available to Canadian corporations. The ruling concluded that since the Canadian corporation was not formed solely to comply with Canadian laws as to title and operation of property, the corporation was not eligible to make the section 1504(d) election.

INDUSTRY/TAXPAYER POSITION

The U.S. Corporation can elect to include a Mexican subsidiary in its consolidated return group.

DISCUSSION

A U.S. corporation organizes a wholly-owned subsidiary under Mexican law. The subsidiary requests and receives approval to operate as a Maquiladora from the Director General of the foreign investment division of the Mexican Secretariat of Commerce (SECOFI).

IRC section 1501 provides that an affiliated group of corporations shall, subject to the provisions of Chapter 6 of the IRC, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. Under section 1504(d) a domestic corporation may elect to include wholly-owned Mexican or Canadian subsidiaries in their consolidated return group, if those subsidiaries are "maintained solely for the purpose of complying with the laws of such country as to title and operation of property."

Kohler supports the view that certain rights such as "economic benefits" conferred by Maquiladora status are not "property" for purposes of section 1504(d). Rev. Rul. 71-523 concluded that since the Canadian corporation was not formed solely to comply with Canadian laws as to title and operation of property, the corporation was not eligible to make the section 1504(d) election.

SETTLEMENT GUIDELINE

The analysis supported by Kohler appears applicable to section 1504(d) election. If one does not meet the "maintained solely" requirement of section 1504(d), an election to consolidate cannot be made. Without the election the maquiladora may not be included on the consolidated return.

The Settlement Guideline does not apply to taxable years ending on or after October 31, 1996, which was the date of certain amendments to the Mexican Maquiladora Decree.