

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[REG-104226-18]

RIN 1545-BO51

**Guidance Regarding the Transition Tax Under Section 965 and Related Provisions****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations implementing section 965 of the Internal Revenue Code (“Code”) as amended by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. The proposed regulations would affect United States persons with direct or indirect ownership interests in certain foreign corporations.

**DATES:** Written or electronic comments and requests for a public hearing must be received by October 9, 2018.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-104226-18), Room 5203, Internal Revenue Service, P.O. 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-104226-18), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-104226-18).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations under §§ 1.962-1 and 1.962-2, 1.965-1 through 4, 1.965-7 through 9, and 1.986(c)-1, Leni C. Perkins at (202) 317-6934; concerning the proposed regulations under §§ 1.965-5 and 1.965-6, Karen J. Cate at (202) 317-6936; concerning submissions of comments and requests for a public hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be

sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by October 9, 2018.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (including underlying assumptions and methodology);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information.

The collections of information in these proposed regulations are in proposed §§ 1.965-2(d)(2)(ii)(B), 1.965-2(f)(2)(iii)(B), 1.965-3(b)(2), 1.965-3(c)(3), 1.965-4(b)(2)(i), 1.965-7(b)(2), 1.965-7(b)(3)(iii)(B), 1.965-7(c)(2), 1.965-7(c)(3)(iv)(B), 1.965-7(c)(3)(v)(D), 1.965-7(c)(6)(i), 1.965-7(d)(3), 1.965-7(e)(2), 1.965-7(f)(5), and 1.965-8(c). The information is required to be provided by taxpayers that make an election or rely on taxpayer-favorable rules. The information provided will be used by the IRS for tax compliance purposes.

*Estimated total annual reporting burden:* 500,000 hours.

*Estimated average annual burden hours per respondent:* Five hours.

*Estimated number of respondents:* 100,000.

*Estimated annual frequency of responses:* Once.

The number of respondents estimate is a rough estimate of the number of taxpayers completing the relevant parts of tax forms. The estimate of five hours per response is intended to capture the burden in gathering the required information for the election to determine the post-1986 earnings and profits and allocation of deficits and transfer agreements. In addition, the IRS intends that information collection

requirements relating to the reporting and payment of tax under section 965 will be set forth in forms and instructions. For purposes of the Paperwork Reduction Act, the reporting burden associated with that collection of information will be reflected in the OMB Form 83-I, Paperwork Reduction Act Submission, associated with those forms.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background****I. In General**

This document contains proposed amendments to 26 CFR part 1 under sections 962, 965, and 986 (the “proposed regulations”). As amended by section 14103 of the Tax Cuts and Jobs Act, Public Law 115-97 (2017) (the “Act”), section 965 applies in the case of the last taxable year of a deferred foreign income corporation (“DFIC”) that begins before January 1, 2018. The Department of the Treasury (“Treasury Department”) and the IRS have previously issued guidance announcing regulations intended to be issued under section 965. *See* Notice 2018-07, 2018-4 I.R.B. 317; Notice 2018-13, 2018-6 I.R.B. 341; and Notice 2018-26, 2018-16 I.R.B. 480 (collectively, the “notices”); *see also* Rev. Proc. 2018-17, 2018-9 I.R.B. 384. The proposed regulations contain the rules related to section 965 described in the notices, with certain modifications, as well as additional guidance related to section 965.

**II. Section 965****A. Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income**

Section 965(a) provides that for the last taxable year of a DFIC (as defined in Part II.F of this Background section) that begins before January 1, 2018 (such year of the DFIC, the “inclusion year”), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (i) the accumulated post-1986 deferred foreign income (as defined in Part II.F of this

Background section) of such corporation determined as of November 2, 2017, or (ii) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, an “E&P measurement date”). The greater of those two amounts is the “section 965(a) earnings amount.”

#### *B. Determination of United States Shareholder's Section 965(a) Inclusion*

Section 965(b)(1) provides that, if a taxpayer is a United States shareholder with respect to at least one DFIC and at least one E&P deficit foreign corporation (as defined in Part II.C of this Background section), then the portion of the section 965(a) earnings amount which would otherwise be taken into account under section 951(a)(1) by a United States shareholder with respect to each DFIC is reduced by the amount of such United States shareholder's aggregate foreign E&P deficit (as defined in Part II.C of this Background section) that is allocated to such DFIC. The portion of the section 965(a) earnings amount that is taken into account under section 951(a)(1) by a United States shareholder, after the reduction described in the preceding sentence and, as applicable, the reduction described in Part II.D of this Background section, is referred to as the “section 965(a) inclusion amount.”

#### *C. Allocation of Aggregate Foreign E&P Deficit and Definition of E&P Deficit Foreign Corporation*

The aggregate foreign E&P deficit of any United States shareholder is allocated to each DFIC of the United States shareholder in an amount that bears the same proportion to such aggregate as (i) the United States shareholder's pro rata share of the section 965(a) earnings amount of the DFIC bears to (ii) the aggregate of the United States shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of the United States shareholder. Section 965(b)(2). The term “aggregate foreign E&P deficit” means, with respect to any United States shareholder, the lesser of (A) the aggregate of the shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of the shareholder or (B) the aggregate of the shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of the shareholder. Section 965(b)(3)(A)(i).

The term “E&P deficit foreign corporation” means, with respect to any taxpayer, any specified foreign corporation (as defined in Part II.G of this Background section) with respect to which the taxpayer is a United States

shareholder, if, as of November 2, 2017, (i) the specified foreign corporation had a deficit in post-1986 earnings and profits (as defined in Part II.F of this Background section), (ii) the corporation was a specified foreign corporation, and (iii) the taxpayer was a United States shareholder of the corporation. Section 965(b)(3)(B). The term “specified E&P deficit” means, with respect to an E&P deficit foreign corporation, the amount of the E&P deficit foreign corporation's deficit in post-1986 earnings and profits as of November 2, 2017. *See* section 965(b)(3)(C).

For purposes of applying section 959 in any taxable year beginning with the inclusion year, with respect to any United States shareholder of a DFIC, an amount equal to the reduction in the shareholder's pro rata share of the section 965(a) earnings amount of the DFIC by reason of the aggregate foreign E&P deficit allocated to such DFIC is treated as an amount which was included in the gross income of such United States shareholder under section 951(a). Section 965(b)(4)(A). With respect to any taxable year beginning with the inclusion year, a United States shareholder's pro rata share of the earnings and profits (“E&P”) of any E&P deficit foreign corporation is increased by the amount of the specified E&P deficit of the E&P deficit foreign corporation taken into account by the shareholder, and, for purposes of section 952, the increase is attributable to the same activity to which the deficit taken into account was attributable. Section 965(b)(4)(B).

#### *D. Aggregate Unused E&P Deficit*

Under section 965(b)(5), in the case of any affiliated group which includes at least one E&P net surplus shareholder and one E&P net deficit shareholder, the amount which would (but for section 965(b)(5)) be taken into account under section 951(a)(1) by reason of section 965(a) by each E&P net surplus shareholder is reduced (but not below zero) by such shareholder's applicable share of the affiliated group's aggregate unused E&P deficit.

The term “affiliated group” has the meaning provided in section 1504. The term “E&P net surplus shareholder” means any United States shareholder which would (but for section 965(b)(5)) take into account a section 965(a) inclusion amount greater than zero. Section 965(b)(5)(B). The term “E&P net deficit shareholder” means any United States shareholder if (i) the aggregate foreign E&P deficit with respect to such shareholder (as defined in section 965(b)(3)(A) without regard to clause (i)(II) thereof, which limits the aggregate

foreign E&P deficit of a United States shareholder to the aggregate of the United States shareholder's pro rata share of the section 965(a) earnings amount of all DFICs of the United States shareholder) exceeds (ii) the amount that would (but for section 965(b)(5)) be taken into account by such shareholder under section 951(a)(1) by reason of section 965(a) (the excess, the “excess aggregate foreign E&P deficit”). Section 965(b)(5)(C). The term “applicable share” means, with respect to any E&P net surplus shareholder in any affiliated group, the amount which bears the same proportion to the group's aggregate unused E&P deficit as (i) the product of (A) the shareholder's group ownership percentage, multiplied by (B) the section 965(a) inclusion amount which would otherwise be taken into account by a United States shareholder, bears to (ii) the aggregate amount determined under clause (i) with respect to all E&P net surplus shareholders in the group. Section 965(b)(5)(E). The term “aggregate unused E&P deficit” means, with respect to any affiliated group, the lesser of (i) the sum of the excess aggregate foreign E&P deficits determined with respect to each E&P net deficit shareholder in such affiliated group, or (ii) with respect to all E&P net surplus shareholders in the group, the aggregate of the product of (A) the shareholder's group ownership percentage, multiplied by (B) the amount which would (but for section 965(b)(5)) be taken into account under section 951(a)(1) by reason of section 965(a) by the shareholder. Section 965(b)(5)(D).

#### *E. Application of the Participation Exemption*

Section 965(c)(1) provides that there shall be allowed as a deduction for the taxable year of a United States shareholder in which a section 965(a) inclusion amount is included in the gross income of the United States shareholder an amount equal to the sum of (i) the United States shareholder's 8 percent rate equivalent percentage (as defined in section 965(c)(2)(A)) of the excess (if any) of (A) the section 965(a) inclusion amount, over (B) the amount of such United States shareholder's aggregate foreign cash position, plus (ii) the United States shareholder's 15.5 percent rate equivalent percentage (as defined in section 965(c)(2)(B)) of so much of the United States shareholder's aggregate foreign cash position as does not exceed the section 965(a) inclusion amount. The amount of the deduction allowed under section 965(c) to a United States shareholder as described in the preceding sentence is referred to

as the “section 965(c) deduction amount.”

Section 965(c)(3)(A) provides that the term “aggregate foreign cash position” means, with respect to any United States shareholder, the greater of (i) the aggregate of the United States shareholder’s pro rata share of the cash position of each specified foreign corporation of the United States shareholder determined as of the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, or (ii) one half of the sum of (A) the aggregate described in clause (i) determined as of the close of the last taxable year of each specified foreign corporation that ends before November 2, 2017, plus (B) the aggregate described in clause (i) determined as of the close of the taxable year of each specified foreign corporation which precedes the taxable year referred to in subclause (A). Each date referred to in the preceding sentence is referred to as a “cash measurement date.”

The cash position of any specified foreign corporation is the sum of (i) cash held by the corporation, (ii) the net accounts receivable of the corporation, and (iii) the fair market value of the following assets held by the corporation (each asset, a “cash-equivalent asset”): (A) Personal property which is of a type that is actively traded and for which there is an established financial market (“actively traded property”); (B) commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government; (C) any foreign currency; (D) any obligation with a term of less than one year (“short-term obligation”); and (E) any asset which the Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B). Section 965(c)(3)(B). Also, for purposes of section 965(c), the term “net accounts receivable” means, with respect to any specified foreign corporation, the excess (if any) of (i) the corporation’s accounts receivable, over (ii) the corporation’s accounts payable (determined consistent with the rules of section 461). Section 965(c)(3)(C).

Section 965(c)(3)(D) provides that net accounts receivable, actively traded property, and short-term obligations shall not be taken into account by a United States shareholder in determining its aggregate foreign cash position to the extent that the United States shareholder demonstrates to the satisfaction of the Secretary that the amount of the net accounts receivable, actively traded property, or short-term obligations is taken into account by the

United States shareholder with respect to another specified foreign corporation.

Section 965(c)(3)(E) provides that an entity (other than a corporation) will be treated as a specified foreign corporation of a United States shareholder for purposes of determining the United States shareholder’s aggregate foreign cash position if any interest in the entity is held by a specified foreign corporation of the United States shareholder (determined after application of the rule in this sentence) and the entity, if it were a foreign corporation, would be a specified foreign corporation of the United States shareholder.

Section 965(c)(3)(F) provides that if the Secretary determines that a principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under section 965(c), the transaction shall be disregarded for purposes of section 965(c).

#### *F. Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income*

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of the United States shareholder that has accumulated post-1986 deferred foreign income greater than zero as of an E&P measurement date. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign corporation except to the extent such E&P (i) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1, or (ii) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed E&P”). Section 965(d)(2). Section 965(d)(3) provides that the term “post-1986 earnings and profits” means the E&P of the foreign corporation (computed in accordance with sections 964(a) and 986, and by taking into account only periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (i) as of the E&P measurement date that is applicable with respect to such foreign corporation, and (ii) without diminution by reason of dividends distributed during the last taxable year of the foreign corporation that begins before January 1, 2018, other than dividends

distributed to another specified foreign corporation.

#### *G. Specified Foreign Corporations and United States Shareholders*

Section 965(e)(1) provides that the term “specified foreign corporation” means (i) any CFC (regardless of whether there is a domestic corporate shareholder) and (ii) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (“10-percent corporation”). However, if a passive foreign investment company (as defined in section 1297) (“PFIC”) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3). An S corporation is treated as a partnership for purposes of sections 951 through 965. *See* section 1373(a). For purposes of sections 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a) (and for purposes of determining a United States shareholder’s pro rata share of any amount with respect to a specified foreign corporation under section 965(f)). Section 965(e)(2).

For taxable years of foreign corporations beginning before January 1, 2018, under section 951(b), a United States shareholder is a United States person (within the meaning of section 957(c)) that owns within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the stock of a foreign corporation. Under section 957(c), a United States person generally has the meaning assigned to it by section 7701(a)(30), which includes a domestic partnership or domestic trust. *But see* Notice 2010–41, 2010–22 I.R.B. 715 (announcing that the Treasury Department and the IRS intend to issue regulations treating certain domestic partnerships as foreign partnerships for purposes of identifying which United States shareholders are required to include amounts in gross income under section 951(a)). Special rules under section 957(c) and § 1.957–3 apply in determining when individuals residing in certain possessions or territories of the United States are considered United States persons for purposes of sections 951 and 965.

#### *H. Determination of Pro Rata Share*

Section 965(f)(1) provides that the determination of any United States shareholder’s pro rata share of any

amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating the amount in the same manner as subpart F income (and by treating the specified foreign corporation as a CFC).

#### *I. Special Rules for Domestic Pass-Through Entities*

Section 965(f)(2) provides that the portion that is included in the income of a United States shareholder under section 951(a)(1) by reason of section 965(a) that is equal to the section 965(c) deduction amount by reason of the inclusion is treated as income exempt from tax for purposes of sections 705(a)(1)(B) and 1367(a)(1)(A) but not treated as income exempt from tax for purposes of determining whether an adjustment is made to an accumulated adjustments account (“AAA”) of an S corporation under section 1368(e)(1)(A).

#### *J. Foreign Tax Credit and Deduction*

Section 965(g)(1) provides that no credit is allowed under section 901 for the applicable percentage of any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a section 965(c) deduction is allowed.

The term “applicable percentage” means the amount (expressed as a percentage) equal to the sum of the following two amounts:

(i) 0.771 multiplied by the ratio of (A) the section 965(a) inclusion amount in excess of the United States shareholder’s aggregate foreign cash position divided by (B) the section 965(a) inclusion amount, and

(ii) 0.557 multiplied by the ratio of (A) the amount of the section 965(a) inclusion amount equal to the United States shareholder’s aggregate cash position, divided by (B) the section 965(a) inclusion amount.

Further, no deduction is allowed for any tax for which credit is not allowable under section 901 by reason of section 965(g)(1) (determined by treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

With respect to the taxes treated as paid or accrued by a domestic corporation with respect to the section 965(a) inclusion amount, section 78 applies only to so much of such taxes as bears the same proportion to the amount of the taxes as (i) the excess of (A) the section 965(a) inclusion amount, over (B) the section 965(c) deduction amount with respect to such amount, bears to (ii) the section 965(a) inclusion amount.

#### *K. Election Under Section 965(h) Concerning Payment of Net Tax Liability Under Section 965*

Section 965(h)(1) provides that in the case of a United States shareholder of a DFIC, the United States shareholder may elect to pay the net tax liability under section 965 in eight installments. Section 965(h)(6) defines the net tax liability under section 965 with respect to any United States shareholder as the excess (if any) of (i) the taxpayer’s net income tax for the taxable year in which an amount is included in the gross income of the United States shareholder under section 951(a)(1) by reason of section 965, over (ii) the taxpayer’s net income tax for such taxable year determined (A) without regard to section 965, and (B) without regard to any income or deduction properly attributable to a dividend received by the United States shareholder from any DFIC. For this purpose, the term “net income tax” means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A. Section 965(h)(6)(B).

Section 965(h)(2) provides that if a taxpayer makes an election under section 965(h), the first installment is due on the due date (without regard to extensions) for the return of tax for the inclusion year. Each successive installment is due on the due date (without regard to extensions) for the return of tax for the taxable year following the taxable year for which the previous installment payment was made.

Section 965(h)(3) provides that if there is an addition to tax for failure to timely pay an installment required under section 965(h), a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), a cessation of business by the taxpayer, or any similar circumstance, the unpaid portion of the remaining installments will be due on the date of such event (or in the case of a title 11 or similar case, the day before the petition is filed). The preceding sentence does not apply in the case of the sale of substantially all the assets of a taxpayer to a buyer if the buyer enters into an agreement with the Secretary under which the buyer is liable for the remaining installments due under section 965(h) in the same manner as if the buyer were the taxpayer.

Section 965(h)(4) provides that if a taxpayer has made an election under section 965(h), and subsequently, a deficiency is assessed with respect to the taxpayer’s net tax liability for purposes of section 965(h), then the amount of the deficiency will be

prorated among the installments. The part of the deficiency prorated to any installment the date for payment of which has not arrived will be collected at the same time as, and as part of, such installment. The part of the deficiency prorated to any installment the date for payment of which has arrived must be paid upon notice and demand from the Secretary. However, the proration rule does not apply if the deficiency is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax.

#### *L. Election Under Section 965(i) Concerning Payment of Net Tax Liability Under Section 965 by an S Corporation Shareholder and Related Reporting Requirements*

Section 965(i)(1) provides that in the case of any S corporation that is a United States shareholder of a DFIC, each shareholder of the S corporation may elect to defer payment of the shareholder’s net tax liability under section 965 with respect to the S corporation until the shareholder’s taxable year which includes the triggering event with respect to such liability.

Under section 965(i)(1), any net tax liability, payment of which is deferred under section 965(i)(1), will be assessed on the return of tax as an addition to tax for the shareholder’s taxable year which includes the triggering event with respect to such liability. As defined in section 965(i)(2), in the case of any shareholder’s net tax liability under section 965 with respect to any S corporation, the triggering event with respect to such liability is whichever of the following occurs first: (i) The corporation ceases to be an S corporation (determined as of the first day of the first taxable year that the corporation is not an S corporation); (ii) a liquidation or sale of substantially all the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, the S corporation ceases to exist, or any similar circumstance; or (iii) a transfer of any share of stock in the S corporation by the taxpayer (including by reason of death, or otherwise). In the case of a transfer of less than all of the taxpayer’s shares of stock in the S corporation, the transfer is only a triggering event with respect to the portion of the taxpayer’s net tax liability under section 965 with respect to the S corporation as is properly allocable to the transferred stock. Section 965(i)(2)(B). Moreover, a transfer of stock in the S corporation is not a triggering event if the transferee enters into an agreement with the

Secretary under which the transferee is liable for the net tax liability under section 965 with respect to the stock in the same manner as if such transferee were the taxpayer. Section 965(i)(2)(C).

If a triggering event occurs, section 965(i)(4) permits a taxpayer to make an election under section 965(h) with respect to the liability to which the section 965(i) election applied by the due date for the return of tax for the taxable year in which the triggering event occurred, and the first installment under section 965(h) must also be paid by the due date (without regard to extensions) for the return for the taxable year of the triggering event. However, the election may only be made with the consent of the Secretary in the case of a triggering event that is a liquidation or sale of substantially all of the assets of the S corporation. *See* section 965(i)(4)(D).

Section 965(i)(3) defines a shareholder's net tax liability under section 965 with respect to any S corporation as the net tax liability under section 965 which would be determined under section 965(h)(6) if the only amounts taken into account by the shareholder under section 951(a)(1) by reason of section 965 were allocations from the S corporation.

Section 965(i)(5) provides that if any shareholder of an S corporation makes an election under section 965(i) to defer payment of its net tax liability under section 965 with respect to an S corporation, the S corporation is jointly and severally liable for the deferred payment and any penalty, addition to tax, or additional amount attributable thereto.

Section 965(i)(6) provides that any limitation on the time period for the collection of a liability deferred under section 965(i) is not treated as beginning before the date of the triggering event with respect to such liability.

Section 965(i)(7) requires any shareholder of an S corporation that makes an election under section 965(i) to report the amount of the shareholder's deferred net tax liability on the shareholder's return of tax for the taxable year for which the election is made and on the return of tax for each taxable year thereafter until the amount has been fully assessed. "Deferred net tax liability" means the amount of net tax liability under section 965 payment of which has been deferred under section 965(i) and which has not been assessed on a return of tax for any prior taxable year. Section 965(i)(7)(B). In the case of any failure to report any amount required to be reported pursuant to section 965(i)(7) with respect to any taxable year before the due date for the

return of tax for the taxable year, there will be assessed on the return as an addition to tax 5 percent of such amount. Section 965(i)(7)(C).

*M. Election Under Section 965(m) Concerning Inclusions of Amounts Under Section 965 and Related Provisions*

Under section 965(m)(1)(B), a real estate investment trust (REIT) that is a United States shareholder of a DFIC may elect, in lieu of including any amount required to be taken into account under section 951(a)(1) by reason of section 965 in the taxable year in which it would otherwise be included in gross income (for purposes of the computation of REIT taxable income under section 857(b)), to include such amount in gross income in eight installments.

If this election is made, the REIT's aggregate section 965(c) deduction must be determined without regard to the election and allocated to each taxable year for which an installment is included in the same proportion as the amount of the installment included in gross income. *See* section 965(m)(2)(B)(i)(II). Furthermore, the REIT may not make a section 965(h) election for any taxable year for which an installment is included. *See* section 965(m)(2)(B)(i)(III). Under section 965(m)(2)(B)(ii), if there is a liquidation or sale of substantially all the assets of the REIT (including in a title 11 or similar case), a cessation of business by the trust, or any similar circumstance, then any amount not yet included in gross income will be included in gross income as of the day before the date of the event, and the unpaid portion of any tax liability with respect to the inclusion will be due on the date of the event (or in the case of a title 11 or similar case, the day before the petition is filed).

Section 965(m)(1)(A) provides that any amount required to be taken into account under section 951(a)(1) by reason of section 965 by a REIT that is a United States shareholder of a DFIC is not taken into account as gross income of the REIT for purposes of applying paragraphs (2) and (3) of section 856(c) to any taxable year for which the amount is taken into account under section 951(a)(1).

*N. Election Under Section 965(n) Not To Apply Net Operating Loss Deduction*

Under section 965(n)(1), a United States shareholder of a DFIC may make an election pursuant to which the amount described in section 965(n)(2) shall not be taken into account (i) in determining the amount of the

shareholder's net operating loss ("NOL") deduction under section 172 for the taxable year, or (ii) in determining the amount of taxable income for the taxable year which may be reduced by NOL carryovers or carrybacks to the taxable year under section 172. The amount described in section 965(n)(2) is the sum of (i) the amount required to be taken into account under section 951(a)(1) by reason of section 965 (determined after the application of section 965(c)), plus (ii) in the case of a domestic corporation which chooses to have the benefits of subpart A of part III of subchapter N for the taxable year, the taxes deemed to be paid by the corporation under subsections (a) and (b) of section 960 for the taxable year with respect to the amount described in section 965(n)(2)(A) which are treated as a dividend under section 78.

*O. Recapture for Expatriated Entities*

Section 965(l) provides that if a section 965(c) deduction is allowed to a United States shareholder and the shareholder first becomes an expatriated entity (as defined under section 7874(a)(2)), except not including an entity if the surrogate foreign corporation with respect to it is treated as a domestic corporation under section 7874(b)) at any time during the 10-year period beginning on the date of the enactment of the Act (with respect to a surrogate foreign corporation (as defined under section 7874(a)(2)(B)) that first becomes a surrogate foreign corporation during such period), the tax imposed under chapter 1 will be increased for the first taxable year in which such taxpayer becomes an expatriated entity by an amount equal to 35 percent of the amount of the section 965(c) deduction, and no credits will be allowed against such increase in tax.

*P. Regulations or Other Guidance*

Section 965(o) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 965, including regulations or other guidance to provide appropriate basis adjustments and regulations or other guidance to prevent the avoidance of the purposes of section 965, including through a reduction in E&P, changes in entity classification or accounting methods, or otherwise.

**III. Other Provisions**

*A. Section 962*

As amended by the Act, section 962 provides that an individual who is a United States shareholder may elect to

have the tax imposed under chapter 1 on amounts that are included in the individual's gross income under section 951(a) be an amount equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. In addition, if an election is made under section 962, the amounts included in the individual's gross income under section 951(a) are treated as if they were received by a domestic corporation for purposes of applying section 960 (relating to foreign tax credits). See § 1.962–1(a). However, the taxable income determined for purposes of applying section 11 is not reduced by any deduction of the United States shareholder. See § 1.962–1(b)(1)(i). An election under section 962 does not affect tax imposed under other chapters, including under chapter 2A.

#### *B. Attribution Rules in Sections 958(b) and 318(a)*

Section 958 provides rules for determining direct, indirect, and constructive stock ownership. Under section 958(a)(1), stock is considered owned by a person if it is owned directly or is owned indirectly through certain foreign entities under section 958(a)(2). Under section 958(b), section 318 applies, with certain modifications, to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), to treat the stock of a domestic corporation as owned by a United States shareholder of a CFC for purposes of section 956(c)(2), or to treat a foreign corporation as a CFC under section 957.

Section 318 provides rules that attribute the ownership of stock to certain family members, between certain entities and their owners, and to holders of options to acquire stock. Section 318(a)(1) provides rules attributing stock ownership among members of a family. Section 318(a)(2) provides rules attributing stock ownership “upward” from partnerships, estates, trusts, and corporations to partners, beneficiaries, owners, and shareholders. In addition, section 318(a)(3) provides specific rules that attribute the ownership of stock “downward” from partners, beneficiaries, owners, and shareholders to partnerships, estates, trusts, and corporations. In particular, section 318(a)(3)(A) provides that stock owned, directly or indirectly, by or for a partner in a partnership or a beneficiary of an estate is considered as owned by the partnership or estate. This provision applies to all partners and beneficiaries without regard to the size of their

interest in the partnership or estate. Section 318(a)(3)(B) similarly provides, subject to certain exceptions, that stock owned, directly or indirectly, by or for a beneficiary of a trust (or a person who is considered an owner of a trust) is considered owned by the trust. In comparison, section 318(a)(3)(C) provides that stock owned, directly or indirectly, by or for a shareholder in a corporation is considered owned by the corporation only if 50 percent or more in value of the stock in the corporation is owned, directly or indirectly, by such person.

Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of the foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of the foreign corporations end, the Act repeals section 958(b)(4). As in effect before repeal, section 958(b)(4) provided that subparagraphs (A), (B), and (C) of section 318(a)(3) (providing for “downward” attribution) were not to be applied so as to consider a United States person as owning stock that is owned by a person who is not a United States person.

#### *C. Miscellaneous Itemized Deductions*

Under section 67(a), miscellaneous itemized deductions are allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income. As amended by the Act, section 67(g) provides that for taxable years beginning after December 31, 2017, and before January 1, 2026, no miscellaneous itemized deductions are allowable under section 67(a). In addition, under section 56(b)(1)(A)(i), an individual subject to the alternative minimum tax in 2017 is not allowed a deduction for any miscellaneous itemized deduction. Under section 63(d), itemized deductions generally mean all allowable deductions except for the deductions allowable in arriving at adjusted gross income pursuant to section 62(a), the deduction provided by section 151, and the deduction provided in section 199A (added by the Act). Miscellaneous itemized deductions include all itemized deductions other than those listed in section 67(b), which does not reference the section 965(c) deduction.

#### *D. Section 4940*

An inclusion under section 951(a)(1), including a section 965(a) inclusion, generally is included in the calculation of gross investment income of a private foundation for purposes of determining the excise tax imposed under section

4940 (generally 2 percent of net investment income). Gross investment income under section 4940 does not include an inclusion under section 951(a)(1), including a section 965(a) inclusion, to the extent the amount is included in computing the unrelated business income tax imposed by section 511. See section 4940(c)(2). Section 4940(c)(3) allows as a deduction all the ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of income.

#### *E. Extensions of Time for Filing Income Tax Returns and Paying Tax for Certain Citizens and Residents Abroad*

In relevant part, regulations under section 6081 provide an extension of time to the fifteenth day of the sixth month following the close of the taxable year for filing returns of income taxes and for paying any tax shown on the return for United States citizens or residents whose tax homes and abodes, in a real and substantial sense, are outside the United States and Puerto Rico, and United States citizens and residents in military or naval service on duty, including non-permanent or short term duty, outside the United States and Puerto Rico (“specified individuals”). See § 1.6081–5(a)(5) and (6).

### **Explanation of Provisions**

#### **I. Overview of Proposed Regulations**

Proposed § 1.965–1 provides general rules and definitions under section 965. Proposed § 1.965–2 provides rules relating to adjustments to E&P and basis to determine and account for the application of section 965 and a rule that limits the amount of gain recognized in connection with the application of section 961(b)(2). Proposed § 1.965–3 provides rules regarding the determination of section 965(c) deductions. Proposed § 1.965–4 sets forth rules that disregard certain transactions for purposes of section 965. Proposed §§ 1.965–5 and 1.965–6 provide rules with respect to foreign tax credits. Proposed § 1.965–7 provides rules regarding elections and payments. Proposed § 1.965–8 provides rules regarding affiliated groups, including consolidated groups. Proposed § 1.965–9 provides dates of applicability. Proposed §§ 1.962–1 and 1.962–2 provide rules relating to section 962 elections. Proposed § 1.986(c)–1 provides rules regarding the application of section 986(c) in connection with section 965.

## II. Definitions and General Rules

Section 1.965–1 of the proposed regulations provides general rules and definitions under section 965, including general rules concerning section 965(a) inclusions, general rules concerning section 965(c) deductions, and rules concerning the treatment of certain specified foreign corporations as CFCs and certain controlled domestic partnerships as foreign partnerships.

### A. General Rules

Proposed § 1.965–1 provides the general rules contained in section 965(a), (b), and (c). Proposed § 1.965–1(b)(1) provides that the subpart F income of a DFIC for its inclusion year is increased by the section 965(a) earnings amount. Proposed § 1.965–1(b)(2) provides that the pro rata share of the DFIC's section 965(a) earnings amount of a United States shareholder that owns, within the meaning of section 958(a), stock (the stock, “section 958(a) stock”, and the shareholder, a “section 958(a) U.S. shareholder”) is reduced by the DFIC's allocable share of the section 958(a) U.S. shareholder's aggregate foreign E&P deficit. If a section 958(a) U.S. shareholder is a member of a consolidated group, all section 958(a) U.S. shareholders that are members of a consolidated group are treated as a single section 958(a) U.S. shareholder for this purpose. *See* Part IX of this Explanation of Provisions section for a discussion of additional rules that apply with respect to a section 958(a) U.S. shareholder that is a member of an affiliated group of which not all members are part of a consolidated group. The amount determined after the reductions referenced in the preceding sentences is defined as the section 965(a) inclusion amount, which is the amount included by a section 958(a) U.S. shareholder of a DFIC for its taxable year in which or with which the DFIC's inclusion year ends (the “section 958(a) U.S. shareholder inclusion year”). *See* proposed § 1.965–1(b)(1); *see also* Part II.B of the Background section of this preamble. The proposed regulations also clarify that because an increase in subpart F income by reason of section 965(a) is generally determined after the subpart F income is otherwise determined under section 952 for the taxable year, neither the section 965(a) earnings amount nor the section 965(a) inclusion amount is subject to the rules or limitations in section 952 or otherwise limited by the accumulated E&P of the DFIC. *Id.*

Proposed § 1.965–1(c) provides that a section 958(a) U.S. shareholder is generally allowed a deduction for a

section 965(c) deduction amount for a section 958(a) U.S. shareholder inclusion year. The proposed regulations clarify that a section 958(a) U.S. shareholder's aggregate foreign cash position is applied against the aggregate section 965(a) inclusion amounts for a section 958(a) U.S. shareholder inclusion year. *See* proposed § 1.965–1(f)(1)–(4), (8), (42). In the case of a section 958(a) U.S. shareholder with more than one section 958(a) U.S. shareholder inclusion year, its aggregate foreign cash position is allocated to each year under proposed § 1.965–3(c)(2), and therefore the section 965(c) deduction amount is determined separately for each section 958(a) U.S. shareholder inclusion year.

Consistent with section 965(e)(2), proposed § 1.965–1(d) provides that a 10-percent corporation is treated as a CFC for purposes of sections 951 and 961, as well as for purposes of § 1.1411–10, so that those rules, applicable to CFCs, are also applicable to DFICs that are not CFCs.

Moreover, the proposed regulations provide that for purposes of identifying section 958(a) U.S. shareholders of specified foreign corporations and the section 958(a) stock of such specified foreign corporations owned by section 958(a) U.S. shareholders, a domestic partnership is treated as a foreign partnership if certain conditions are satisfied. *See* proposed § 1.965–1(e)(1). This is an expansion on the reference in section 2.13 of Notice 2018–26 to Notice 2010–41, which referred to CFCs, whereas the expanded rule includes specified foreign corporations generally.

### B. Definitions

Section 1.965–1(f) of the proposed regulations sets forth definitions for terms that apply for all of the proposed regulations under section 965. Except as otherwise described in this Explanation of Provisions section, the definitions set forth in the proposed regulations that are also used in section 965 or one of the notices have the meaning described therein. This Part II.B of the Explanation of Provisions section also describes rules incorporated into certain defined terms that are not described elsewhere in this Explanation of Provisions section.

#### 1. Specified Foreign Corporation

The proposed regulations provide that a specified foreign corporation means any CFC or 10-percent corporation, other than a foreign corporation that is a PFIC with respect to a shareholder and not a CFC. *See* proposed § 1.965–1(f)(45)(i) and (iii).

Section 3.01 of Notice 2018–26 noted that as a result of the application of the constructive ownership rule in section 318(a)(3)(A) (providing for “downward” attribution of stock from a partner to a partnership), it may be difficult to determine if a foreign corporation is a specified foreign corporation under certain circumstances. Consistent with that section of the notice, the definition of specified foreign corporation provides that, solely for purposes of determining whether a foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B), stock owned, directly or indirectly, by or for a partner (“tested partner”) will not be considered as being owned by a partnership under sections 958(b) and 318(a)(3)(A) if the tested partner owns less than five percent of the interests in the partnership's capital and profits. *See* proposed § 1.965–1(f)(45)(ii). For purposes of the preceding sentence, an interest in the partnership owned by another partner will be considered as being owned by the tested partner under the principles of sections 958(b) and 318, as modified pursuant to the preceding sentence, as if the interest in the partnership were stock.

#### 2. Post-1986 Earnings and Profits

Section 3.02(b) of Notice 2018–07 indicated that the reduction of post-1986 earnings and profits of a specified foreign corporation to reflect dividends distributed during the corporation's inclusion year to another specified foreign corporation (the “dividend reduction rule”) is intended to address the potential double-counting of the E&P of the distributing specified foreign corporation in calculating the section 965(a) inclusion amounts of a United States shareholder with respect to the distributing specified foreign corporation and the distributee specified foreign corporation. It noted, however, that to the extent that a portion of a distribution reduces the post-1986 earnings and profits of a distributing specified foreign corporation (for example, by reason of a reduction pursuant to section 312(a)(3)) in an amount in excess of the increase in the post-1986 earnings and profits of the distributee specified foreign corporation, the reduction would not relieve double-counting and thus would be inconsistent with the purpose of the rule.

Accordingly, consistent with section 3.02(b) of Notice 2018–07, the definition of “post-1986 earnings and profits” clarifies, in proposed § 1.965–1(f)(29)(i)(B), that the amount by which the post-1986 earnings and profits of a

specified foreign corporation is reduced under section 965(d)(3)(B) as a result of a distribution made to a specified foreign corporation in the last taxable year of the foreign corporation that begins before January 1, 2018, may not exceed the amount by which the post-1986 earnings and profits of the distributee corporation is increased as a result of the distribution. Additionally, similar to section 3.03 of Notice 2018–26, in computing post-1986 earnings and profits on November 2, 2017, in certain cases, a reduction is allowed for a portion of foreign income taxes that accrue after November 2, 2017, and on or before December 31, 2017 (“applicable taxes”). In particular, post-1986 earnings and profits on November 2, 2017, are reduced by the portion of the applicable taxes that are attributable to the portion of the taxable income (as determined under foreign law) that accrues on or before November 2, 2017, and during the specified foreign corporation’s U.S. taxable year that includes November 2, 2017. *See* proposed § 1.965–1(f)(29)(ii).

Moreover, consistent with the Conference Report accompanying the Act (the “Conference Report”) and section 3.03(b) of Notice 2018–13, proposed § 1.965–1(f)(29)(iii) provides that all deficits related to post-1986 earnings and profits, including hovering deficits, are taken into account for purposes of determining the post-1986 earnings and profits (including a deficit) of a specified foreign corporation. *See* H.R. Rep. No. 115–466, at 619 (2017) (Conf. Rep.). The fact that hovering deficits are taken into account for purposes of determining post-1986 earnings and profits, and ultimately the section 965(a) inclusion amount of a section 958(a) U.S. shareholder, does not mean that hovering deficits are taken into account for any other purpose. For example, this rule does not result in hovering deficits being taken into account for purposes of determining post-1986 undistributed earnings or pre-1987 accumulated profits in computing the taxes deemed paid for the foreign tax credit. The Treasury Department and the IRS request comments on whether additional rules are needed to address the treatment of hovering deficits that reduce post-1986 earnings and profits of a DFIC, for example when the hovering deficit creates a specified E&P deficit.

Comments noted that a specified foreign corporation that is not a CFC does not generally track E&P under U.S. tax principles and requested that taxpayers be allowed to use an alternative measurement method for determining its post-1986 earnings and

profits and cash position, such as audited financial statements. This comment is not adopted in the proposed regulations. Generally, audited financial statements may serve as a starting point in the determination of a specified foreign corporation’s E&P. *See* § 1.964–1. The Treasury Department and the IRS appreciate that obtaining accurate information for U.S. federal income tax purposes may present administrative challenges, particularly in the case of United States shareholders that do not have a majority interest in a specified foreign corporation. However, this challenge is not unique to this context; there are numerous longstanding provisions in the Code where minority shareholders of foreign corporations must determine E&P consistent with section 312 where no alternative measurement method is provided. For example, United States persons who own stock in PFICs must, if they make an election to treat the PFIC as a qualified electing fund under section 1293, determine the E&P of the PFIC in accordance with principles of section 312. *See* section 1293(e)(3). Additionally, minority shareholders who are nonetheless United States shareholders of CFCs must know the E&P of the CFC in order to apply the rules under subpart F. Accordingly, the Treasury Department and the IRS have determined that it would not be appropriate for the proposed regulations to provide alternative methods for determining a corporation’s E&P or cash position.

### 3. E&P Deficit Foreign Corporation

Consistent with section 3.01 of Notice 2018–13, under the proposed regulations, for purposes of determining the status of a specified foreign corporation as a DFIC or an E&P deficit foreign corporation, it must first be determined whether the specified foreign corporation is a DFIC. Proposed § 1.965–1(f)(17)(ii) provides that, if a specified foreign corporation meets the definition of a DFIC, it is classified solely as a DFIC and not also as an E&P deficit foreign corporation, even if the specified foreign corporation otherwise satisfies the requirements of section 965(b)(3)(B) and proposed § 1.965–1(f)(22). If a specified foreign corporation does not meet the definition of a DFIC, it then must be determined whether it is an E&P deficit foreign corporation. In some cases, a specified foreign corporation may be classified as neither a DFIC nor an E&P deficit foreign corporation, despite having post-1986 earnings and profits greater than zero or a deficit in accumulated post-

1986 deferred foreign income. *See* proposed § 1.965–1(g), *Example 5*.

Comments requested that previously taxed E&P should be disregarded in determining a specified E&P deficit of an E&P deficit foreign corporation. Section 965(b)(3)(B) provides that a specified foreign corporation is an E&P deficit foreign corporation if it has a deficit in post-1986 earnings and profits as of November 2, 2017. For purposes of section 965, the term post-1986 earnings and profits is defined in section 965(d)(3) and is computed in accordance with sections 964(a) and 986. Under section 964(a), earnings and profits are determined according to rules substantially similar to those applicable to domestic corporations.

Previously taxed E&P are a type of E&P. *See* section 959(c). No express exclusion of previously taxed E&P is provided in section 965(d)(3) for purposes of determining post-1986 earnings and profits. In contrast, the term accumulated post-1986 deferred foreign income, as defined in section 965(d)(2), explicitly excludes previously taxed E&P. *See* section 965(d)(2)(B) (citing section 959). Accordingly, the proposed regulations provide that previously taxed E&P is not excluded in determining the existence and amount of a specified E&P deficit, which is defined in reference to post-1986 earnings and profits and not in reference to accumulated post-1986 deferred foreign income. The Treasury Department and the IRS are considering other rules with respect to the definitions of post-1986 earnings and profits, accumulated post-1986 deferred foreign income, and specified E&P deficit in connection with the finalization of these proposed regulations. *See* section 965(o). The Treasury Department and the IRS welcome comments on this subject.

### 4. Accumulated Post-1986 Deferred Foreign Income

Consistent with section 3.02(c) of Notice 2018–07, proposed § 1.965–1(f)(7)(i)(C) provides that in the case of a CFC that has shareholders that are not United States shareholders on an E&P measurement date, the accumulated post-1986 deferred foreign income of the CFC on such E&P measurement date is reduced by amounts that would be described in section 965(d)(2)(B) if those shareholders were United States shareholders. In such cases, the principles of Revenue Ruling 82–16, 1982–1 C.B. 106, apply in order to determine the amounts by which accumulated post-1986 deferred foreign income is reduced.



Proposed § 1.965–1(f)(7)(ii) clarifies that, for purposes of determining the accumulated post-1986 deferred foreign income of a specified foreign corporation as of an E&P measurement date, the E&P of the specified foreign corporation that are described in section 959(c)(2) (or that would be described in section 959(c)(2) applying the principles of Revenue Ruling 82–16, 1982–1 C.B. 106) by reason of subpart F income are treated as described in section 965(d)(2)(B) and proposed § 1.965–1(f)(7)(i)(B) or (f)(7)(i)(C) only to the extent that such income is accrued by the specified foreign corporation as of such E&P measurement date. For rules regarding the interaction of sections 951, 956, 959, and 965 generally, see Part IV.A of this Explanation of Provisions section.

#### 5. Cash Measurement Dates

Consistent with section 3.02 of Notice 2018–26, the definitions of the cash measurement dates, and of pro rata share, provide the following:

(i) The final cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any;

(ii) The second cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any;

(iii) The first cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any; and

(iv) A United States shareholder takes into account its pro rata share of the cash position of a specified foreign corporation as of any cash measurement date of the specified foreign corporation on which the United States shareholder is a United States shareholder of the specified foreign corporation, regardless of whether the United States shareholder is a United States shareholder of the specified foreign corporation as of any other cash measurement date, including the final cash measurement date of the specified foreign corporation.

See proposed § 1.965–1(f)(24), (31), (25), and (30)(iii), respectively. Section 3.02 of Notice 2018–26 also announced that for purposes of applying the rules contained therein, a 52–53-week taxable year is deemed to begin on the first day of the calendar month nearest to the first day of the 52–53-week taxable year and is deemed to end or close on the last day

of the calendar month nearest to the last day of the 52–53-week taxable year, as the case may be. See § 1.441–2(c). The Treasury Department and the IRS have determined that the rules contained in § 1.441–2(c), which relate to the application of effective dates, are not relevant in determining when a 52–53-week taxable year is considered to begin or end for purposes of the cash measurement dates; instead, the actual dates on which such a year begins and ends should be taken into account in determining cash measurement dates. Therefore, the proposed regulations do not contain the rule in section 3.02 of Notice 2018–26 referring to § 1.441–2(c).

Comments requested guidance on the measurement of cash when a section 381 transaction occurs during the last year of a specified foreign corporation that begins before January 1, 2018. The Treasury Department and the IRS have defined cash measurement date in the notices and largely adopted the definition in the proposed regulations. The Treasury Department and the IRS have determined that these rules provide appropriate guidance, and therefore additional rules are not necessary. See also Part V.A.2 of this Explanation of Provisions section, for a discussion of the rules for disregarding certain assets to prevent double-counting under section 965(c)(3)(D), and Part VI.A of this Explanation of Provisions section, for a discussion of the anti-avoidance rule in proposed § 1.965–4(b), which could apply, for example, to liquidations that reduce a section 958(a) U.S. shareholder's aggregate foreign cash position.

#### 6. Cash Position & Derivative Financial Instruments

Consistent with section 3.01(c) of Notice 2018–07, the proposed regulations address the treatment of derivative financial instruments for purposes of measuring the cash position of a specified foreign corporation. Generally, the cash position of any specified foreign corporation includes, among other things, the fair market value of the cash-equivalent assets held by the corporation. See proposed § 1.965–1(f)(16)(i)(C). Consistent with section 3.01(c) of Notice 2018–07, the proposed regulations define the term cash-equivalent asset to include derivative financial instruments held by the specified foreign corporation that is not a bona fide hedging transaction. See proposed § 1.965–1(f)(13)(v). Derivative financial instruments include notional principal contracts, options contracts, forward contracts, futures contracts, short positions in securities and commodities, and any similar financial

instruments. See proposed § 1.965–1(f)(18).

The proposed regulations provide that the value of each derivative financial instrument that must be taken into account in determining the cash position of a specified foreign corporation may be positive or negative, but that the aggregate amount taken into account for all derivative financial instruments (excluding bona fide hedging transactions) of a specified foreign corporation cannot be less than zero. See proposed § 1.965–1(f)(16)(iii).

Consistent with section 3.01(c) of Notice 2018–07, the proposed regulations also provide that if a derivative financial transaction is a bona fide hedging transaction that is used to hedge a cash-equivalent asset, the value of the cash-equivalent asset identified on the taxpayer's books and records as the asset being hedged must be adjusted by the fair market value of the bona fide hedging transaction that is used to hedge such cash-equivalent asset (such hedging transaction, a “cash-equivalent asset hedging transaction”). See proposed § 1.965–1(f)(16)(ii). The value of a cash-equivalent asset hedging transaction must be taken into account in determining the cash position of a specified foreign corporation whether the cash-equivalent asset hedging transaction has positive or negative value, but only to the extent that the cash-equivalent asset hedging transaction (or transactions) does not reduce the fair market value of the asset being hedged below zero. *Id.* A bona fide hedging transaction with respect to an asset that is not a cash-equivalent asset or with respect to a liability (as described in § 1.1221–2(b)(2)) is not included in a specified foreign corporation's cash position for purposes of section 965(c)(3)(B).

The proposed regulations define a bona fide hedging transaction as a hedging transaction that meets the requirements of a bona fide hedging transaction described in § 1.954–2(a)(4)(ii) and that is properly identified as such in accordance with the requirements of that subparagraph. Proposed § 1.965–1(f)(12). Consistent with the definition of a bona fide hedging transaction in § 1.954–2(a)(4)(ii), in the case of an asset hedging transaction, the risk being hedged may be with respect to ordinary property, section 1231 property, or a section 988 transaction. Because the identification requirements of § 1.954–2(a)(4)(ii) are generally relevant only to CFCs, whereas section 965 applies to all specified foreign corporations, the proposed regulations provide that the

identification requirements apply only with respect to CFCs. *Id.*

#### 7. Accounts Receivable and Accounts Payable

Consistent with section 3.04(a) of Notice 2018–13 as well as the clarification provided in section 3.06 of Notice 2018–26, the definitions of “accounts payable” and “accounts receivable” in proposed § 1.965–1(f)(5) and (6) provide that for purposes of determining net accounts receivable taken into account in determining the cash position of a specified foreign corporation, the term “accounts receivable” means receivables described in section 1221(a)(4), and the term “accounts payable” means payables arising from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers, and only receivables or payables with a term upon issuance that is less than one year are taken into account. In addition, receivables that are treated as accounts receivable within the meaning of section 965(c)(3)(C)(i) and proposed § 1.965–1(f)(6) are not also treated as short-term obligations. *See* proposed § 1.965–1(f)(43).

Comments requested modifications to the definition of accounts payable for purposes of determining a specified foreign corporation’s cash position, including that accounts payable be defined to include payables related to the licensing of intellectual property, payables to employees in the ordinary course of business, and payables arising from property described in section 1221(a)(2). The term “accounts payable” is not defined in the statute, and the Treasury Department and the IRS have determined that the definition in the proposed regulations is consistent with the ordinary meaning of accounts payable. Therefore no change is made in the proposed regulations to the definition of accounts payable.

#### 8. Short-Term Obligations

Consistent with section 3.04(b) of Notice 2018–13, proposed § 1.965–1(f)(43) provides that, for purposes of determining a specified foreign corporation’s cash position, a loan that must be repaid on the demand of the lender (or that must be repaid within one year of such demand) is treated as a short-term obligation, regardless of the stated term of the instrument, and thus is included in the specified foreign corporation’s cash position. In response to a comment, proposed § 1.965–1(f)(43) clarifies that an instrument’s term upon issuance is used for purposes of

determining whether an obligation is a short-term obligation.

A comment requested that taxpayers be able to prove, based on facts and circumstances, that a demand loan should not be treated as a short-term obligation. The Treasury Department and the IRS have determined that any facts-and-circumstances test would not be administrable, particularly to the extent that the test required a determination of a taxpayer’s subjective intent with respect to the payment of the loan. Accordingly, this comment is not adopted.

#### 9. Pro Rata Share

Consistent with section 3.03(a) of Notice 2018–13, the proposed regulations provide that, for purposes of determining a United States shareholder’s pro rata share of the specified E&P deficit of an E&P deficit foreign corporation that has multiple classes of stock outstanding, the specified E&P deficit is allocated among the shareholders of the corporation’s common stock and in proportion to the value of the common stock held by such shareholders. *See* proposed § 1.965–1(f)(30)(ii). Comments are requested regarding whether there are circumstances in which a specified E&P deficit should be allocated to shareholders of an E&P deficit foreign corporation’s preferred stock and, if so, how to allocate as between shareholders of common stock and shareholders of preferred stock as well as among shareholders of preferred stock. The proposed regulations also clarify that, for purposes of determining a shareholder’s pro rata share of a specified E&P deficit, the value of the common stock is determined as of the last day of the last taxable year of the E&P deficit foreign corporation that begins before January 1, 2018. *Id.*

*See* Part II.B.5 of this Explanation of Provisions section for a discussion of the definition of pro rata share with respect to the cash position of a specified foreign corporation.

#### 10. Domestic Pass-Through Entities

As explained in section 3.05(b) of Notice 2018–26, section 965 increases the amount included in the gross income of a United States shareholder under section 951(a)(1) only if the United States shareholder owns section 958(a) stock of one or more specified foreign corporations. *See* section 951(a)(2)(A). Accordingly, if a domestic pass-through entity is a United States shareholder of a DFIC and owns section 958(a) stock of the DFIC, the section 965(a) inclusion amount with respect to the section 958(a) stock and the section

965(c) deduction amount with respect to the section 965(a) inclusion amount are each determined at the level of the domestic pass-through entity. *See* section 951(a)(1). However, the domestic pass-through owners of the domestic pass-through entity are subject to federal income tax on their share of the aggregate section 965(a) inclusion amount with respect to section 958(a) stock owned by the domestic pass-through entity. Accordingly, in the case of a domestic pass-through entity that is a section 958(a) U.S. shareholder with respect to one or more DFICs, each domestic pass-through owner takes into account its share of the aggregate section 965(a) inclusion amount with respect to section 958(a) stock of one or more DFICs of the domestic pass-through entity and its share of the section 965(c) deduction amount with respect to such amount (each, a “domestic pass-through owner share”), regardless of whether such domestic pass-through owner is also a United States shareholder with respect to such DFIC, giving rise to a “section 965(a) inclusion” and a “section 965(c) deduction” to the domestic pass-through owner. *See* proposed § 1.965–1(f)(21), (37) and (41). For this purpose, a pass-through owner’s share is determined under the provisions of subchapter K of the Code.

Proposed § 1.965–3(g) provides that an aggregate section 965(a) inclusion amount for a section 958(a) U.S. shareholder inclusion year and the related section 965(c) deduction amount must be allocated in the same proportion. For example, if a domestic pass-through owner is allocated 50 percent of an aggregate section 965(a) inclusion amount with respect to section 958(a) stock of a domestic pass-through entity, the domestic pass-through owner must be allocated 50 percent of the related section 965(c) deduction amount. If the domestic pass-through owner is also a section 958(a) U.S. shareholder with respect to the DFIC because it owns section 958(a) stock of the DFIC, the section 965(a) inclusion amount with respect to the section 958(a) stock of the domestic pass-through owner and the section 965(c) deduction amount with respect to such amount are determined separately from the domestic pass-through owner’s share of the aggregate section 965(a) inclusion amount and section 965(c) deduction amount of the domestic pass-through entity.

Consistent with section 3.05(b) of Notice 2018–26, proposed § 1.965–1(f)(19) defines the term “domestic pass-through entity” to mean a pass-through entity that is a United States person (as defined in section 7701(a)(30)), and

proposed § 1.965–1(f)(28) defines the term “pass-through entity” to mean a partnership, S corporation, or any other person to the extent that the income or deductions of such person are included in the income of one or more direct or indirect owners or beneficiaries of the person. Accordingly, if, for example, a domestic trust owns section 958(a) stock of a single DFIC and is subject to federal income tax on a portion of its section 965(a) inclusion amount and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion. As defined, a pass-through entity does not include a REIT or a regulated investment company (“RIC”). The term “domestic pass-through owner” means a United States person that is a partner, shareholder, beneficiary, grantor, or owner, as the case may be, in a domestic pass-through entity, except that, in the case of tiered pass-through entities, the term does not include a partner, shareholder, beneficiary, grantor, or owner that is itself a domestic pass-through entity. See proposed § 1.965–1(f)(20). In the case of tiered pass-through entities, a reference to a domestic pass-through owner includes a United States person that is an indirect partner, shareholder, beneficiary, grantor, or owner through one or more other pass-through entities, and a reference to a domestic pass-through owner share of the aggregate section 965(a) inclusion amount and section 965(c) deduction amount of a domestic pass-through entity includes such domestic pass-through owner’s share of the aggregate section 965(a) inclusion amount and section 965(c) deduction amount of a domestic pass-through entity owned indirectly by the domestic pass-through owner through one or more other pass-through entities. See proposed § 1.965–1(f)(20) and (21).

### C. Foreign Currency Translation

Consistent with section 3.05(a) of Notice 2018–13, the proposed regulations provide that, for purposes of determining the section 965(a) earnings amount of a specified foreign corporation, the accumulated post-1986 deferred foreign income of the specified foreign corporation as of each of the E&P measurement dates must be compared in the functional currency of the specified foreign corporation. See proposed § 1.965–1(f)(36). If the functional currency of a specified foreign corporation changes between the two E&P measurement dates, the comparison must be made in the functional currency of the specified

foreign corporation as of December 31, 2017, by translating the specified foreign corporation’s E&P as of November 2, 2017, into the new functional currency using the spot rate on November 2, 2017. *Id.*; see also proposed § 1.965–4(c)(1) (disregarding any such change in functional currency for purposes of applying section 965 to a United States shareholder of the specified foreign corporation under certain circumstances).

Furthermore, the proposed regulations are consistent with section 3.05(b) of Notice 2018–13, which indicates that the spot rate on December 31, 2017, is to be used for translating the section 965(a) earnings amount of a DFIC into U.S. dollars for purposes of determining the section 965(a) inclusion amount of a United States shareholder with respect to the DFIC, as well as for purposes of translating other amounts necessary for the application of section 965(b), including (i) translating a section 965(a) earnings amount into U.S. dollars in computing amounts described in section 965(b)(2)(A) and (B), (ii) translating a specified E&P deficit into U.S. dollars in order to determine a United States shareholder’s aggregate foreign E&P deficit under section 965(b)(3)(A), (iii) translating a section 965(a) inclusion amount with respect to a DFIC (if the amount was reduced by an aggregate foreign E&P deficit under section 965(b)(1)) back into the functional currency of the DFIC for purposes of determining the E&P of the DFIC described in section 959(c)(2), and (iv) translating the portion of the U.S. dollar-denominated aggregate foreign E&P deficit allocated to a DFIC under section 965(b)(2) into the functional currency of the DFIC for purposes of determining its E&P described in section 959(c)(2) by reason of section 965(b)(4)(A). See proposed §§ 1.965–1(b)(1), (f)(9) and (11), and 1.965–2(c) and (d). Proposed § 1.965–6(b) also provides that in applying section 902, the section 965(a) inclusion amount must be translated (if necessary) back into the DFIC’s functional currency using the spot rate on December 31, 2017.

Section 3.05(c) of Notice 2018–13 describes regulations to ensure that the cash position of a specified foreign corporation with respect to any cash measurement date is expressed in U.S. dollars, so that the amount of a United States shareholder’s aggregate foreign cash position is the greater of the aggregate amounts on each cash measurement date. In determining the cash position attributable to net accounts receivable, the amount of accounts receivable and accounts

payable (in each case, if not otherwise denominated in U.S. dollars) must be translated into U.S. dollars at the spot rate on the relevant cash measurement date. The fair market value of assets described in section 965(c)(3)(B)(iii) must also be determined in U.S. dollars on the relevant cash measurement date. For example, in the case of foreign currency, the fair market value equals the currency amount translated at the spot rate on the relevant cash measurement date. Consistent with section 3.05(c) of Notice 2018–13, the proposed regulations provide that amounts taken into account in determining the cash position are translated (if necessary) using the spot rate on the relevant cash measurement date. See proposed § 1.965–1(f)(16)(iv).

### III. Section 962 Elections

The proposed regulations provide rules consistent with section 5 of Notice 2018–26 related to elections under section 962. Proposed § 1.962–2(a) clarifies that an individual domestic pass-through owner that is a United States shareholder with respect to a DFIC may make an election under section 962 with respect to the individual’s share of the section 965(a) inclusion amount of a domestic pass-through entity with respect to the DFIC, and an individual who is not a United States shareholder of a DFIC is not permitted to make an election under section 962 with respect to the individual’s share of a section 965(a) inclusion amount of a domestic pass-through entity with respect to the DFIC. See also proposed § 1.962–1(b)(1)(i)(A)(1)(ii).

In addition, notwithstanding the rule in current § 1.962–1(b)(1)(i) providing that a deduction of a United States shareholder does not reduce the amount included in gross income under section 951(a) for purposes of computing the amount of tax that would be imposed under section 11, the Treasury Department and the IRS have determined that in the case of a taxpayer making an election under section 962, the section 965(c) deduction (which is generally available to United States shareholders of DFICs, including individuals) should be allowed with respect to the tax imposed under section 11 rather than under section 1. See H.R. Rep. No. 115–466, at 620 (2017) (Conf. Rep.). Thus, under proposed § 1.962–1(b)(1)(i)(B), “taxable income” as used in section 11 is reduced by a taxpayer’s section 965(c) deduction with respect to a section 965(a) inclusion to which the section 962 election applies. However, the proposed regulations clarify that, subject to future guidance, “taxable

income” as used in section 11 is not reduced by any other amounts, including any other deductions.

To clarify that a section 965(c) deduction taken into account in determining “taxable income” as used in section 11 cannot then be deducted again at the individual level, the proposed regulations provide that any section 965(c) deduction allowed in determining “taxable income” as used in section 11 for purposes of computing the tax due as a result of a section 962 election is not also allowed for purposes of determining an individual’s actual taxable income. See proposed § 1.965–3(e)(1).

#### IV. Adjustments to E&P and Basis

Proposed § 1.965–2 contains rules related to adjustments to E&P and basis to determine and account for the application of section 965(a) and (b) and proposed § 1.965–1(b) and a rule that limits the amount of gain recognized in connection with the application of section 961(b)(2).

##### *A. Determination of and Adjustments to E&P in the Last Taxable Year of a Specified Foreign Corporation That Begins Before January 1, 2018, for Purposes of Applying Sections 959 and 965*

Consistent with section 3.02(d) of Notice 2018–07, the proposed regulations clarify the interaction between the rules under sections 959 and 965 in the last taxable year of a specified foreign corporation that begins before January 1, 2018, and the taxable year of a section 958(a) U.S. shareholder of the specified foreign corporation in which or with which such year ends. Proposed § 1.965–2(b) provides the following rules relating to adjustments to E&P for determining a section 958(a) U.S. shareholder’s inclusion under section 951(a)(1), including by reason of section 965(a) and proposed § 1.965–1(b), and the treatment of distributions under section 959: First, the subpart F income of the specified foreign corporation is determined without regard to section 965(a), and a section 958(a) U.S. shareholder’s inclusion under section 951(a)(1)(A) by reason of such amount is taken into account.

Second, the treatment of a distribution from the specified foreign corporation to another specified foreign corporation that is made before January 1, 2018, is determined under section 959.

Third, each of the post-1986 earnings and profits (including a deficit) of the specified foreign corporation, the accumulated post-1986 deferred foreign income of the specified foreign

corporation, the section 965(a) earnings amount of the specified foreign corporation, and the section 965(a) inclusion amount of the section 958(a) U.S. shareholder with respect to the specified foreign corporation, if any, is determined, and the E&P (including a deficit) of the specified foreign corporation are adjusted as provided in proposed § 1.965–2(c) and (d) (as discussed in Part IV.B of this Explanation of Provisions section). For a rule disregarding subpart F income earned after an E&P measurement date for purposes of calculating accumulated post-1986 deferred foreign income as of the E&P measurement date, see Part II.B.4 of this Explanation of Provisions section and proposed § 1.965–2(j), *Example 2* and *Example 3*.

Fourth, the treatment of all distributions from the specified foreign corporation other than those described in step 2 is determined under section 959.

Fifth, an amount is determined under section 956 with respect to the specified foreign corporation and the section 958(a) U.S. shareholder, and the shareholder’s inclusion under section 951(a)(1)(B) is taken into account.

##### *B. Adjustments to E&P by Reason of Section 965(a) and (b)*

###### 1. Adjustments to E&P by Reason of Section 965(a)

Proposed § 1.965–2(c) provides that if a section 958(a) U.S. shareholder has a section 965(a) inclusion with respect to a DFIC, the DFIC will have previously taxed E&P with respect to the section 958(a) U.S. shareholder in an amount equal to the section 965(a) inclusion amount (referred to as “section 965(a) previously taxed earnings and profits”). Because section 965(a) previously taxed earnings and profits must be tracked in functional currency whereas the section 965(a) inclusion amount is in U.S. dollars, as noted in Part II.C of this Explanation of Provisions section, the proposed regulations provide that the section 965(a) inclusion amount must be translated (if necessary) into the functional currency of the DFIC using the spot rate on December 31, 2017, in determining the amount of the section 965(a) previously taxed earnings and profits.

Under proposed § 1.965–2(c), the E&P of a DFIC described in section 959(c)(3) are reduced by an amount equal to the section 965(a) previously taxed earnings and profits of the corporation. In certain cases, the section 965(a) inclusion amount with respect to the DFIC, and therefore the section 965(a) previously taxed earnings and profits of the DFIC

with respect to a section 958(a) U.S. shareholder, may exceed the E&P described in section 959(c)(3) of the DFIC. For example, this will be the case when a DFIC incurs a loss after the E&P measurement date on which it determines its section 965(a) earnings amount and before the end of its inclusion year. In such a case, under the proposed regulations, a deficit in E&P described in section 959(c)(3) will be created or increased.

###### 2. Adjustments to E&P by Reason of Section 965(b)

Proposed § 1.965–2(d) provides rules relating to E&P of DFICs and E&P deficit foreign corporations by reason of a reduction under section 965(b)(1) and proposed § 1.965–1(b)(2) (reduction by the DFIC’s allocable share of a section 958(a) U.S. shareholder’s aggregate foreign E&P deficit) or section 965(b)(5) and proposed § 1.965–8(b) (reduction by the DFIC’s allocable share of a section 958(a) U.S. shareholder’s applicable share of an affiliated group’s aggregate unused E&P deficit) (collectively, the “reduction rules”).

###### i. Adjustments to E&P of DFICs

Under proposed § 1.965–2(d)(1), if a section 958(a) U.S. shareholder’s pro rata share of the section 965(a) earnings amount of a DFIC is reduced under the reduction rules, the DFIC will have previously taxed E&P (referred to as “section 965(b) previously taxed earnings and profits”) with respect to the section 958(a) U.S. shareholder in an amount equal to the amount of the reduction, if any, translated (if necessary) into the functional currency of the DFIC using the spot rate on December 31, 2017. For purposes of applying section 959, section 965(b) previously taxed earnings and profits are treated as E&P that are included in the gross income of the section 958(a) U.S. shareholder under section 951(a)(1)(A). Furthermore, the E&P (including a deficit) described in section 959(c)(3) of the DFIC are reduced (or, in the case of a deficit, increased) by an amount equal to the section 965(b) previously taxed earnings and profits.

###### ii. Adjustments to E&P of E&P Deficit Foreign Corporations

Under proposed § 1.965–2(d)(2)(i)(A), the E&P described in section 959(c)(3) of an E&P deficit foreign corporation are increased by an amount equal to the portion of a section 958(a) U.S. shareholder’s pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under the reduction rules, translated (if necessary) into the functional currency

of the E&P deficit foreign corporation using the spot rate on December 31, 2017. The proposed regulations clarify that the E&P increased by reason of this provision are not treated as E&P of the taxable year described in section 316(a)(2). See also proposed § 1.965–6(c)(3) for a rule on the timing of this adjustment for purposes of determining a deemed paid credit allowed under sections 902 and 960 with respect to the E&P deficit foreign corporation (which is discussed in Part VII.C.1 of this Explanation of Provisions section).

In addition, proposed § 1.965–2(d)(2)(i)(B) provides that, for purposes of section 952, a section 958(a) U.S. shareholder's pro rata share of the E&P of an E&P deficit foreign corporation is increased by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under the reduction rules, translated (if necessary) into the functional currency of the E&P deficit foreign corporation using the spot rate on December 31, 2017, and such increase is attributable to the same activity to which the deficit so taken into account was attributable.

Proposed § 1.965–2(d)(2)(ii) provides rules for determining the portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit of an E&P deficit foreign corporation taken into account under the reduction rules. Proposed § 1.965–2(d)(2)(ii)(A) details the circumstances in which all of a pro rata share of a specified E&P deficit will be taken into account. Proposed § 1.965–2(d)(2)(ii)(B) provides that if the rule in the preceding sentence does not apply, a section 958(a) U.S. shareholder must designate the portion taken into account.

### C. Adjustments to Basis by Reason of Section 965(a) and (b)

#### 1. Adjustments to Basis by Reason of Section 965(a)

Proposed § 1.965–2(e) provides that, under section 961(a), a section 958(a) U.S. shareholder's basis in section 958(a) stock of a DFIC, or property by reason of which the section 958(a) U.S. shareholder is considered under section 958(a)(2) as owning section 958(a) stock of a DFIC ("applicable property"), is increased by the section 958(a) U.S. shareholder's section 965(a) inclusion amount with respect to the DFIC. However, rules relating to basis adjustments in the case of a section 962 election are reserved. Comments are requested as to the appropriate amount of a basis adjustment with respect to a

DFIC with respect to which a section 962 election is effective.

#### 2. Adjustments to Basis by Reason of Section 965(b)

Proposed § 1.965–2(f)(1) clarifies that, in general, no adjustments to basis of stock or property are made under section 961 (or any other provision of the Code) to take into account the reduction to a section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of a DFIC under the reduction rules. However, section 965(o) provides authority to write regulations concerning basis adjustments in contemplation of the fact that "basis adjustments (increases or decreases) may be necessary with respect to both the stock of the DFIC and the E&P deficit foreign corporation." H.R. Rep. No. 115–466, at 620 (2017) (Conf. Rep.). The Conference Report stated:

For example, with respect to the stock of the deferred foreign income corporation, the Secretary may determine that a basis increase is appropriate in the taxable year of the section 951A [sic] inclusion or, alternatively, the Secretary may modify the application of section 961(b)(1) with respect to such stock. Moreover, with respect to the stock of the E&P deficit [foreign] corporation, the Secretary may require a reduction in basis for the taxable year in which the U.S. shareholder's pro rata share of the earnings of the E&P deficit [foreign] corporation are increased.

*Id.* at 620–21.

The Treasury Department and the IRS have determined that an increase to the basis of stock of DFICs is appropriate only if there is a corollary reduction to the basis of the stock of E&P deficit foreign corporations. However, the Treasury Department and the IRS recognize that such reduction, which could in certain cases give rise to gain, could be overly burdensome for taxpayers. Accordingly, proposed § 1.965–2(f)(2) allows taxpayers to elect to make the relevant basis adjustments, in which case such adjustments must be consistently made with respect to all section 958(a) stock of specified foreign corporations owned by a section 958(a) U.S. shareholder and related persons. The relevant basis adjustments are (i) an increase in the section 958(a) U.S. shareholder's basis in the section 958(a) stock of a DFIC or applicable property with respect to a DFIC by an amount equal to the section 965(b) previously taxed earnings and profits of the DFIC with respect to the section 958(a) U.S. shareholder, and (ii) a reduction in the section 958(a) U.S. shareholder's basis in the section 958(a) stock of an E&P deficit foreign corporation or applicable

property with respect to an E&P deficit foreign corporation by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under the reduction rules. However, as noted in Part IV.C.1 of this Explanation of Provisions section, rules relating to basis adjustments in the case of a section 962 election are reserved. An election under § 1.965–2(f)(2) is generally made by attaching a statement, signed under penalties of perjury, to the section 958(a) U.S. shareholder's return for the first taxable year that includes the last day of the last taxable year of a DFIC or E&P deficit foreign corporation of the shareholder that begins before January 1, 2018, including the shareholder's name and taxpayer identification number and a statement that the shareholder and all related persons make the election. See proposed § 1.965–2(f)(2)(iii)(B).

#### D. Gain-Reduction Rule

Consistent with section 3.03 of Notice 2018–07, and with the modification described in section 4 of Notice 2018–13, proposed § 1.965–2(g)(1) provides a gain-reduction rule pursuant to which, if a section 958(a) U.S. shareholder receives distributions through a chain of ownership described under section 958(a) from a DFIC during the inclusion year that are attributable to section 965(a) previously taxed earnings and profits, the amount of gain that would otherwise be recognized under section 961(b)(2) by the section 958(a) U.S. shareholder with respect to the section 958(a) stock of the DFIC, or applicable property with respect to the DFIC, is reduced (but not below zero) by an amount equal to the section 965(a) previously taxed earnings and profits of the DFIC with respect to the section 958(a) U.S. shareholder.

If a taxpayer makes the election described in proposed § 1.965–2(f)(2), the gain-reduction rule will also apply to distributions attributable to section 965(b) previously taxed earnings and profits, and the amount of gain that would otherwise be recognized by the section 958(a) U.S. shareholder is also reduced by the amount of the section 965(b) previously taxed earnings and profits of the DFIC with respect to the section 958(a) U.S. shareholder.

In order to ensure that the amount of gain in the section 958(a) stock or applicable property that would have been recognized under section 961(b)(2) remains reflected in the section 958(a) stock or applicable property, proposed § 1.965–2(g)(2) provides that the basis in the section 958(a) stock or applicable

property must be reduced by the amount that would have been recognized as gain.

#### *E. Rules of Application for Basis Adjustments*

The proposed regulations provide certain rules of application common to all basis adjustments described in proposed § 1.965–2(e), (f)(2), and (g)(2) (“specified basis adjustments”). See proposed § 1.965–2(h). The rules address the timing and allocation among shares of the specified basis adjustments. See proposed § 1.965–2(h)(1) and (4). They also require netting of the specified basis adjustments and gain recognition to the extent that a net downward adjustment would exceed basis. See proposed § 1.965–2(h)(2) and (3). In addition, they make clear that the specified basis adjustments are limited to adjustments to property held by a section 958(a) U.S. shareholder, except in circumstances involving foreign pass-through entities. See proposed § 1.965–2(h)(5).

#### **V. Section 965(c) Deductions**

Proposed § 1.965–3 provides rules regarding section 965(c) deductions and section 965(c) deduction amounts.

##### *A. Determination of Aggregate Foreign Cash Position*

###### **1. Disregard of Certain Obligations Between Related Specified Foreign Corporations**

Consistent with section 3.01(b) and (c) of Notice 2018–07, the proposed regulations provide that, for purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder, accounts receivable, accounts payable, short-term obligations, and derivative financial instruments between related specified foreign corporations are disregarded, if applicable, on the corresponding cash measurement dates of the specified foreign corporations to the extent of the smallest of the section 958(a) U.S. shareholder’s ownership percentages of section 958(a) stock of the specified foreign corporations owned by the section 958(a) U.S. shareholder on the corresponding cash measurement dates. See proposed § 1.965–3(b)(1).

###### **2. Disregard of Certain Assets To Prevent Double Counting**

Section 3.05(a) of Notice 2018–26 announced the intent to issue forms, publications, regulations, or other guidance specifying the documentation that a United States shareholder must maintain or provide, and the time and manner for providing any such documentation, in order to make the

required demonstration to the Secretary to rely on section 965(c)(3)(D) in excluding net accounts receivable, actively traded property, and short-term obligations in determining its aggregate foreign cash position. To disregard assets under this rule, the proposed regulations provide that a section 958(a) U.S. shareholder must attach a statement to its timely filed return (taking into account extensions, if any) containing a description of the asset that would be taken into account with respect to both specified foreign corporations; a statement of the amount by which its pro rata share of the cash position of one specified foreign corporation is reduced; a detailed explanation of why there would otherwise be double-counting, including the computation of the amount taken into account with respect to the other specified foreign corporation; and an explanation of why the rule described in Part V.A.1 of this Explanation of Provisions section does not apply to disregard such amounts. See proposed § 1.965–3(b)(2).

##### *B. Determination of Aggregate Foreign Cash Position for Section 958(a) U.S. Shareholder Inclusion Year*

Consistent with section 3.05(a) of Notice 2018–07, the proposed regulations provide that in the case of a section 958(a) U.S. shareholder that has a section 965(a) inclusion amount in more than one taxable year, the amount of the aggregate foreign cash position taken into account in the first taxable year will equal the lesser of the section 958(a) U.S. shareholder’s aggregate foreign cash position or the aggregate 965(a) inclusion amount taken into account by the section 958(a) U.S. shareholder in that taxable year. Furthermore, the amount of the section 958(a) U.S. shareholder’s aggregate foreign cash position taken into account in any succeeding taxable year will be the lesser of the excess, if any, of its aggregate foreign cash position over the amount of its aggregate foreign cash position taken into account in preceding taxable years, or the aggregate section 965(a) inclusion amount taken into account by the section 958(a) U.S. shareholder in such succeeding taxable year. See proposed § 1.965–3(c)(2).

In addition, also consistent with section 3.05(a) of Notice 2018–07, the proposed regulations provide that, for purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder for a taxable year in which it takes into account a section 965(a) inclusion amount, a section 958(a) U.S. shareholder can assume that its pro rata share of the cash position of

any specified foreign corporation whose last taxable year beginning before January 1, 2018, ends after the date the return for such taxable year of the section 958(a) U.S. shareholder is timely filed (taking into account extensions, if any) will be zero as of the cash measurement date with which the year of the specified foreign corporation ends. If a section 958(a) U.S. shareholder’s pro rata share of the cash position of a specified foreign corporation was treated as zero pursuant to the preceding sentence for a section 958(a) U.S. shareholder inclusion year (an “estimated section 958(a) U.S. shareholder inclusion year”), the final cash measurement date amount in fact exceeds the average of the first and second cash measurement date amounts with respect to the section 958(a) shareholder, and the shareholder’s aggregate section 965(a) inclusion amount in fact exceeds the final cash measurement date amount, interest and penalties will not be imposed if the section 958(a) U.S. shareholder makes appropriate adjustments by amending the return for the estimated section 958(a) U.S. shareholder inclusion year to reflect the correct aggregate foreign cash position by the due date (taking into account extensions, if any) for the return for the year after the estimated section 958(a) U.S. shareholder inclusion year. See proposed § 1.965–3(c)(3).

##### *C. Recapture of Section 965(c) Deductions for Expatriated Entities*

Proposed § 1.965–3(d) harmonizes the rule provided in section 965(l) requiring the recapture of a section 965(c) deduction by an expatriated entity with the expanded scope of availability of section 965(c) deductions (that is, to a domestic pass-through owner that is not itself a United States shareholder) by requiring recapture of all section 965(c) deductions taken into account by an expatriated entity without regard to whether the expatriated entity was itself a United States shareholder.

##### *D. Treatment of Section 965(c) Deductions Under Certain Code Provisions*

Consistent with section 3.06 of Notice 2018–26, proposed § 1.965–3(f)(1) provides that a section 965(c) deduction will not be treated as an itemized deduction for any purpose of the Code (including, as described in Notice 2018–26, for purposes of sections 56 and 67).

The Treasury Department and the IRS are aware that the rules of subchapter K and subchapter S may prevent a partner or S corporation shareholder from taking into account its domestic pass-

through owner share of a section 965(c) deduction amount in certain circumstances if allocated by a partnership or S corporation separately from the corresponding section 965(a) inclusion amount, particularly to the extent that a partnership or S corporation makes distributions to one or more partners or shareholders (as the case may be) during the year of its section 965(a) inclusion. *See, e.g.*, section 1366(d). Accordingly, proposed § 1.965-3(f)(2)(i) provides that in the case of a domestic partnership or S corporation, the aggregate amount of its section 965(a) inclusions net of the aggregate amount of its section 965(c) deductions is treated as a separately stated item of net income solely for purposes of calculating basis under section 705(a) and § 1.705-1(a) and section 1367(a)(1) and § 1.1367-1(f). Furthermore, the proposed regulations incorporate the rules concerning basis and AAA adjustments contained in section 965(f)(2) and provide an example illustrating the application of the rules described in this paragraph. *See* proposed § 1.965-3(f)(2)(i)(B), (ii), and (iii).

The proposed regulations clarify whether a United States person that must pay tax under section 1411 on a section 965(a) inclusion is entitled to take into account a section 965(c) deduction for purposes of determining the amount of such tax. Section 965(c) deductions are intended to reduce the rate of income tax to which section 965(a) inclusions are subject. *See* H.R. Rep. No. 115-466, at 620 (2017) (Conf. Rep.). The Treasury Department and the IRS have determined that the section 965(c) deduction was not intended to reduce the rate of tax imposed by non-income tax provisions outside of chapter 1. Accordingly, proposed § 1.965-3(f)(3) provides that for purposes of section 1411 and § 1.1411-4(f)(6), a section 965(c) deduction is not treated as a deduction properly allocable to a corresponding section 965(a) inclusion. Consistent with the rule for section 1411, proposed § 1.965-3(f)(4) provides that a section 965(c) deduction is not treated as an ordinary and necessary expense paid or incurred for the production or collection of gross investment income for purposes of section 4940(c)(3)(A).

## VI. Disregard of Certain Transactions

Proposed § 1.965-4 provides rules that disregard certain transactions for purposes of applying section 965. In particular, proposed § 1.965-4 provides rules that disregard (i) transactions undertaken with a principal purpose of reducing the section 965 tax liability of

a United States shareholder, (ii) certain changes in method of accounting and entity classification elections, and (iii) certain transactions occurring between E&P measurement dates.

### A. Anti-Avoidance Rules

The proposed regulations provide rules, consistent with section 3.04 of Notice 2018-26, to prevent the avoidance of section 965, including an anti-avoidance rule disregarding certain transactions and rules disregarding certain changes in accounting methods and entity classification elections. *See* proposed § 1.965-4(b) through (e). The application of the anti-avoidance rule is based on whether there is a “change in the amount of a section 965 element” rather than a change in the section 965 tax liability, as described in the notice. *See* proposed § 1.965-4(b)(1). For this purpose, generally there is a change in the amount of a section 965 element if there is a reduction of a section 958(a) inclusion amount or aggregate foreign cash position or an increase in deemed paid foreign income taxes as a result of a section 965(a) inclusion. *See* proposed § 1.965-4(d) and (e)(1).

Comments requested that the anti-avoidance rule not apply to the extent a reduction in tax liability by reason of section 965 is offset by an equal amount of tax increase pursuant to a different Code provision. This comment is not adopted. The Conference Report reflects an intent for the Treasury Department and the IRS to address all strategies for avoiding a section 965(a) inclusion, without regard to the effect on overall tax liability. *See* H.R. Rep. No. 115-466, at 619 (2017) (Conf. Rep.). Furthermore, it would be difficult for the IRS to determine whether a particular increase in tax liability for non-section 965 reasons is related to the reduction in the taxpayer’s section 965(a) inclusion. Finally, the anti-avoidance rule generally does not apply without a principal purpose of changing the amount of a section 965 element. Depending on the facts and circumstances, transactions that do not reduce overall tax liability may not meet the principal purpose test described in proposed § 1.965-4(b)(1).

Comments also requested a de minimis exception for the anti-avoidance rule. This comment is not adopted. The Treasury Department and the IRS have determined that any reduction in tax imposed by reason of section 965 through tax avoidance strategies occurring after November 2, 2017, is inconsistent with congressional intent and should not be respected.

Comments to Notice 2018-26 requested that the rule disregarding

changes to methods of accounting not apply when the change is from an impermissible to a permissible method, and that a principal purpose test should apply. These comments are not adopted. Proposed § 1.965-4(c)(1) does not affect a taxpayer’s ability to change its method of accounting, including to change to a permissible method. Instead, the rule disregarding an accounting method change is relevant only for the limited purpose of determining the amount of a taxpayer’s section 965 elements.

The choice of a November 2, 2017, measurement date reflects an intent to impose a transition tax on a snapshot of earnings as of a date that coincides with the introduction of the Act in Congress, and reflects a general policy of disregarding taxpayer actions occurring after November 2, 2017, that reduce the taxpayer’s liability imposed by reason of section 965, even if such future actions are otherwise respected under the Code. Such actions can include changes in accounting methods, whether to methods that are permissible or impermissible and regardless of the principal purpose for such change. A rule disregarding such changes is also consistent with the Conference Report, which reflects a clear intent for the Treasury Department and the IRS to exercise their authority under section 965(o) to disregard accounting method changes that reduce a taxpayer’s tax liability under section 965. *See* H.R. Rep. No. 115-466, at 619 (2017) (Conf. Rep.).

### B. Disregard of Certain Transactions Occurring Between E&P Measurement Dates

In section 3.02(a) of Notice 2018-07, the Treasury Department and the IRS announced the intent to issue regulations to address the possibility of double-counting or double non-counting in the computation of post-1986 earnings and profits arising from amounts paid or incurred (including certain dividends) between related specified foreign corporations of a United States shareholder that occur between E&P measurement dates and that would otherwise reduce the post-1986 earnings and profits as of December 31, 2017, of the specified foreign corporation that paid or incurred such amounts. The notice contained examples illustrating fact patterns involving double-counting or double non-counting to be addressed by the future regulations. The proposed regulations provide, consistent with section 3.02(a) of Notice 2018-07, that amounts paid or incurred between related specified foreign corporations of a section 958(a) U.S. shareholder

between E&P measurement dates that would otherwise reduce the post-1986 earnings and profits as of December 31, 2017, of the specified foreign corporation that paid or incurred such amounts are disregarded for purposes of determining the post-1986 earnings and profits of both of the specified foreign corporations as of the E&P measurement date on December 31, 2017. *See* proposed § 1.965–4(f).

A number of comments requested that these rules be expanded to cover other transactions that could lead to double counting and double non-counting in the computation of post-1986 earnings and profits of a specified foreign corporation, including: (i) Deductible payments by a specified foreign corporation to a United States shareholder or to a partnership owned by the United States shareholder; and (ii) distributions by specified foreign corporations to a United States shareholder. The recommendations in these comments are not adopted. The Treasury Department and the IRS have determined that the concerns regarding issues of double counting and double non-counting in the computation of post-1986 earnings and profits of a specified foreign corporation relate to transactions occurring between specified foreign corporations rather than between a specified foreign corporation and a United States shareholder. *See* H.R. Rep. No. 115–466, at 619 (2017) (Conf. Rep.). Payments by a specified foreign corporation to a United States shareholder only affect the post-1986 earnings and profits of a single specified foreign corporation, and thus do not result in double counting in determining a United States shareholder's section 965(a) inclusion amount. Additionally, payments by a specified foreign corporation to a United States shareholder can have attendant U.S. tax effects that do not occur with respect to payments between specified foreign corporations and that would need to be considered if such payments were disregarded. For example, a distribution from a specified foreign corporation to its United States shareholder may permit the United States shareholder to take into account foreign tax credits under section 902 and avoid the limitation under section 965(g)(1) that would apply if the underlying foreign taxes had been deemed paid with respect to the United States shareholder's section 965(a) inclusion amount.

## VII. Foreign Tax Credits

### A. In General

Section 14301 of the Act repealed section 902 effective for taxable years of foreign corporations beginning after December 31, 2017, and taxable years of United States shareholders in which or with which such taxable years of foreign corporations end. The proposed regulations include, in addition to rules under the foreign tax credit specific rules of section 965, rules coordinating the provisions of section 965 with the foreign tax credit provisions as in effect before their repeal or amendment by the Act.

### B. Allowance of a Credit or Deduction for Foreign Income Taxes

#### 1. Scope

Section 965(g)(1) provides that no credit is allowed under section 901 for the applicable percentage of any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a section 965(c) deduction amount is allowed. The Conference Report does not elaborate on the meaning of “taxes paid or accrued” or “taxes treated as paid or accrued.” Comments requested clarification of the meaning of these terms and the scope of section 965(g). Under the proposed regulations, “taxes paid or accrued” refers to foreign income taxes paid or accrued directly by the taxpayer under section 901, and “taxes treated as paid or accrued” includes foreign income taxes deemed paid by the taxpayer under section 960, foreign income taxes allocated to an entity under § 1.901–2(f)(4), and a distributive share of taxes paid by a partnership.

#### 2. Applicable Percentage

The proposed regulations clarify that the term “applicable percentage” is determined with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year. As a result, if a section 958(a) U.S. shareholder has more than one section 958(a) U.S. shareholder inclusion year, the shareholder might have more than one applicable percentage as a result of differing aggregate foreign cash positions for those different section 958(a) U.S. shareholder inclusion years. *See* proposed § 1.965–5(d)(1). In addition, if a person is a domestic pass-through owner with respect to more than one domestic pass-through entity, each of which is a section 958(a) U.S. shareholder, the person might have a different applicable percentage with respect to each of those domestic pass-through entities because of differing

aggregate foreign cash positions of those entities, as well as a different applicable percentage with respect to the person's section 958(a) stock, if any. *See* proposed § 1.965–5(d)(2). Therefore, the amount of foreign tax credits disallowed under section 965(g) and proposed § 1.965–5(b) and (c) could differ depending on the section 958(a) U.S. shareholder inclusion year and section 958(a) U.S. shareholder to which the foreign income taxes relate.

### 3. Foreign Income Taxes Paid or Accrued Directly by Taxpayer

For purposes of section 965(g)(1), foreign income taxes paid or accrued directly by a taxpayer include foreign income taxes imposed on the taxpayer on a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits. Section 965(g)(3) provides that no deduction is allowed for any tax for which a credit is not allowable under section 901 by reason of section 965(g)(1). The proposed regulations provide that neither a deduction (including under section 164) nor a credit under section 901 is allowed for the applicable percentage of any foreign income taxes paid or accrued with respect to any amount for which a section 965(c) deduction is allowed for a section 958(a) U.S. shareholder inclusion year. The proposed regulations also provide that neither a deduction nor a credit under section 901 is allowed for the applicable percentage of any foreign income taxes attributable to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits. *See* proposed § 1.965–5(b).

Accordingly, no deduction or credit is allowed for the applicable percentage of any withholding taxes imposed on a United States shareholder by the jurisdiction of residence of the distributing foreign corporation with respect to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits. Similarly, no deduction or credit is allowed for the applicable percentage of net basis taxes imposed on a United States citizen by the citizen's jurisdiction of residence upon receipt of a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits.



#### 4. Foreign Income Taxes Treated as Paid or Accrued by Taxpayer

##### i. Section 960(a)(1)

For taxable years of foreign corporations beginning before January 1, 2018, and taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, section 960(a)(1) provides that, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to E&P of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)). The proposed regulations provide that a credit under section 901 is not allowed for the applicable percentage of any foreign income taxes treated as paid or accrued under section 960(a)(1) (for taxable years of foreign corporations beginning before January 1, 2018, and to taxable years of United States persons in which or with which such taxable years of foreign corporations end) with respect to any amount for which a section 965(c) deduction is allowed for a section 958(a) U.S. shareholder inclusion year.

##### ii. Section 960(a)(3)

For a taxable year of a foreign corporation beginning before January 1, 2018, section 960(a)(3) provides that any portion of a distribution from such a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) is treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any foreign taxes, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation for any prior taxable year.

Accordingly, the proposed regulations provide that the credit allowed under section 960(a)(3) is only with respect to foreign income taxes imposed on an upper-tier foreign corporation on distributions of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits from a lower-tier foreign corporation. See proposed § 1.965–5(c)(1)(ii). Furthermore, section 960(a)(3) does not allow a credit for foreign income taxes attributable to the portion of a section 965(a) earnings

amount that was reduced pursuant to section 965(b) since such taxes were not imposed on a distribution of previously taxed E&P. Instead, because section 965(b) previously taxed earnings and profits are treated as having been included in a United States shareholder's income under section 951(a), foreign income taxes that would have been deemed paid with respect to section 965(b) previously taxed earnings and profits under section 960(a)(1) had such amounts actually been included in income are treated as having been deemed paid, with the result that no credit is allowed under section 960(a)(3) or any other provision of the Code for such taxes. *Id.*

The proposed regulations also provide that the disallowance under section 965(g) applies to foreign taxes deemed paid under section 960(a)(3) with respect to distributions of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits with respect to a section 958(a) U.S. shareholder inclusion year. For example, if a lower-tier foreign corporation distributes section 965(a) previously taxed earnings and profits to an upper-tier foreign corporation, and the upper-tier foreign corporation pays a foreign withholding tax with respect to the distribution of the section 965(a) previously taxed earnings and profits, such withholding tax would be creditable under section 960(a)(3) upon a distribution by the upper-tier foreign corporation to an eligible domestic corporation. However, the domestic corporation cannot claim a credit for the applicable percentage of such withholding tax. See proposed § 1.965–5(c)(ii).

The Act replaces section 960(a)(3) with section 960(b). The proposed regulations only address distributions out of section 965(a) previously taxed earnings and profits and section 965(b) previously taxed earnings and profits in years before the effective date of section 960(b) in the Act. The Treasury Department and the IRS anticipate that future regulations will provide similar rules in connection with new section 960(b).

##### iii. Disallowance of Deduction

The proposed regulations clarify that no deduction, including under section 164, is allowed for the applicable percentage of any foreign income taxes treated as paid or accrued with respect to any amount for which a section 965(c) deduction is allowed. See proposed § 1.965–5(c)(2).

#### C. Computation of Foreign Income Taxes Deemed Paid

##### 1. General Rule and Exception

Comments requested clarification regarding the determination of deemed paid taxes under section 960 in connection with section 965. One comment also requested specific changes to the application of sections 902 and 960 that would permit a taxpayer to reduce the post-1986 undistributed earnings of a DFIC by the amount of any deficit from an E&P deficit foreign corporation that reduced the section 965(a) earnings amount of the DFIC. In general, the proposed regulations confirm that sections 902 and 960 apply in the same manner for section 965(a) inclusions as for other inclusions under section 951(a)(1)(A), and therefore a DFIC's post-1986 undistributed earnings is not reduced by specified E&P deficits from an E&P deficit foreign corporation.

A comment noted that in determining the indirect credit with respect to a section 965(a) inclusion, the numerator of the section 902 fraction (as defined in proposed § 1.965–6(c)(1)) may be greater than the denominator given that the section 965(a) inclusion is determined on one of two measurement dates. For example, if the amount of the accumulated post-1986 deferred foreign income of a DFIC is greater on November 2, 2017, than such amount is on December 31, 2017, the section 965(a) earnings amount of the DFIC will be based on E&P as of the November 2, 2017 date. However, the denominator of the section 902 fraction, post-1986 undistributed earnings, is determined as of the close of the taxable year of the foreign corporation and without diminution by reason of earnings distributed or otherwise included in income during the year. Section 902(c)(1). Where the post-1986 undistributed earnings as of the close of the DFIC's U.S. taxable year is positive, but less than the section 965(a) earnings amount, this could result in a section 902 fraction greater than one.

The section 902 fraction cannot exceed one. See *H.H. Robertson Co. v. Commissioner of Internal Revenue*, 59 T.C. 53 (1972), *aff'd* 500 F.2d 1399 (3d Cir. 1974). For the avoidance of doubt, the proposed regulations clarify that when the denominator of the section 902 fraction is positive but less than the numerator of such fraction, the section 902 fraction is one. See proposed § 1.965–6(c)(2).

Comments also requested that taxpayers be deemed to pay taxes when the denominator of the section 902 fraction is zero or less than zero, either

by treating the DFIC as having post-1986 undistributed earnings equal to the DFIC's post-1986 foreign income taxes, or by determining the DFIC's post-1986 undistributed earnings as of the measurement date used to determine its section 965(a) earnings amount. This comment is not adopted. The Treasury Department and the IRS have determined that the Act was not intended to alter the application of sections 902 and 960 with respect to section 965. Thus, the proposed regulations confirm that when the denominator of the section 902 fraction is zero or less than zero, no taxes are deemed paid with respect to the section 965(a) inclusion. See proposed § 1.965-6(c)(2); cf. § 1.902-1(b)(4) (providing that no foreign income taxes are deemed paid in the case of a distribution out of current E&P that is treated as a "nimble" dividend under section 316(a)(2) when there is a deficit in accumulated E&P).

Section 965(b)(4)(B), which provides that a United States shareholder's pro rata share of the E&P of any E&P deficit foreign corporation is increased by the amount of the specified E&P deficit of such corporation taken into account by such shareholder by reason of allocation of such deficit to a DFIC, does not indicate whether that increase applies for purposes of determining the post-1986 undistributed earnings in the last taxable year of an E&P deficit foreign corporation that begins before January 1, 2018. The Treasury Department and the IRS have determined that section 965(b)(4)(B) should not apply for purposes of section 902 in that year. Therefore, the proposed regulations provide that post-1986 undistributed earnings of an E&P deficit foreign corporation are increased by reason of section 965(b)(4)(B) or proposed § 1.965-2(d)(2)(i) as of the first day of the foreign corporation's first taxable year following the E&P deficit foreign corporation's last taxable year that begins before January 1, 2018.

Comments also recommended that, to the extent that a hovering deficit is treated as reducing the post-1986 earnings and profits of a DFIC, those taxes should be added to the DFIC's post-1986 foreign income taxes in the inclusion year with respect to the DFIC. The Treasury Department and the IRS have determined that the existing rules adequately address this issue and decline to adopt this comment. The proposed regulations do not provide special rules for foreign income taxes that are related to hovering deficits; as a result, the rules in § 1.367(b)-7 continue to apply with respect to such foreign income taxes.

## 2. Taxes Deemed Paid in the Case of Certain Lower-Tier Corporations

A credit is allowable under section 960(a)(1) for taxes paid or accrued by a foreign corporation only if it is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation. Section 902(b)(2) states that the term "qualified group" does not include any foreign corporation below the third tier in the chain unless the foreign corporation is a CFC and the domestic corporation is a United States shareholder with respect to it. Comments requested clarification as to whether a 10-percent corporation treated as a CFC under section 965(e)(2) for purposes of sections 951 and 961 is treated as a CFC for purposes of section 902(b).

Section 965(e)(2) applies to treat a 10-percent corporation as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a) and for purposes of determining the United States shareholder's pro rata share of the section 965(a) inclusion amount. The proposed regulations also treat a 10-percent corporation as a CFC for other limited purposes. See Part I.A of this Explanation of Provisions. However, section 965 does not modify the computation of foreign income taxes deemed paid under sections 902 and 960, or for purposes of any other Code section. Therefore, the proposed regulations clarify that a United States shareholder is not entitled to an indirect credit with respect to a 10-percent corporation that is below the third tier in a chain of foreign corporations of the United States shareholder. See proposed § 1.965-1(d).

### D. Allocation and Apportionment of Expenses

The generally applicable rules of sections 861 through 865 and the regulations thereunder for allocating and apportioning deductions to separate categories of income described in section 904(d)(1) and § 1.904-4(m) apply for purposes of determining the foreign tax credits allowed by reason of a section 965(a) inclusion. For purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from such asset) is not taken into account. See section 864(e)(3). A similar rule applies in the case of the portion of any dividend (other than a qualifying dividend as defined in section 243(b)) equal to the deduction allowable under section 243 or 245(a) with respect to such dividend and in the case of a like portion of any stock the dividends on which would be

so deductible and would not be qualifying dividends (as so defined). The proposed regulations confirm that the allowance of a deduction under section 965(c) with respect to the section 965(a) inclusion does not result in any portion of the section 965(a) inclusion being treated as exempt income. In addition, the assets to which the section 965(a) inclusion relates are not treated as exempt assets under section 864(e)(3) or § 1.861-8T(d).

The proposed regulations also confirm that section 965(a) previously taxed earnings and profits and 965(b) previously taxed earnings and profits, like all previously taxed E&P, do not give rise to exempt treatment under section 864(e)(3). See proposed § 1.965-6(d).

Under section 864(e)(4), for purposes of allocating and apportioning expenses on the basis of assets, the adjusted basis in stock of any nonaffiliated 10-percent owned corporation is increased by the E&P accumulated during the period the taxpayer held the stock, or reduced (but not below zero) by deficits in E&P of the corporation attributable to the stock for such period. The purpose for this adjustment is to better approximate the value of such stock. See Joint Committee on Tax'n, General Explanation of the Tax Reform Act of 1986 (Pub. L. 99-514) (May 4, 1987), JCS-10-87, at p.87 (adjustment to E&P "takes account of some changes in value attributable to taxpayer's equity interests in such corporations").

In order to avoid double counting of previously taxed E&P and the basis adjustments under section 961, section 864(e)(4)(D) provides that proper adjustments must be made to the E&P of a corporation to account for previously taxed E&P and reflected in the adjusted basis of the stock. See Joint Committee on Tax'n, General Explanation of the Tax Reform Act of 1986 (Pub. L. 99-514) (May 4, 1987), JCS-10-87, at p.91. Section 1.861-12T(c)(2)(i)(B) provides that a taxpayer's basis in stock of a CFC shall not include any amount included in basis under section 961. At the same time, all E&P (including previously taxed E&P) generally increase the taxpayer's adjusted basis in stock of a CFC.

As a result of the enactment of section 965, the Treasury Department and the IRS recognize that the application of section 965(b)(4)(A) and (B) may warrant the issuance of special rules for the determination of adjusted basis. Furthermore, a different rule may be needed if a taxpayer has made an election under proposed § 1.965-2(f)(2) to adjust its basis to reflect the use of a specified E&P deficit. The Treasury

Department and the IRS request comments on what rules may be appropriate, including whether the rules under § 1.861–12(c)(2) should be modified.

#### *E. Application of Section 904*

The proposed regulations do not address the assignment of a section 965(a) inclusion and the related taxes to a separate category of income. The Treasury Department and the IRS have determined that the application of section 904 is clear with respect to section 951(a) inclusions regardless of whether the DFIC is a CFC or a 10-percent corporation. Furthermore, the Treasury Department and the IRS have determined that no clarification is necessary with respect to § 1.904–6 for purposes of relating the creditable portion of the foreign income taxes with respect to a section 965(a) inclusion to a separate category of income. For example, withholding tax imposed on a distribution of section 965(a) previously taxed earnings and profits and section 965(b) previously taxed earnings and profits will be related to the separate category of income to which the original section 965(a) inclusion was assigned. *See* § 1.904–6(b)(2) and (c), *Example 7*.

The Treasury Department and the IRS request comments on whether more guidance is necessary with respect to the assignment of the section 965(a) inclusion and the related taxes to a separate category or categories of income.

In addition, comments are requested on whether additional rules are needed for determining the amount of the increase in the section 904 limitation with respect to distributions of section 965(a) previously taxed earnings and profits and section 965(b) previously taxed earnings and profits, taking into account the section 965(c) deduction and the disallowed foreign taxes under section 965(g). *See* section 960(b) (effective with respect to taxable years of foreign corporations beginning before January 1, 2018, and to taxable years of United States shareholders with or within which such taxable years of those foreign corporations end) and section 960(c) for later years.

### **VIII. Election, Payment, and Other Special Rules**

#### *A. In General*

Section 965 provides certain elections that taxpayers can make with respect to the application of section 965. *See* Parts II.K through N of the Background section of this preamble. As discussed in Part II.B.10 of this Explanation of Provisions section and in section 3.05(b)

of Notice 2018–26, if the United States shareholder of a DFIC is a domestic pass-through entity and owns section 958(a) stock of the DFIC, then each domestic pass-through owner of the domestic pass-through entity will take into account its share of the section 965(a) inclusion amount with respect to the section 958(a) stock of the DFIC of the domestic pass-through entity and the section 965(c) deduction amount with respect to such amount, regardless of whether the domestic pass-through owner is itself also a United States shareholder with respect to the DFIC. The elections described in Parts II.K through N of the Background section of this preamble under sections 965(h) (the “section 965(h) election”), 965(m) (the “section 965(m) election”), and 965(n) (the “section 965(n) election”) are available to a United States shareholder of a DFIC under the terms of section 965. However, because a domestic pass-through owner will take into account its share of a section 965(a) inclusion amount (and the related section 965(c) deduction amount) whether or not it is itself a United States shareholder, the proposed regulations provide, consistent with section 3.05(b) of Notice 2018–26, that a domestic pass-through owner may make the section 965(h) election, the section 965(m) election, and the section 965(n) election.

#### *B. Net Tax Liability Under Section 965*

The proposed regulations define a new term, “total net tax liability under section 965,” which reflects the definition of net tax liability under section 965 in section 965(h)(6) with respect to a person as if the person were a United States shareholder of all DFICs with respect to which it has section 965(a) inclusions, consistent with section 3.05(c) of Notice 2018–26. *See* proposed § 1.965–7(g)(10). However, the proposed regulations provide that the dividends excluded pursuant to the second prong of the computation (the “without” prong) include dividends received directly or through a chain of ownership described in section 958(a). *See* proposed § 1.965–7(g)(10)(i)(B)(2).

For purposes of determining a person’s total net tax liability under section 965, the proposed regulations also clarify the computation of the foreign tax credit for purposes of the amount described in section 965(h)(6)(A)(ii)(II) and proposed § 1.965–7(g)(10)(i)(B) (the net income tax liability determined without regard to section 965 and dividends from DFICs). Specifically, the proposed regulations provide that the foreign tax credits disregarded in determining net income tax determined under section

965(h)(6)(A)(ii)(II) and proposed § 1.965–7(g)(10)(i)(B) includes the credits for foreign income taxes deemed paid with respect to section 965(a) inclusions or foreign income taxes deemed paid with respect to a dividend, including a distribution that would have been treated as a dividend in the absence of section 965, as well as the credits for foreign income taxes imposed on distributions of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits made in the taxable year in which the person includes a section 965(a) inclusion in income.

#### *C. Section 965(h) Election*

The proposed regulations provide that the section 965(h) election may be made by any person with a section 965(h) net tax liability (which includes a section 958(a) U.S. shareholder or a domestic pass-through owner in a domestic pass-through entity that is a section 958(a) U.S. shareholder, but not a domestic pass-through entity itself). Under the proposed regulations, the section 965(h) election may be revoked only by paying the full amount of the unpaid section 965(h) net tax liability. *See* proposed § 1.965–7(b)(1). The proposed regulations also provide that a section 965(h) election is made with respect to the section 965(h) net tax liability of a person, which is the person’s total net tax liability under section 965 reduced by the aggregate amount of the person’s section 965(i) net tax liabilities, if any, with respect to which elections under section 965(i) are effective. *See* proposed § 1.965–7(g)(4).

##### **1. Underpayment of an Installment**

As noted in Part II.K of the Background section of this preamble, section 965(h)(3) provides that an addition to tax for failure to timely pay an installment required under section 965(h) is an acceleration event with respect to the unpaid portion of the remaining installments. Section 965(h)(4) provides that if a taxpayer has made an election under section 965(h), and subsequently a deficiency is assessed with respect to the taxpayer’s net tax liability for purposes of section 965(h), then the amount of the deficiency will be prorated among the installments.

Comments requested clarification regarding whether the underpayment of an installment (including payment of the first installment that reflects a section 965(h) net tax liability lower than what is calculated on a tax return filed by the extended due date) would constitute an acceleration event under section 965(h)(3) or would result in the

proration under section 965(h)(4) of the difference between the section 965(h) net tax liability initially calculated and the subsequently determined section 965(h) net tax liability. The proposed regulations provide that if a person is assessed a deficiency with respect to the person's section 965(h) net tax liability, or the person timely files a return increasing the amount of its section 965(h) net tax liability above the amount taken into account in the payment of the first installment, or the person files an amended return increasing the amount of its section 965(h) net tax liability, the deficiency or additional amount will be prorated among the installments under section 965(h)(4). This proration rule does not apply if the deficiency or additional liability is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax, in which case, the proposed regulations clarify that the deficiency is payable on notice and demand. *See* proposed § 1.965-7(b)(1)(ii)(C).

A comment also requested guidance regarding whether an underpayment of the first installment would prevent a taxpayer from making an election under section 965(h). The proposed regulations provide that if a taxpayer makes a section 965(h) election and does not pay the correct amount for the first installment, and if the rule in the preceding paragraph applies to prorate the additional liability, the remaining installment payments due pursuant to the section 965(h) election will not be accelerated, and the taxpayer's section 965(h) election will not be affected. *See* proposed § 1.965-7(b)(1)(ii).

## 2. Acceleration Events

The proposed regulations provide that if a taxpayer makes a section 965(h) election, and subsequently an acceleration event described in section 965(h)(3) and proposed § 1.965-7(b)(3)(ii) occurs, the unpaid portion of all remaining installments of the taxpayer's section 965(h) net tax liability generally will be accelerated and due on the date of the event.

Proposed § 1.965-7(b)(3)(ii) lists the events treated as acceleration events for this purpose. As noted in Section II.K of the Background section of this preamble, acceleration events include an addition to tax for failure to timely pay an installment required under section 965(h), a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), a cessation of business by the taxpayer, or any similar circumstance. The proposed regulations identify circumstances similar to those referenced in section 965(h)(3).

Proposed § 1.965-7(b)(3)(ii)(B) provides that, in addition to a liquidation or sale of substantially all of the assets of a taxpayer, any exchange or other disposition of substantially all of the assets of a taxpayer constitutes an acceleration event. In addition, proposed § 1.965-7(b)(3)(ii)(D) provides that any event that results in a person no longer being a United States person (including, for example, a resident alien becoming a nonresident alien) is an acceleration event. Proposed § 1.965-7(b)(3)(ii)(E) provides that a person that was not a member of any consolidated group becoming a member of a consolidated group is treated as an acceleration event with respect to the person. Proposed § 1.965-7(b)(3)(ii)(F) provides that when a consolidated group ceases to exist, or otherwise no longer files a consolidated return, that constitutes an acceleration event.

A comment requested guidance specifying that the liquidation of a member of a consolidated group, other than the consolidated parent, would not constitute an acceleration event for purposes of section 965(h)(3). Because proposed § 1.965-8(e)(1) provides that all of the members of a consolidated group are treated as a single person for purposes of the section 965(h) election, a liquidation of one member of the group would not constitute an acceleration event for purposes of section 965(h)(3) and proposed § 1.965-7(b).

The proposed regulations provide an exception (the "eligible section 965(h) transferee exception") pursuant to which the acceleration provisions of section 965(h)(3) and proposed § 1.965-7(b)(3)(ii) do not apply (such that the unpaid portion of all remaining installments will not be due as of the date specified therein) to a person with respect to which an acceleration event occurs if the requirements described in proposed § 1.965-7(b)(3)(iii)(A)(1) (describing the acceleration events eligible for this exception) and (2) (setting forth the terms of a required transfer agreement) are satisfied.

Generally, acceleration events eligible for this exception include (i) liquidations, sales, exchanges, or other dispositions of substantially all of the assets of a person (with the exception of, in the case of an individual, by reason of death, and with special rules applying in the case of a consolidated group), (ii) a corporation that was not a member of any consolidated group becoming a member of a consolidated group, and (iii) a consolidated group ceasing to exist by reason of acquisition and immediately joining another consolidated group. In each case, the

exception applies only to the extent that the person with respect to which an acceleration event occurs (an "eligible section 965(h) transferor") and an eligible section 965(h) transferee (generally, a United States person that is not a domestic pass-through entity and that satisfies certain requirements set forth in the proposed regulations) enter into a transfer agreement described in proposed § 1.965-7(b)(3)(iii)(B).

Generally, a transfer agreement must include various acknowledgments, representations, and information, including an agreement by the eligible section 965(h) transferee to assume the liability of the eligible section 965(h) transferor for any unpaid installment payments of the eligible section 965(h) transferor under section 965(h); an agreement that the eligible section 965(h) transferee agrees to comply with all of the conditions and requirements of section 965(h) and proposed § 1.965-7(b), as well as any other applicable requirements in the section 965 regulations; a representation that the eligible section 965(h) transferee is able to make the remaining payments required under section 965(h) and proposed § 1.965-7(b) with respect to the section 965(h) net tax liability being assumed; and, if the eligible section 965(h) transferor continues to exist immediately after the acceleration event, an acknowledgement that the eligible section 965(h) transferor and any successor to the eligible section 965(h) transferor will remain jointly and severally liable for any unpaid installment payments of the eligible section 965(h) transferor under section 965(h), including, if applicable, under § 1.1502-6. *See* proposed § 1.965-7(b)(3)(iii)(B)(4). The proposed regulations also provide procedural rules regarding the completion and submission of a transfer agreement, as well as rules relating to the Commissioner's review of such agreements. *See generally* proposed § 1.965-7(b)(3)(iii)(B) and (C).

## 3. Election Mechanics

Section 965(h)(5) provides that a section 965(h) election must be made no later than the due date (taking into account extensions, if any) for the return for the taxable year in which the taxpayer has the section 965(a) inclusions to which the section 965(h) net tax liability is attributable and must be made in the manner prescribed by the Secretary. A comment requested that taxpayers with section 965(a) inclusions be treated as having made a section 965(h) election by default. The Treasury Department and the IRS decline to adopt this comment because the statute

provides for an affirmative election, and the proposed regulations provide an extended period in which to make it. Under proposed § 1.965-7(b)(2)(ii), a section 965(h) election must be made no later than the due date taking into account extensions, if any, or any additional time that would have been granted if the person had made an extension request, without regard to whether an extension request was made. The election is made by attaching a statement, signed under penalties of perjury, to the taxpayer's return for the relevant taxable year including the taxpayer's name, taxpayer identification number, total net tax liability under section 965, section 965(h) net tax liability, section 965(i) net tax liability with respect to which a section 965(i) election is effective (if applicable), and anticipated amounts of each installment. Proposed § 1.965-7(b)(2)(iii).

#### 4. Application to Non-Chapter 1 Taxes

Comments requested that the Treasury Department and the IRS provide that tax imposed under section 1411 on section 965(a) inclusions be payable in installments under section 965(h). However, because the definition of net income tax in section 965(h)(6)(B) refers to credits allowed under subparts A, B, and D of part IV of subchapter A of chapter 1 of subtitle A of the Code, the Treasury Department and the IRS have determined that section 965(h) applies only with respect to tax imposed under subchapter A of chapter 1 of subtitle A of the Code. Accordingly, elections may not be made under section 965(h) to pay tax imposed under other subchapters or chapters (such as, for example, the taxes imposed under sections 1411 and 4940) in eight installments. *See also* sections 55(a)(2) and 26(b)(2) (excluding the minimum tax under section 55 from the definition of regular tax).

#### D. Section 965(i) Election

As discussed in Part II.L of the Background section of this preamble, section 965(i) provides that a shareholder of an S corporation that is itself a United States shareholder of a DFIC may elect to defer payment of its net tax liability under section 965 with respect to such S corporation until the shareholder's taxable year which includes a triggering event with respect to such liability. The proposed regulations provide guidance regarding how an S corporation shareholder can make a section 965(i) election and, consistent with section 3.05(b) of Notice 2018-26, provide that any shareholder of an S corporation that is a United

States shareholder of a DFIC, whether it owns section 958(a) stock of such DFIC or not, may make the election. However, if the S corporation is not a United States shareholder with respect to a DFIC, the shareholders of that S corporation may not make a section 965(i) election for their shares of the section 965(a) inclusion or section 965(c) deduction with respect to that DFIC. *See* proposed § 1.965-7(c) and (g)(6).

Furthermore, the proposed regulations implement the statutory reporting requirements in section 965(i)(7) until the section 965(i) net tax liability is fully assessed. *See* proposed § 1.965-7(c)(6).

#### 1. Election Mechanics

The proposed regulations provide procedural rules regarding how an S corporation shareholder can make the section 965(i) election. A section 965(i) election must be made no later than the due date (taking into account extensions, if any) for the S corporation shareholder's return for the taxable year that includes the last day of the taxable year of the S corporation in which the S corporation has a section 965(a) inclusion to which the shareholder's section 965(i) net tax liability is attributable by attaching a statement, signed under penalties of perjury, to its return for that year. The statement must include the shareholder's name, taxpayer identification number, the name and taxpayer identification number of the S corporation with respect to which the election is made, the amount described in § 1.965-7(g)(10)(i)(A) as modified by § 1.965-1(f)-7(g)(6) for purposes of determining the section 965(i) net tax liability with respect to the S corporation, the amount described in § 1.965-7(g)(10)(i)(B), and the section 965(i) net tax liability with respect to the S corporation. *See* proposed § 1.965-7(c)(2)(ii) and (iii).

#### 2. Triggering Events

The proposed regulations also provide rules concerning triggering events described in section 965(i)(2). An event will not be treated as a triggering event (such that a shareholder's section 965(i) net tax liability with respect to an S corporation will not be assessed as an addition to tax for the shareholder's taxable year that includes the triggering event) if the triggering event is the transfer of any share of stock of the S corporation by the shareholder (including by reason of death or otherwise), and the shareholder (an "eligible section 965(i) transferor") and an eligible section 965(i) transferee (a United States person that is not a

domestic pass-through entity) enter into a transfer agreement. *See generally* proposed § 1.965-7(c)(3)(iv); *see also* § 1.965-7(c)(4)(iv)(B)(4) (setting forth the required terms of a transfer agreement).

#### 3. Consent for Section 965(h) Election in the Event of a Triggering Event

The proposed regulations also provide rules for an S corporation shareholder to obtain the consent of the Secretary to make a section 965(h) election in the event of a triggering event that is a liquidation, sale, exchange, or other disposition of substantially all of the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, or the S corporation ceasing to exist. *See* proposed § 1.965-7(c)(3)(v)(D). To obtain consent, the shareholder intending to make the section 965(h) election must file the agreement described in proposed § 1.965-7(c)(3)(v)(D)(4) and must provide, with its timely-filed return for the taxable year during which the triggering event occurs (taking into account extensions, if any), the election statement for the section 965(h) election. *See* proposed § 1.965-7(c)(3)(v)(D)(2). For the required terms of the agreement, *see generally* proposed § 1.965-7(c)(3)(v)(D).

A comment requested guidance specifying that if an S corporation shareholder makes a section 965(i) election, the S corporation's income inclusion is not deferred, and the S corporation's AAA should be increased by the gross amount (and not the net amount after the application of the section 965(c) deduction). Because, by its terms, a section 965(i) election affects only the timing of assessment and payment of an S corporation shareholder's section 965(a) net tax liability and not the timing or amount of the section 965(a) inclusion of either the S corporation or the S corporation shareholder, the Treasury Department and the IRS have determined that it is not necessary that the proposed regulations provide this additional guidance. *See* Part V.D of this Explanation of Provisions section for a discussion of the consequences of section 965(a) inclusions and section 965(c) deductions for the AAA of an S corporation.

#### E. Section 965(m) Election

The proposed regulations provide procedural rules regarding how a REIT can make the section 965(m) election. A REIT makes a section 965(m) election by attaching a statement, signed under penalties of perjury, to its return for the taxable year in which it would

otherwise be required to include REIT section 965 amounts (as defined in proposed § 1.965–7(g)(2)) in gross income. The statement must include the REIT's name, taxpayer identification number, REIT section 965 amounts, and anticipated amounts of each portion of the REIT section 965 amounts to be included in each year. Proposed § 1.965–7(d)(3)(ii) and (iii). With respect to a REIT that has made the section 965(m) election, adjustments described in proposed § 1.965–2 to the E&P of any specified foreign corporations held by the REIT, and the basis of stock of a specified foreign corporation and other applicable property held by a REIT, are made as of the close of each year in which an installment is included in the gross income of the REIT. A comment requested that RICs also be allowed to make a similar election to include any amount required to be taken into account under section 951(a)(1) by reason of section 965 in eight installments. This comment is not adopted because the statute provides the election solely for REITs.

For the reasons discussed in Part VIII.A of this Explanation of Provisions section, the proposed regulations also provide that no section 965(a) inclusions of a REIT are taken into account as gross income for purposes of section 856(c)(2) and (3), regardless of whether the REIT is a United States shareholder with respect to the DFIC with respect to which it has a section 965(a) inclusion. See section 965(m)(1)(A) and proposed § 1.965–7(d)(6).

#### F. Section 965(n) Election

As discussed in Part II.N of the Background section of this preamble, section 965(n) provides that a United States shareholder of a DFIC may elect to exclude the amount described in section 965(n)(2) from the determination of the amount of the NOL deduction under section 172 of such shareholder for such taxable year or the amount of taxable income for such taxable year which may be reduced by NOL carryovers or carrybacks to such taxable year under section 172. The proposed regulations provide procedural rules regarding how a taxpayer may make the section 965(n) election, clarify the effect of the election, and provide that the election is irrevocable.

##### 1. Scope of Election

As discussed in section 3.05(d) of Notice 2018–26, comments have requested clarification regarding the scope of the section 965(n) election as a result of the use of the term “deduction” in section 965(n)(1)(A). An

NOL “deduction” for a taxable year generally refers to the amount of an NOL carried to such taxable year from a prior or subsequent year rather than the NOL arising from such year. Compare section 172(a) and (c). However, interpreting “deduction” in section 965(n)(1)(A) to refer to carryovers or carrybacks to the taxable year (and not the NOL for the taxable year) would cause that paragraph to be duplicative of section 965(n)(1)(B), which already provides that amounts described in section 965(n)(2) are disregarded for purposes of applying NOL carryovers or carrybacks to such taxable year under section 172. The Treasury Department and the IRS have determined that section 965(n)(1)(A) was intended to apply to a different set of losses than those to which section 965(n)(1)(B) applies. A comment also requested clarification regarding whether taxpayers could make the section 965(n) election for only a portion of their NOLs. The Treasury Department and the IRS have determined that the election was intended to apply to the NOL amount in its entirety. Accordingly, the proposed regulations provide that if a section 965(n) election is made for a taxable year, the election applies to NOLs for the taxable year for which the election is made as well as the NOL carryovers or carrybacks to such taxable year, each in their entirety. See proposed § 1.965–7(e)(1)(iii).

A comment also requested clarification regarding whether consolidated groups could make the section 965(n) election. The proposed regulations clarify that the section 965(n) election also applies to all components of the consolidated NOL deduction (as defined in § 1.1502–21(a)). *Id.*

##### 2. Election Mechanics

A person makes a section 965(n) election by attaching a statement, signed under penalties of perjury, to its return for the taxable year (taking into account extensions, if any) to which the election applies. Proposed § 1.965–7(e)(2)(ii). The statement must include the person's name, taxpayer identification number, the amounts described in section 965(n)(2)(A) and proposed § 1.965–7(e)(1)(ii)(A) and section 965(n)(2)(B) and proposed § 1.965–7(e)(1)(ii)(B), and the sum thereof. Proposed § 1.965–7(e)(2)(iii).

#### G. Election To Use Alternative Method for Calculation of Post-1986 Earnings and Profits

Under section 965(a) and (d)(3), a United States shareholder of a specified

foreign corporation must determine its accumulated post-1986 deferred foreign income as of either of the two E&P measurement dates (November 2, 2017, and December 31, 2017) by determining its post-1986 earnings and profits as of each of those dates. As discussed in section 3.02 of Notice 2018–13, it may be impractical for some taxpayers to determine the post-1986 earnings and profits of a specified foreign corporation as of the November 2, 2017, E&P measurement date because it does not fall on the last day of a month. Therefore, the proposed regulations provide that an election may be made to determine the post-1986 earnings and profits of a specified foreign corporation using the alternative method. See proposed § 1.965–7(f).

Under the alternative method, for a specified foreign corporation other than a specified foreign corporation with a 52–53-week taxable year (as described in § 1.441–2(a)(1)), the amount of its post-1986 earnings and profits as of the November 2, 2107, E&P measurement date equals the sum of (1) the specified foreign corporation's post-1986 earnings and profits as of October 31, 2017, and (2) the specified foreign corporation's “annualized earnings and profits amount.” For this purpose, the term “annualized earnings and profits amount” means the amount equal to the product of two (the number of days after October 31, 2017, and on or before the measurement date on November 2, 2017) and the “daily earnings amount” of the specified foreign corporation. The “daily earnings amount” of the specified foreign corporation is the post-1986 earnings and profits (including a deficit) of the specified foreign corporation as of the close of October 31, 2017, that were accumulated during the specified foreign corporation's taxable year that includes October 31, 2017, divided by the number of days that have elapsed in that taxable year as of the close of October 31, 2017. A specified foreign corporation that does not have a 52–53-week taxable year may not use the alternative method to determine its post-1986 earnings and profits as of the December 31, 2017, measurement date. See proposed § 1.965–7(f)(1), (3), and (4).

For a specified foreign corporation that has a 52–53-week taxable year, an election to use the alternative method applies to both measurement dates, in each case determining the post-1986 earnings and profits consistent with the method described in the previous paragraph as of the closest end of a fiscal month to each measurement date. For example, if the closest end of a fiscal month of a specified foreign

corporation that has a 52–53-week taxable year occurs after a measurement date, the annualized earnings amount is subtracted from (rather than added to) the post-1986 earnings and profits of the specified foreign corporation as of the fiscal month end. See proposed § 1.965–7(f)(2), (3), and (4). See proposed § 1.965–7(f)(5) for details on how to make the election.

A comment requested that individuals be permitted to calculate post-1986 earnings and profits by prorating E&P for the November 2, 2017, measurement date based on year-end numbers. This comment is not adopted. Allowing individuals to use year-end numbers and prorate to November 2, 2017, would allow taxpayers to base their post-1986 earnings and profits for both dates on the E&P as of a single date, contrary to the intent of the two E&P measurement dates in the statute.

### IX. Affiliated Groups (Including Consolidated Groups)

Proposed § 1.965–8 provides rules for applying section 965 and the section 965 regulations to members of an affiliated group (as defined in section 1504(a)), including members of a consolidated group (as defined in § 1.1502–1(h)).

#### A. Treatment of Consolidated Groups

##### 1. Treated as a Single United States Shareholder

The proposed regulations provide that all members of a consolidated group that are section 958(a) U.S. shareholders of a specified foreign corporation are treated as a single section 958(a) U.S. shareholder for purposes of section 965(b) and proposed § 1.965–1(b)(2), and that all members of a consolidated group are treated as a single person for purposes of paragraphs (h), (k), and (n) of section 965 and proposed § 1.965–7. See proposed § 1.965–8(e). Thus, for example, the determination of whether the sale of assets by a member of a consolidated group to a non-member would constitute a sale of substantially all of the assets of the taxpayer for purposes of causing an acceleration event under section 965(h)(3) and proposed § 1.965–7(b)(3) takes into account all of the assets of the consolidated group, which for purposes of this determination, includes all of the assets of each consolidated group member (but generally does not include the stock of another consolidated group member).

This rule does not apply to treat all members of a consolidated group as a single section 958(a) U.S. shareholder or single person, as applicable, for

purposes of determining the amount of any member's inclusion under section 951 (including a section 965(a) inclusion), any member's section 965(c) deduction, or any purpose other than those specifically listed in proposed § 1.965–8(e)(1). The proposed regulations also clarify that for purposes of computing the foreign income taxes deemed paid with respect to a section 965(a) inclusion, the foreign income taxes deemed paid must be computed on a separate member basis. Therefore, a domestic corporation is not deemed to pay any foreign income taxes with respect to a section 965(a) inclusion from a foreign corporation that is not a member of a qualified group with respect to the domestic corporation, even if other members of the domestic corporation's consolidated group qualify to compute deemed paid credits with respect to that foreign corporation. Sections 960(a)(3), 902(b).

##### 2. Aggregate Foreign Cash Position of a Member of a Consolidated Group

For purposes of computing a member's section 965(c) deduction, the member's aggregate foreign cash position generally is determined by reference to its pro rata share of the consolidated group's aggregate foreign cash position as a whole. Specifically, the proposed regulations provide that the aggregate foreign cash position with respect to a section 958(a) U.S. shareholder that is a member of a consolidated group equals the aggregate section 965(a) inclusion amount of the section 958(a) U.S. shareholder multiplied by the group cash ratio of the consolidated group. For this purpose, the term "group cash ratio" means the ratio of the consolidated group aggregate foreign cash position (generally, the sum of the aggregate foreign cash positions of the members of a consolidated group) to the sum of the aggregate section 965(a) inclusion amounts of all members of the consolidated group. See proposed § 1.965–8(e)(3), (f)(4), and (f)(8).

##### 3. Adjustments to E&P and Stock Basis

As described in section 3.04 of Notice 2018–07, the proposed regulations indicate that the regulations under § 1.1502–32 provide for adjustments to the basis of the stock of each member of the consolidated group. See proposed § 1.965–8(d)(2).

#### B. Affiliated Groups

The proposed regulations include guidance regarding the application of section 965(b)(5) to determine the section 965(a) inclusion amounts of a member of an affiliated group. Proposed § 1.965–8(b) applies when, after the

application of the rules in proposed § 1.965–1(b)(2) (which generally implements the operative rule of section 965(b)(1)), a section 958(a) U.S. shareholder is both an E&P net surplus shareholder and a member of an affiliated group in which not all members are members of the same consolidated group. When proposed § 1.965–8(b) applies, the U.S. dollar amount of a section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of a DFIC is reduced (but not below zero) by the DFIC's allocable share of the section 958(a) U.S. shareholder's applicable share of the affiliated group's aggregate unused E&P deficit. The proposed regulations include rules and definitions for determining, respectively, a DFIC's allocable share and a section 958(a) U.S. shareholder's applicable share of an affiliated group's aggregate unused E&P deficit. See proposed § 1.965–8(f)(2) and (3).

For purposes of this rule, if some but not all members of an affiliated group are properly treated as members of a consolidated group, then the consolidated group is treated as a single member of the affiliated group. Proposed § 1.965–8(b)(2).

#### C. Source of Aggregate Unused E&P Deficits

Proposed § 1.965–8(c) provides guidance for designating the source of an aggregate unused E&P deficit of an affiliated group that is not a consolidated group when, generally, the amount of the affiliated group's aggregate unused E&P deficit exceeds the aggregate section 965(a) inclusion amounts of E&P net surplus shareholders of the affiliated group determined without regard to the application of section 965(b)(5) and proposed § 1.965–8(b)). Generally, when proposed § 1.965–8(c) applies, each member of an affiliated group that is an E&P net deficit shareholder must designate by maintaining in its books and records a statement (identical to the statement maintained by all other such members of the affiliated group) setting forth the portion of its excess aggregate foreign E&P deficit that is taken into account by one or more net E&P net surplus shareholders of the affiliated group.

If some but not all members of an affiliated group are properly treated as members of a consolidated group, then the consolidated group is treated as a single member of the affiliated group for purposes of this rule. Proposed § 1.965–8(c)(2).

## X. Application of Section 986(c)

The proposed regulations provide that, for purposes of section 986(c), foreign currency gain or loss with respect to distributions of section 965(a) previously taxed earnings and profits is determined based on movements in the exchange rate between December 31, 2017, and the date on which such E&P are actually distributed. See proposed § 1.986(c)-1(a).

Consistent with section 3.05 of Notice 2018-07, the proposed regulations also provide that any gain or loss recognized under section 986(c) with respect to distributions of section 965(a) previously taxed earnings and profits is reduced in the same proportion as the reduction by a section 965(c) deduction amount of the section 965(a) inclusion amount that gave rise to such section 965(a) previously taxed earnings and profits, consistent with the statute and other indicia of congressional intent. See H.R. Rep. No. 115-466, at 620 (2017) (Conf. Rep.), and proposed § 1.986(c)-1(b).

Because section 965(b) previously taxed earnings and profits are not included in gross income under section 951(a)(1), the Treasury Department and the IRS have determined it would not be appropriate to apply section 986(c) with respect to distributions of those E&P. Therefore, proposed § 1.986(c)-1(c) provides that section 986(c) does not apply with respect to distributions of section 965(b) previously taxed earnings and profits.

## XI. Other Comments

### A. Repeal of Section 958(b)(4)

Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year, and for the taxable years of United States shareholders in which or with which such taxable years of the foreign corporations end, the Act repealed section 958(b)(4). Before repeal, section 958(b)(4) provided that subparagraphs (A), (B), and (C) of section 318(a)(3) were not to be applied to consider a United States person to own stock which is owned by a person who is not a United States person. As discussed in Part III.B of the Background section of this preamble, the subparagraphs of section 318(a)(3) generally attribute stock owned by a person to a partnership, estate, trust, or corporation in which such person has an interest (so-called “downward” attribution).

Multiple comments requested guidance be issued addressing the repeal of section 958(b)(4). This issue is beyond the scope of the proposed regulations.

However, consistent with section 5.02 of Notice 2018-13, the instructions to Form 5471 will be amended to provide an exception from certain filing requirements for a United States person that is a United States shareholder with respect to a CFC or other specified foreign corporation if no United States shareholder (including the United States person) owns, within the meaning of section 958(a), stock of the CFC or other specified foreign corporation, and the foreign corporation is a CFC or specified foreign corporation solely because a United States person is considered to own the stock of the CFC or other specified foreign corporation owned by a foreign person under section 318(a)(3). Consistent with section 6 of Notice 2018-13 and section 7 of Notice 2018-26, taxpayers may rely on this exception with respect to the last taxable year of a foreign corporation beginning before January 1, 2018, and each subsequent year of the foreign corporation, and for the taxable years of a United States shareholder in which or with which these taxable years of the foreign corporation end.

### B. Reporting and Filing

#### 1. Section 965 Reporting and Filing Requirements

The proposed regulations provide guidance regarding filing and reporting with respect to section 965(h) elections, section 965(i) elections, section 965(m) elections, and section 965(n) elections, as well as the election to use the alternative method to calculate post-1986 earnings and profits. In addition, the relevant forms and instructions will be updated, as necessary, for taxpayers to properly report amounts under section 965 and the proposed regulations. For the 2017 tax year, instructions for how and when to properly report section 965-related amounts and file returns reporting such amounts, as well as instructions for how and when to make payments with respect to a net tax liability under section 965, were provided in Frequently Asked Questions (FAQs) that are available at the IRS website. The FAQs were posted on March 13, 2018, and updated on April 13, 2018, and June 4, 2018.

#### 2. Extensions

Comments requested an extension of time for reporting and paying section 965-related amounts and an extension of time for making the section 965(h) election. The statute provides for an extended time to file returns reporting section 965-related amounts and to make applicable elections. In addition,

with the section 965(h) election, the statute provides a method for taxpayers to delay payment of the total net tax liability under section 965. Furthermore, as discussed in Part VIII.C.3 of this Explanation of Provisions section, the proposed regulations provide that a taxpayer eligible to make a section 965(h) election may make the election on its timely-filed return taking into account extensions, if any, or any additional time that would have been granted if the person had made an extension request. In addition, as described in section 3.05(e) of Notice 2018-26, the proposed regulations provide that for a person who is a specified individual (as defined in proposed § 1.965-7(g)(9)) for the year within which an installment payment would be required to be made who makes a section 965(h) election and who otherwise receives an extension of time to file and pay under § 1.6081-5(a)(5) or (6), the due date for an installment payment will be the fifteenth day of the sixth month following the close of the prior taxable year, regardless of whether the person was a specified individual for the year of the person's section 965(a) inclusion. See proposed § 1.965-7(b)(1)(iii)(B). Moreover, the IRS has announced relief from additions to tax (and related acceleration events under section 965(h)(3)) for certain individual filers that do not timely pay their first installment of tax due with respect to the 2017 tax year under section 965(h). For more information, see “Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns,” Q&A 16, available at <https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns>. Thus, comments requesting additional extensions are not adopted.

### C. Individuals

#### 1. In General

Numerous comments were received requesting guidance exempting individuals from the application of section 965. The statute is clear that section 965 applies to all United States shareholders. In addition, the Conference Report makes clear that section 965 applies to individuals as well as corporate shareholders by providing, “In contrast to the participation exemption deduction [in section 245A] available only to domestic corporations that are U.S. shareholders under subpart F, the transition rule applies to all U.S. shareholders.” H.R. Rep. No. 115-466, at 606 (2017) (Conf. Rep.). Because the statute and legislative



history are clear that section 965 was intended to apply to all United States shareholders, including individuals, the Treasury Department and the IRS have determined that providing the requested relief is not appropriate.

## 2. Rates of Tax on Section 965(a) Inclusions

Comments also requested that guidance be provided changing the application of the participation exemption to individuals. As discussed in Part II.E of the Background section of this preamble, the amount of the participation exemption depends on the application of the United States shareholder's 8 percent rate equivalent percentage (as defined in section 965(c)(2)(A) and proposed § 1.965-1(f)(2)) and its 15.5 percent rate equivalent percentage (as defined in section 965(c)(2)(B) and proposed § 1.965-1(f)(4)). Both the 8 percent rate equivalent percentage and the 15.5 percent rate equivalent percentage are based off of the highest rate of tax specified in section 11, which is applicable to corporations. As a result, when the participation exemption is calculated for individuals, the applicable rates of tax may not be 8 percent and 15.5 percent.

However, this result was anticipated by Congress. The Conference Report provides, "Individual U.S. shareholders, and the investors in U.S. shareholders that are pass-through entities generally can elect application of corporate rates for the year of inclusion." H.R. Rep. No. 115-466, at 620 (2017) (Conf. Rep.). As discussed in Part III of this Explanation of Provisions section, individuals may make an election under section 962 to have the tax imposed under chapter 1 on amounts that are included in the individual's gross income under section 951(a) with respect to a foreign corporation with respect to which it is a United States shareholder be equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. Accordingly, because of the availability of the section 962 election and Congress's express intent with respect to the rate equivalent percentages, these comments are not adopted.

## D. Determination of Aggregate Foreign Cash Position

### 1. Liquidity-Based Exceptions

A number of comments were received requesting guidance modifying the definition of a specified foreign corporation's cash position or the calculation of a United States shareholder's aggregate foreign cash

position. For example, comments requested guidance excluding certain assets from a specified foreign corporation's cash position, or otherwise providing special rules with respect to those assets, including (i) cash used, or intended to be used, to fund foreign acquisitions; (ii) blocked, restricted, or segregated cash; (iii) cash used, or to be used, to pay third-party payables within a specified period (for example, 12 months after a cash measurement date); (iv) obligations with respect to which there was an inclusion under section 956; (v) cash held in a fiduciary or trust capacity; (vi) cash held or attributable to an entity that is engaged in a regulated industry, such as life insurance; and (vii) cash pledged against defined liabilities as well as potential or contingent liabilities. In addition, comments requested exceptions for commodities representing inventory or supplies and stock of a publicly traded company in which the specified foreign corporation holds at least 10 percent of the stock, each of which is personal property of a type that is actively traded and for which there is an established financial market, and thus included in the cash position of a specified foreign corporation.

In general, these comments are premised on the view that an asset that otherwise would be included in the cash position of a specified foreign corporation should be excluded to the extent that the asset cannot be otherwise employed; that is, if the asset is not sufficiently "liquid." Although the legislative history describing a specified foreign corporation's cash position refers to earnings that are "liquid," neither the legislative history nor the statute indicates that the cash position of a specified foreign corporation should be determined by reference to an analysis of whether any particular asset should be considered a liquid asset. *See, e.g.,* Senate Committee on Finance, Explanation of the Bill, at 360-361 (November 22, 2017) ("The cash position of an entity consists of all cash, net accounts receivables, and the fair market value of similarly liquid assets, specifically including personal property that is actively traded on an established financial market . . . , government securities, certificates of deposit, commercial paper, and short-term obligations."). Instead, as the Conference Report notes, the statute includes a specific list of assets that are included in the cash position of a specified foreign corporation.

The Treasury Department and the IRS have determined that the definition of cash position in section 965(c)(3)(B) is

the best indication of what Congress believed was a liquid asset. Depending on the facts, any particular asset may be required to be used for a specific purpose, or a taxpayer may intend to retain the asset for a lengthy period of time. However, the Treasury Department and the IRS have determined that it would not be administrable to create individual regulatory exceptions to the statute in the absence of a statutory standard for liquidity because it would likely require introducing a facts-and-circumstances test that analyzes the liquidity of every asset, which would be difficult to administer. Furthermore, while some assets that would otherwise be treated as cash-equivalent assets could be excluded from a specified foreign corporation's cash position for being insufficiently liquid, other assets that are not treated as cash-equivalent assets but are liquid would need to be included in a specified foreign corporation's cash position. Accordingly, the proposed regulations do not introduce new regulatory exceptions to the definition of cash position. The Treasury Department and the IRS welcome comments with respect to the definition of cash position of a specified foreign corporation.

### 2. Other Modifications Requested to Statutory Rules

Comments also requested modifications to the rules regarding the calculation of a specified foreign corporation's cash position or a United States shareholder's aggregate foreign cash position, including requests that (i) accounts payable be allowed to offset both accounts receivable and other components of a specified foreign corporation's cash position; (ii) the pro rata share of cash held through a pass-through entity be limited to the amount of cash that a specified foreign corporation would have been entitled to on liquidation of the pass-through entity; (iii) the cash position be reduced by section 301(c) cash distributions by the specified foreign corporation when using the average of the aggregate cash positions on the first two cash measurement dates; and (iv) the cash position be reduced by undistributed previously taxed E&P. The Treasury Department and the IRS have determined that the statute is unambiguous as to how, in each of these circumstances, a specified foreign corporation's cash position or a United States shareholder's aggregate foreign cash position should be determined, such that it is unnecessary to provide guidance or to revise the operation of

the statute by regulation under these circumstances.

### 3. Notional Cash Pooling Arrangements

Comments requested that the proposed regulations provide that notional cash pooling arrangements are treated as creating intercompany receivables for purposes of section 965. The proposed regulations do not adopt this recommendation. The determination of whether transactions in a notional cash pooling arrangement are treated as occurring among participants in the arrangement, or between the participants and a third party, depends on the application of federal income tax principles. *Cf. Rev. Rul. 87-89, 1987-2 C.B. 195.*

### 4. Non-Corporate Entities Under Section 965(c)(3)(E)

A comment requested clarification regarding whether section 965(c)(3)(E), which treats a non-corporate entity held by a specified foreign corporation as a specified foreign corporation (if it would otherwise be a specified foreign corporation) for purposes of taking into account its cash position, applies to an entity that is disregarded as an entity separate from its owner for U.S. federal income tax purposes (“disregarded entity”). The Treasury Department and the IRS have determined that it is clear under existing law that the assets of a disregarded entity are considered as held directly by the disregarded entity’s owner, such that the rule in section 965(c)(3)(E) does not apply with respect to disregarded entities, and no specific rules addressing the application of section 965(c)(3)(E) are necessary. *See generally* § 301.7701-2(a).

#### E. Blocked Foreign Income

Comments requested that the proposed regulations provide rules with respect to income subject to certain exchange controls or other foreign legal restrictions. Generally, section 964(b) and § 1.964-2 (the blocked foreign income rules) provide that no part of the E&P of a CFC are included in the CFC’s E&P for purposes of sections 952 and 956 if it is established to the satisfaction of the Secretary that the E&P could not have been distributed by the CFC to United States shareholders that own the stock of the CFC due to currency or other foreign legal restrictions. Section 965(a) inclusion amounts are not, however, limited by section 952, such that the blocked foreign income rules do not affect the determination of such amounts. Comments requested that the proposed regulations adopt rules similar to the blocked foreign income rules for

purposes of section 965 by reducing the post-1986 earnings and profits of a specified foreign corporation by an amount equal to any amounts subject to restrictions on distributions by a specified foreign corporation.

The Treasury Department and the IRS have determined that it is not appropriate to provide rules similar to the blocked foreign income rules for purposes of computing post-1986 earnings and profits. Section 965(d)(3) expressly provides that the term post-1986 earnings and profits means E&P “computed in accordance with section 964(a) and 986,” giving rise to a clear inference that the principles of section 964(b) should not be given effect in computing post-1986 earnings and profits.

#### F. Additional Comments

Several other comments were received that did not pertain to section 965 or were otherwise outside the scope of the section 965 regulations. Some of those comments related to reporting and payment requirements and have been addressed in the FAQs that are available at the IRS website. Other comments that did not relate to the rules described in Notices 2018-07, 2018-17, or 2018-26 or that were outside the scope of this notice of proposed rulemaking are not addressed in this preamble. In addition, other comments were received after the proposed regulations had been substantially developed, such that the Treasury Department and the IRS did not have time to fully consider the comments. The Treasury Department and the IRS will include these comments in the administrative record for the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register** and fully consider the comments in connection with finalization of the proposed regulations.

### XII. Applicability Dates

Consistent with the applicability date of section 965, as amended by the Act, under section 7805(b)(2), the proposed regulations generally apply beginning the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a United States person, beginning the taxable year in which or with which such taxable year of the foreign corporation ends. Taxpayers may choose to apply the rules in proposed § 1.965-7 in their entirety to all tax years as if they were final regulations.

For the avoidance of doubt, proposed § 1.965-9(b) clarifies that the rules described in proposed §§ 1.965-4 apply to all foreign corporation and

shareholder taxable years described in proposed § 1.965-9(b), even if the relevant transaction, the effective date of a change in method of accounting or entity classification election, or specified payment occurred in a prior taxable year. This is because the proposed regulations affect only the tax consequences in taxable years described in proposed § 1.965-9(b) and do not affect any prior taxable year.

### Special Analyses

#### I. Regulatory Planning and Review

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. This proposed rule has been designated a “significant regulatory action” under section 3(f) of Executive Order 12866 and the Memorandum of Agreement (MOA), *Review of Tax Regulations under Executive Order 12866* (April 11, 2018). Accordingly, the proposed rule has been reviewed by the Office of Management and Budget. The Treasury Department requests comment on this designation.

#### A. Need for the Proposed Regulations

These regulations implement section 965 of the Internal Revenue Code as amended by the Act. The proposed regulations provide rules for determining the section 965(a) inclusion amount of a U.S. shareholder of a foreign corporation with deferred foreign income. The proposed regulations directly implement the statutory requirements. The Senate Committee on Finance stated with respect to section 965 that, “[t]o ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system, the Committee believes that it is appropriate to tax such earnings as if they had been repatriated under present law, but at a reduced rate. The Committee believes the tax on accumulated foreign earnings should apply without requiring an actual distribution of earnings, and further believes that the tax rate should take into account the liquidity of the accumulated earnings.” *See* Senate Committee on Finance, Explanation of the Bill, at 358 (November 22, 2017).

### B. Background

The international tax system prior to the Act created strong incentives for U.S. companies to keep their earnings and profits overseas, an action known as deferral, in order to avoid paying a sizeable residual U.S. tax. The Act ended deferral and the resulting “lockout effect.” It introduced a one-time tax on the stock of any deferred earnings and profits not previously taxed by the United States, regardless of whether those earnings are repatriated. Cash or cash-equivalent assets held by a foreign corporation result in a higher rate of repatriation tax than non-cash assets, such as plant, property, and equipment. The tax applies to the accumulated stock of deferred earnings and profits as of the last taxable year of a foreign corporation beginning before January 1, 2018, and with respect to United States shareholders, for taxable years in which or with which the taxable year of the foreign corporation ends; these details are important for understanding the economic impacts of the proposed regulations.

The proposed regulations address open questions regarding the application of section 965. They provide rules related to section 965 described in the three notices issued since December 22, 2017, with certain modifications, as well as additional guidance related to section 965. Specifically, the guidance provides general rules and definitions, as well as rules related to the determination and treatment of section 965(c) deductions, rules that disregard certain transactions in connection with section 965, rules related to foreign tax credits, rules regarding elections and payments, rules regarding the application of the section 965 regulations to affiliated groups, including consolidated groups, rules on dates of applicability, rules relating to section 962 elections, and rules regarding the application of section 986(c) in connection with section 965. These proposed regulations are designed to provide clarity and reduce unnecessary burdens on taxpayers, including by providing guidance on how to apply particular mechanical rules.

### C. Baseline

The baseline constitutes a world in which no regulations pertaining to section 965 had been promulgated, and thus taxpayers would have made decisions relevant to section 965 in the absence of specific guidance. The following qualitative analysis describes the anticipated impacts of the proposed regulations relative to the baseline.

### D. Consideration of Alternatives

For a discussion of the alternatives considered in the promulgation of the proposed regulations, see the Explanation of Provisions section of this preamble. For example, see Part II.B of the Explanation of the Provisions section for a discussion of the alternatives considered with respect to the determination of, among other things, post-1986 earnings and profits (E&P), cash measurement dates, and short-term obligations and Part IV.C.2 of the Explanation of Provisions section for a discussion of the alternatives considered to the rule permitting elective basis adjustments to the stock of certain deferred foreign income corporations and E&P deficit foreign corporations.

### E. Anticipated Benefits

In consultation with taxpayers, the Treasury Department determined that there are multiple instances throughout the statute where the transition tax may be artificially inflated because of double counting of cash and E&P due to multiple testing dates and chains of ownership. Double counting is inequitable because similarly situated taxpayers may differ in terms of the amounts of income that fall into the specific categories that may be subject to double counting. As a result of this analysis, the regulations aim to reduce double counting and produce more equitable tax outcomes across otherwise similarly situated taxpayers by: (1) Preventing double counting in computing the aggregate foreign cash position, for example by disregarding receivables and payables between related specified foreign corporations with a common U.S. shareholder; and (2) preventing double-counting and non-counting in the computation of deferred earnings arising from amounts paid or incurred between related parties between measurement dates.

Inequitable outcomes may also arise in the absence of the proposed regulations due to uncertainty and ambiguity over interpretation of the section 965 requirements. Absent these regulations, different parties would likely interpret the statute in different ways. Such disparate interpretations could lead similarly situated taxpayers to calculate their tax liability differently, an inequitable situation. The proposed regulations aim to reduce uncertainty and ambiguity by: (1) Providing that all members of a consolidated group that are U.S. shareholders of a specified foreign corporation are treated as a single U.S. shareholder; (2) introducing definitions of terminology used; (3)

coordinating foreign tax credit rules; (4) making explicit the process for making elections and paying the tax, and (5) providing dates of applicability.

### F. Anticipated Impacts on Administrative and Compliance Costs

Absent these regulations, different parties would likely interpret the statute in different ways. In addition to the impacts described above, different parties interpreting the statute in different ways implies increased administrative costs for the Internal Revenue Service and increased compliance costs for taxpayers while the inevitable disputes are dealt with through sub-regulatory guidance or resolved through litigation.

For a discussion of the one-time annual reporting burden associated with the statute see the Paperwork Reduction Act (PRA) section of this preamble, which provides further detail regarding the assumptions underlying these estimates. These estimates are that 100,000 respondents will require 5 hours per response for a total reporting burden of 500,000 hours. A valuation of the burden hours at \$95/hour leads to a PRA-based estimate of the reporting costs to taxpayers of \$47,500,000. This is a one-time paperwork burden associated with a one-time tax, and Treasury anticipates all paperwork burdens to be incurred within the next year. Any subsequent reporting (such as over the eight-year payment period) would be nominal burdens that implement payments calculated in the initial year. This estimate does not disaggregate the cost specifically due to the proposed regulations. The Treasury Department solicits comments on the assumptions and appropriateness of the methodology used to calculate the compliance costs imposed by the proposed regulations relative to the baseline.

### II. Executive Order 13771

This proposed rule is expected to be an Executive Order 13771 regulatory action. Details on the estimated costs of this proposed rule can be found in the rule’s economic analysis.

### III. Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Any burden on small entities in these regulations stems from the collection of information requirements in proposed §§ 1.965–2(d)(2)(ii)(B), 1.965–2(f)(2)(iii)(B), 1.965–3(b)(2), 1.965–3(c)(3), 1.965–4(b)(2)(i), 1.965–7(b)(2), 1.965–7(b)(3)(iii)(B), 1.965–

7(c)(2), 1.965–7(c)(3)(iv)(B), 1.965–7(c)(3)(v)(D), 1.965–7(c)(6)(i), 1.965–7(d)(3), 1.965–7(e)(2), 1.965–7(f)(5), and 1.965–8(c). It is hereby certified that these collection of information requirements will not have a significant economic impact on a substantial number of small entities. Accordingly, an initial regulatory flexibility analysis is not required. This certification is based on several facts. First, the average burden is five hours, which is minimal, particularly in comparison to other regulatory requirements related to owning stock in a specified foreign corporation. Second, the requirements apply only if a taxpayer chooses to make an election or rely on a favorable rule. Third, the collections of information apply to the owners of specified foreign corporations. Because it takes significant resources and investment for a foreign business to be operated in corporate form by a United States person, specified foreign corporations will infrequently be small entities. Moreover, because the collection of information requirements apply to the owners of specified foreign corporations rather than the specified foreign corporations themselves, a specified foreign corporation that was a small entity would not be subject to the collections of information. Fourth, the collection of information requirements in this regulation apply primarily to persons that are United States shareholders of specified foreign corporations. The ownership of sufficient stock in specified foreign corporations in order to constitute a United States shareholder generally entails significant resources and investment, such that businesses that are United States shareholders are generally not small businesses. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for a Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written 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 authors of the proposed regulations are Leni C. Perkins and Karen J. Cate of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in the development of the proposed regulations.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### 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 entries in numerical order to read as follows:

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

\* \* \* \* \*

Section 1.962–1 also issued under 26 U.S.C. 965(o).

Section 1.965–1 also issued under 26 U.S.C. 965(c)(3)(B)(iii)(V), 965(d)(2), 965(o), 989(c), and 7701(a).

Section 1.965–2 also issued under 26 U.S.C. 965(b)(3)(A)(ii), 965(o) and 961(a) and (b).

Section 1.965–3 also issued under 26 U.S.C. 965(c)(3)(D) and 965(o).

Section 1.965–4 also issued under 26 U.S.C. 965(c)(3)(F) and 965(o).

Sections 1.965–5 through 1.965–6 also issued under 26 U.S.C. 965(o) and 26 U.S.C. 902(c)(7) (as in effect on December 21, 2017).

Section 1.965–7 also issued under 26 U.S.C. 965(h)(3), 965(h)(5), 965(i)(2), 965(i)(8)(B), 965(m)(2)(A), 965(n)(3), and 965(o).

Section 1.965–8 also issued under 26 U.S.C. 965(o).

Section 1.965–9 also issued under 26 U.S.C. 965(o).

\* \* \* \* \*

Section 1.986(c)–1 also issued under 26 U.S.C. 965(o) and 26 U.S.C. 989(c).

\* \* \* \* \*

■ **Par. 2.** Section 1.962–1 is amended by:

■ 1. Revising paragraph (b)(1)(i).

■ 2. Redesignating paragraphs (b)(2)(iv)(a) and (b) as paragraph (b)(2)(iv)(A) and (B), respectively.

■ 3. Adding paragraph (d).

The revision and addition read as follows:

### § 1.962–1 Limitation of tax for individuals on amounts included in gross income under section 951(a).

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(i) *Determination of taxable income.*

The term *taxable income* means the excess of—

(A) The sum of—

(1) All amounts required to be included in his gross income under section 951(a) for the taxable year with respect to a foreign corporation of which he is a United States shareholder, including—

(i) His section 965(a) inclusion amounts (as defined in § 1.965–1(f)(38)); and

(ii) His domestic pass-through owner shares (as defined in § 1.965–1(f)(21)) of section 965(a) inclusion amounts with respect to deferred foreign income corporations (as defined in § 1.965–1(f)(17)) of which he is a United States shareholder; plus

(2) All amounts which would be required to be included in his gross income under section 78 for the taxable year with respect to the amounts referred to in paragraph (b)(1)(i)(A)(1) of this section if the shareholder were a domestic corporation; over

(B) The sum of his section 965(c) deduction amount (as defined in § 1.965–1(f)(42)) and his domestic pass-through owner shares of section 965(c) deduction amounts corresponding to the amounts referred to in paragraph (b)(1)(i)(A)(1)(ii) of this section for the taxable year, but not any other deductions or amounts.

\* \* \* \* \*

(d) *Applicability dates.* Paragraph (b)(1)(i) of this section applies beginning the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a United States person, for the taxable year in which or with which such taxable year of the foreign corporations ends.

■ **Par. 3.** Section 1.962–2 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

### § 1.962–2 Election of limitation of tax for individuals.

(a) *Who may elect.* The election under section 962 may be made only by an individual (including a trust or estate) who is a United States shareholder (including an individual who is a United States shareholder because, by reason of section 958(b), he is considered to own stock of a foreign corporation owned (within the meaning of section 958(a)) by a domestic pass-

through entity (as defined in § 1.965–1(f)(19)).

\* \* \* \* \*

(d) *Applicability dates.* Paragraph (a) of this section applies beginning the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a United States person, for the taxable year in which or with which such taxable year of the foreign corporations ends.

■ **Par. 4.** Section 1.965–0 is added to read as follows:

**§ 1.965–0 Outline of section 965 regulations.**

This section lists the headings for §§ 1.965–1 through 1.965–9.

§ 1.965–1 *Overview, general rules, and definitions.*

- (a) Overview.
  - (1) In general.
  - (2) Scope.
  - (b) Section 965(a) inclusion amounts.
    - (1) Inclusion of the pro rata share of the section 965(a) earnings amount.
    - (2) Reduction by the allocable share of the aggregate foreign E&P deficit.
  - (c) Section 965(c) deduction amounts.
  - (d) Treatment of specified foreign corporation as a controlled foreign corporation.
  - (e) Special rule for certain controlled domestic partnerships.
    - (1) In general.
    - (2) Definition of a controlled domestic partnership.
  - (f) Definitions.
    - (1) 8 percent rate amount.
    - (2) 8 percent rate equivalent percentage.
    - (3) 15.5 percent rate amount.
    - (4) 15.5 percent rate equivalent percentage.
    - (5) Accounts payable.
    - (6) Accounts receivable.
    - (7) Accumulated post-1986 deferred foreign income.
    - (8) Aggregate foreign cash position.
    - (9) Aggregate foreign E&P deficit.
    - (10) Aggregate section 965(a) inclusion amount.
    - (11) Allocable share.
    - (12) Bona fide hedging transaction.
    - (13) Cash-equivalent asset.
    - (14) Cash-equivalent asset hedging transaction.
    - (15) Cash measurement dates.
    - (16) Cash position.
      - (i) General rule.
      - (ii) Fair market value of cash-equivalent assets.
      - (iii) Measurement of derivative financial instruments.
      - (iv) Translation of cash position amounts.
    - (17) Deferred foreign income corporation.
      - (i) In general.
      - (ii) Priority rule.
    - (18) Derivative financial instrument.
    - (19) Domestic pass-through entity.
    - (20) Domestic pass-through owner.
    - (21) Domestic pass-through owner share.
    - (22) E&P deficit foreign corporation.
      - (i) In general.
      - (ii) Determination of deficit in post-1986 earnings and profits.

- (23) E&P measurement dates.
- (24) Final cash measurement date.
- (25) First cash measurement date.
- (25) Inclusion year.
- (26) Net accounts receivable.
- (28) Pass-through entity.
- (29) Post-1986 earnings and profits.
  - (i) General rule.
  - (ii) Foreign income taxes.
  - (iii) Deficits in earnings and profits.
- (30) Pro rata share.
- (31) Second cash measurement date.
- (32) Section 958(a) stock.
- (33) Section 958(a) U.S. shareholder.
- (34) Section 958(a) U.S. shareholder inclusion year.
- (35) Section 965 regulations.
- (36) Section 965(a) earnings amount.
- (37) Section 965(a) inclusion.
- (38) Section 965(a) inclusion amount.
- (39) Section 965(a) previously taxed earnings and profits.
  - (40) Section 965(b) previously taxed earnings and profits.
  - (41) Section 965(c) deduction.
  - (42) Section 965(c) deduction amount.
  - (43) Short-term obligation.
  - (44) Specified E&P deficit.
  - (45) Specified foreign corporation.
    - (i) General rule.
    - (ii) Special attribution rule.
    - (iii) Passive foreign investment companies.
  - (46) Spot rate.
  - (47) United States shareholder.
  - (g) Examples.

§ 1.965–2 *Adjustments to earnings and profits and basis.*

- (a) Scope.
- (b) Determination of and adjustments to earnings and profits in the last taxable year of a specified foreign corporation that begins before January 1, 2018, for purposes of applying sections 959 and 965.
  - (c) Adjustments to earnings and profits by reason of section 965(a).
  - (d) Adjustments to earnings and profits by reason of section 965(b).
    - (1) Adjustments to earnings and profits described in section 959(c)(2) and (c)(3) of deferred foreign income corporations.
    - (2) Adjustments to earnings and profits described in section 959(c)(3) of E&P deficit foreign corporations.
      - (i) Increase in earnings and profits by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit.
        - (A) In general.
        - (B) Reduction of a qualified deficit.
      - (ii) Determination of portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit taken into account.
        - (A) In general.
        - (B) Designation of portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit taken into account.
      - (e) Adjustments to basis by reason of section 965(a).
        - (1) General rule.
        - (2) Section 962 election.
      - (f) Adjustments to basis by reason of section 965(b).
        - (1) In general.
        - (2) Election to make adjustments to basis to account for the application of section 965(b).

- (i) In general.
- (ii) Basis adjustments.
  - (A) Increase in basis with respect to a deferred foreign income corporation.
  - (B) Reduction in basis with respect to an E&P deficit foreign corporation.
  - (C) Section 962 election.
    - (iii) Rules regarding the election.
      - (A) Consistency requirement.
      - (B) Making of making election.
    - (1) Timing.
      - (i) In general.
      - (ii) Transition rule.
    - (2) Election statement.
    - (g) Gain reduction rule.
      - (1) Reduction in gain recognized under section 961(b)(2) by reason of distributions attributable to section 965 previously taxed earnings and profits in the inclusion year.
        - (i) In general.
        - (ii) Definition of section 965 previously taxed earnings and profits.
          - (2) Reduction in basis by an amount equal to the gain reduction amount.
        - (h) Rules of application for specified basis adjustments.
          - (1) Timing of basis adjustments.
          - (2) Netting of basis adjustments.
          - (3) Gain recognition for reduction in excess of basis.
          - (4) Adjustments with respect to each share.
            - (i) Section 958(a) stock.
            - (ii) Applicable property.
          - (5) Stock or property for which adjustments are made.
            - (i) In general.
            - (ii) Special rule for an interest in a foreign pass-through entity.
              - (i) Definitions.
                - (1) Applicable property.
                - (2) Foreign pass-through entity.
                - (3) Property.
              - (j) Examples.

§ 1.965–3 *Section 965(c) deductions.*

- (a) Scope.
- (b) Rules for disregarding certain assets for determining aggregate foreign cash position.
  - (1) Disregard of certain obligations between related specified foreign corporations.
  - (2) Disregard of other assets upon demonstration of double-counting.
  - (3) Examples.
  - (c) Determination of aggregate foreign cash position for a section 958(a) U.S. shareholder inclusion year.
    - (1) Single section 958(a) U.S. shareholder inclusion year.
    - (2) Multiple section 958(a) U.S. shareholder inclusion years.
      - (i) Allocation to first section 958(a) U.S. shareholder inclusion year.
      - (ii) Allocation to succeeding section 958(a) U.S. shareholder inclusion years.
    - (3) Estimation of aggregate foreign cash position.
    - (4) Examples.
    - (d) Increase of income by section 965(c) deduction of an expatriated entity.
      - (1) In general.
      - (2) Definition of expatriated entity.
      - (3) Definition of surrogate foreign corporation.
        - (e) Section 962 election.
          - (1) In general.
          - (2) Example.

(f) Treatment of section 965(c) deduction under certain provisions of the Internal Revenue Code.

(1) Section 63(d).

(2) Sections 705, 1367, and 1368.

(i) Adjustments to basis

(ii) S corporation accumulated adjustments account.

(iii) Example.

(3) Section 1411.

(4) Section 4940.

(g) Domestic pass-through entities.

§ 1.965-4 *Disregard of certain transactions.*

(a) Scope.

(b) Transactions undertaken with a principal purpose of changing the amount of a section 965 element.

(1) General rule.

(2) Presumptions and exceptions for the application of the general rule.

(c) Disregard of certain changes in method of accounting and entity classification elections.

(1) Changes in method of accounting.

(2) Entity classification elections.

(d) Definition of a section 965 element.

(e) Rules for applying paragraphs (b) and (c) of this section.

(1) Determination of whether there is a change in the amount of a section 965 element.

(2) Treatment of domestic pass-through owners as United States shareholders.

(f) Disregard of certain transactions occurring between E&P measurement dates.

(1) Disregard of specified payments.

(2) Definition of specified payment.

(3) Definition of tentative E&P measurement date.

(g) Examples.

§ 1.965-5 *Allowance of credit or deduction for foreign income taxes.*

(a) Scope.

(b) Rules for foreign income taxes paid or accrued.

(c) Rules for foreign income taxes treated as paid or accrued.

(1) Disallowed credit.

(i) In general.

(ii) Foreign income taxes deemed paid under section 960(a)(3) (as in effect on December 21, 2017).

(iii) Foreign income taxes deemed paid under section 960(b) (as applicable to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States persons in which or with which such taxable years of foreign corporations end).

(2) Disallowed deduction.

(3) Coordination with section 78.

(i) In general.

(ii) Domestic corporation that is a domestic pass-through owner.

(d) Applicable percentage.

(1) In general.

(2) Applicable percentage for domestic pass-through owners.

§ 1.965-6 *Computation of foreign income taxes deemed paid and allocation and apportionment of deductions.*

(a) Scope.

(b) Computation of foreign incomes taxes deemed paid.

(c) Section 902 fraction.

(1) In general.

(2) Dividend or inclusion in excess of post-1986 undistributed earnings.

(3) Treatment of adjustment under section 965(b)(4)(B).

(d) Allocation and apportionment of deductions.

§ 1.965-7 *Elections and payment rules.*

(a) Scope.

(b) Section 965(h) election.

(1) In general.

(i) Amount of installments.

(ii) Increased installments due to a deficiency or a timely filed or amended return.

(A) In general.

(B) Timing.

(C) Exception for negligence, intentional disregard, or fraud.

(iii) Due date of installments.

(A) In general.

(B) Extension for specified individuals.

(2) Manner of making election.

(i) Eligibility.

(ii) Timing.

(iii) Election statement.

(3) Acceleration of payment.

(i) Acceleration.

(ii) Acceleration events.

(iii) Eligible section 965(h) transferee exception.

(A) In general.

(1) Requirement to have a covered acceleration event.

(2) Requirement to enter into a transfer agreement.

(B) Transfer agreement.

(1) Eligibility.

(2) Filing requirements.

(i) In general.

(ii) Transition rule.

(3) Signature requirement.

(4) Terms of agreement.

(5) Consolidated groups.

(C) Consent of Commissioner.

(1) In general.

(2) Material misrepresentations and omissions.

(D) Effect of assumption.

(1) In general.

(2) Eligible section 965(h) transferor liability.

(E) Qualifying consolidated group member transaction.

(1) Definition of qualifying consolidated group member transaction.

(2) Definition of qualified successor.

(3) Departure of multiple members of a consolidated group.

(c) Section 965(i) election.

(1) In general.

(2) Manner of making election.

(i) Eligibility.

(ii) Timing.

(iii) Election statement.

(3) Triggering events.

(i) In general.

(ii) Triggering events.

(iii) Partial transfers.

(iv) Eligible section 965(i) transferee exception.

(A) In general.

(1) Requirement to have a covered triggering event.

(2) Requirement to enter into a transfer agreement.

(B) Transfer agreement.

(1) Eligibility.

(2) Filing requirements.

(i) In general.

(ii) Transition rule.

(3) Signature requirement.

(4) Terms of agreement.

(C) Consent of Commissioner.

(1) In general.

(2) Material misrepresentations and omissions.

(D) Effect of assumption.

(1) In general.

(2) Eligible section 965(i) transferor liability.

(v) Coordination with section 965(h) election.

(A) In general.

(B) Timing for election.

(C) Due date for installment.

(D) Limitation.

(1) In general.

(2) Manner of obtaining consent.

(i) In general.

(ii) Transition rule.

(3) Signature requirement.

(4) Terms of agreement.

(5) Consent of Commissioner.

(i) In general.

(ii) Material misrepresentations and omissions.

(4) Joint and several liability.

(5) Extension of limitation on collection.

(6) Annual reporting requirement.

(i) In general.

(ii) Failure to report.

(d) Section 965(m) election and special rule for real estate investment trusts.

(1) In general.

(2) Inclusion schedule for section 965(m) election.

(3) Manner of making election.

(i) Eligibility.

(ii) Timing.

(iii) Election statement.

(4) Coordination with section 965(h).

(5) Acceleration of inclusion.

(6) Treatment of section 965(a) inclusions of a real estate investment trust.

(e) Section 965(n) election.

(1) In general.

(i) General rule.

(ii) Applicable amount for section 965(n) election.

(iii) Scope of section 965(n) election.

(2) Manner of making election.

(i) Eligibility.

(ii) Timing.

(iii) Election statement.

(f) Election to use alternative method for calculating post-1986 earnings and profits.

(1) Effect of election for specified foreign corporations that do not have a 52-53-week taxable year.

(2) Effect of election for specified foreign corporations that have a 52-53-week taxable year.

(3) Computation of post-1986 earnings and profits using alternative method.

(4) Definitions.

(i) 52-53-week taxable year.

(ii) Annualized earnings and profits amount.

(iii) Daily earnings amount.

(iv) Notional measurement date.

(5) Manner of making election.

- (i) Eligibility.
- (ii) Timing.
- (iii) Election statement.
- (6) Examples.
- (g) Definitions.
- (1) Deferred net tax liability.
- (2) REIT section 965 amounts.
- (3) Section 965(h) election.
- (4) Section 965(h) net tax liability.
- (5) Section 965(i) election.
- (6) Section 965(i) net tax liability.
- (7) Section 965(m) election.
- (8) Section 965(n) election.
- (9) Specified individual.
- (10) Total net tax liability under section 965.

- (i) General rule.
- (ii) Net income tax.
- (iii) Foreign tax credits.

**§ 1.965-8 Affiliated groups (including consolidated groups).**

(a) Scope.

(b) Reduction of E&P net surplus shareholder's pro rata share of the section 965(a) earnings amount of a deferred foreign income corporation by the allocable share of the applicable share of the aggregate unused E&P deficit.

- (1) In general.
- (2) Consolidated group as part of an affiliated group.

(c) Designation of portion of excess aggregate foreign E&P deficit taken into account.

- (1) In general.
- (2) Consolidated group as part of an affiliated group.

(d) Adjustments to earnings and profits and stock basis.

(1) Affiliated groups that are not consolidated groups.

- (2) Consolidated groups.

(e) Treatment of a consolidated group as a single section 958(a) U.S. shareholder or a single person.

- (1) In general.
- (2) Limitation.
- (3) Determination of section 965(c) deduction amount.

- (f) Definitions.

(1) Aggregate unused E&P deficit.

(i) In general.

(ii) Reduction with respect to E&P net deficit shareholders that are not wholly owned by the affiliated group.

- (2) Allocable share.
- (3) Applicable share.

(4) Consolidated group aggregate foreign cash position.

- (5) E&P net deficit shareholder.
- (6) E&P net surplus shareholder.
- (7) Excess aggregate foreign E&P deficit.
- (8) Group cash ratio.
- (9) Group ownership percentage.
- (g) Examples.

**§ 1.965-9 Applicability dates.**

(a) In general.

(b) Applicability dates for rules disregarding certain transactions.

■ **Par. 5.** Section 1.965-1 is added to read as follows:

**§ 1.965-1 Overview, general rules, and definitions.**

(a) *Overview*—(1) *In general.* The section 965 regulations provide rules under section 965. This section provides general rules and definitions under section 965. Section 1.965-2 provides rules relating to adjustments to earnings and profits and basis to determine and account for the application of section 965 and a rule that limits the amount of gain recognized under section 961(b)(2) by reason of distributions attributable to section 965 previously taxed earnings and profits (as defined in § 1.965-2(g)(1)(ii)) in the inclusion year. Section 1.965-3 provides rules regarding the determination of section 965(c) deductions. Section 1.965-4 sets forth rules that disregard certain transactions for purposes of section 965. Sections 1.965-5 and 1.965-6 provide rules with respect to foreign tax credits. Section 1.965-7 provides rules regarding elections and payments. Section 1.965-8 provides rules regarding affiliated groups, including consolidated groups. Section 1.965-9 provides dates of applicability. *See also* §§ 1.962-1 and 1.962-2 (providing rules regarding the application of section 962) and 1.986(c)-1 (providing rules regarding the application of section 986(c)).

(2) *Scope.* Paragraph (b) of this section provides the general rules concerning section 965(a) inclusion amounts. Paragraph (c) of this section provides the general rule concerning section 965(c) deduction amounts. Paragraph (d) of this section provides a rule for specified foreign corporations that are not controlled foreign corporations. Paragraph (e) of this section treats certain controlled domestic partnerships as a foreign partnership for purposes of section 965. Paragraph (f) of this section provides definitions applicable for the section 965 regulations and §§ 1.962-1, 1.962-2, and 1.986(c)-1. Paragraph (g) of this section contains examples illustrating the general rules and definitions set forth in this section.

(b) *Section 965(a) inclusion amounts*—(1) *Inclusion of the pro rata share of the section 965(a) earnings amount.* For an inclusion year of a deferred foreign income corporation, the subpart F income of the deferred foreign income corporation (as otherwise determined for the inclusion year under section 952 and § 1.952-1) is increased by the section 965(a) earnings amount of the deferred foreign income corporation. *See* section 965(a). Accordingly, a section 958(a) U.S. shareholder with respect to a deferred foreign income corporation generally includes in gross income under section 951(a)(1) for the section 958(a) U.S. shareholder

inclusion year its pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017, and subject to reduction under section 965(b), paragraph (b)(2) of this section, and § 1.965-8(b). The amount of the section 958(a) U.S. shareholder's inclusion with respect to a deferred foreign income corporation as a result of section 965(a) and this paragraph (b)(1), as reduced under section 965(b), paragraph (b)(2) of this section, and § 1.965-8(b), as applicable, is referred to as the *section 965(a) inclusion amount*. Neither the section 965(a) earnings amount nor the section 965(a) inclusion amount is subject to the rules or limitations in section 952 or limited by the accumulated earnings and profits of the deferred foreign income corporation on the date of the inclusion.

(2) *Reduction by the allocable share of the aggregate foreign E&P deficit.* For purposes of determining a section 958(a) U.S. shareholder's section 965(a) inclusion amount with respect to a deferred foreign income corporation, the U.S. dollar amount of the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017, is reduced by the deferred foreign income corporation's allocable share of the section 958(a) U.S. shareholder's aggregate foreign E&P deficit. *See* section 965(b). If the section 958(a) U.S. shareholder is a member of a consolidated group, under § 1.965-8(e), all section 958(a) U.S. shareholders that are members of the consolidated group are treated as a single section 958(a) U.S. shareholder for purposes of this paragraph (b)(2).

(c) *Section 965(c) deduction amounts.* For a section 958(a) U.S. shareholder inclusion year, a section 958(a) U.S. shareholder is generally allowed a deduction in an amount equal to the section 965(c) deduction amount.

(d) *Treatment of specified foreign corporation as a controlled foreign corporation.* A specified foreign corporation described in section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section that is not otherwise a controlled foreign corporation is treated as a controlled foreign corporation solely for purposes of paragraph (b) of this section and sections 951, 961, and § 1.1411-10. *See* 965(e)(2).

(e) *Special rule for certain controlled domestic partnerships*—(1) *In general.* For purposes of the section 965 regulations, a controlled domestic partnership is treated as a foreign

partnership for purposes of determining the section 958(a) U.S. shareholder of a specified foreign corporation and the section 958(a) stock of the specified foreign corporation owned by the section 958(a) U.S. shareholder if the following conditions are satisfied—

(i) Without regard to this paragraph (e), the controlled domestic partnership is a section 958(a) U.S. shareholder of the specified foreign corporation and thus owns section 958(a) stock of the specified foreign corporation (*tested section 958(a) stock*);

(ii) If the controlled domestic partnership (and all other controlled domestic partnerships in the chain of ownership of the specified foreign corporation) were treated as foreign—

(A) The specified foreign corporation would continue to be a specified foreign corporation; and

(B) At least one United States shareholder of the specified foreign corporation—

(1) Would be treated as a section 958(a) U.S. shareholder of the specified foreign corporation; and

(2) Would be treated as owning (within the meaning of section 958(a)) tested section 958(a) stock of the specified foreign corporation through another foreign corporation that is a direct or indirect partner in the controlled domestic partnership.

(2) *Definition of a controlled domestic partnership.* For purposes of paragraph (e)(1) of this section, the term *controlled domestic partnership* means, with respect to a United States shareholder described in paragraph (e)(1)(ii)(B) of this section, a domestic partnership that is controlled by the United States shareholder and persons related to the United States shareholder. For purposes of this paragraph (e)(2), control is determined based on all the facts and circumstances, except that a partnership will be deemed to be controlled by a United States shareholder and related persons if those persons, in the aggregate, own (directly or indirectly through one or more partnerships) more than 50 percent of the interests in the partnership capital or profits. For purposes of this paragraph (e)(2), a related person is, with respect to a United States shareholder, a person that is related (within the meaning of section 267(b) or 707(b)(1)) to the United States shareholder.

(f) *Definitions.* This paragraph (f) provides definitions that apply for purposes of the section 965 regulations and §§ 1.962-1, 1.962-2, and 1.986(c)-1. Unless otherwise indicated, all amounts are expressed as positive numbers.

(1) *8 percent rate amount.* The term *8 percent rate amount* means, with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year, the excess, if any, of the section 958(a) U.S. shareholder's aggregate section 965(a) inclusion amount for the section 958(a) U.S. shareholder inclusion year over the amount of the section 958(a) U.S. shareholder's aggregate foreign cash position for the section 958(a) U.S. shareholder inclusion year as determined under § 1.965-3(c).

(2) *8 percent rate equivalent percentage.* The term *8 percent rate equivalent percentage* means, with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year, the percentage that would result in the 8 percent rate amount being subject to an 8 percent rate of tax determined by only taking into account a deduction equal to such percentage of such amount and the highest rate of tax specified in section 11 for the section 958(a) U.S. shareholder inclusion year. In the case of a section 958(a) U.S. shareholder inclusion year of a section 958(a) U.S. shareholder to which section 15 applies, the highest rate of tax under section 11 before the effective date of the change in rates and the highest rate of tax under section 11 after the effective date of such change will each be taken into account under the preceding sentence in the same proportions as the portion of the section 958(a) U.S. shareholder inclusion year that is before and after such effective date, respectively.

(3) *15.5 percent rate amount.* The term *15.5 percent rate amount* means, with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year, the amount of the section 958(a) U.S. shareholder's aggregate foreign cash position for the section 958(a) U.S. shareholder inclusion year as determined under § 1.965-3(c) to the extent it does not exceed the section 958(a) U.S. shareholder's aggregate section 965(a) inclusion amount for the section 958(a) U.S. shareholder inclusion year.

(4) *15.5 percent rate equivalent percentage.* The term *15.5 percent rate equivalent percentage*, with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year, has the meaning provided for the term "8 percent rate equivalent percentage" applied by substituting "15.5 percent rate amount" for "8 percent rate amount" and "15.5 percent rate of tax" for "8 percent rate of tax."

(5) *Accounts payable.* The term *accounts payable* means payables

arising from the purchase of property described in section 1221(a)(1) or section 1221(a)(8) or the receipt of services from vendors or suppliers, provided the payables have a term upon issuance of less than one year.

(6) *Accounts receivable.* The term *accounts receivable* means receivables described in section 1221(a)(4) that have a term upon issuance of less than one year.

(7) *Accumulated post-1986 deferred foreign income—(i) In general.* The term *accumulated post-1986 deferred foreign income* means, with respect to a specified foreign corporation, the post-1986 earnings and profits of the specified foreign corporation except to the extent such earnings and profits—

(A) Are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1;

(B) If distributed, would, in the case of a controlled foreign corporation, be excluded from the gross income of a United States shareholder under section 959; or

(C) If distributed, would, in the case of a controlled foreign corporation that has shareholders that are not United States shareholders on an E&P measurement date, be excluded from the gross income of such shareholders under section 959 if such shareholders were United States shareholders, determined by applying the principles of Revenue Ruling 82-16, 1982-1 C.B. 106.

(ii) *Earnings and profits attributable to subpart F income in the same taxable year as an E&P measurement date.* For purposes of determining the accumulated post-1986 deferred foreign income of a specified foreign corporation as of an E&P measurement date, earnings and profits of the specified foreign corporation that are or would be, applying the principles of Revenue Ruling 82-16, 1982-1 C.B. 106, described in section 959(c)(2) by reason of subpart F income (as defined in section 952 without regard to section 965(a)) are described in section 965(d)(2)(B) and paragraph (f)(7)(i)(B) or (f)(7)(i)(C) of this section only to the extent that such income has been accrued by the specified foreign corporation as of the E&P measurement date. For rules regarding the interaction of sections 951, 956, 959, and 965 generally, see § 1.965-2(b).

(8) *Aggregate foreign cash position—(i) In general.* The term *aggregate foreign cash position* means, with respect to a section 958(a) U.S. shareholder that is



not a member of a consolidated group, the greater of—

(A) The aggregate of the section 958(a) U.S. shareholder's pro rata share of the cash position of each specified foreign corporation determined as of the final cash measurement date of the specified foreign corporation.

(B) One half of the sum of—

(1) The aggregate described in paragraph (f)(8)(i)(A) of this section determined as of the second cash measurement date of each specified foreign corporation, plus

(2) The aggregate described in paragraph (f)(8)(i)(A) of this section determined as of the first cash measurement date of each specified foreign corporation.

(ii) *Other rules.* For rules for determining the aggregate foreign cash position for a section 958(a) U.S. shareholder inclusion year of the section 958(a) U.S. shareholder, see § 1.965-3(c). For the rule for determining the aggregate foreign cash position of a section 958(a) U.S. shareholder that is a member of a consolidated group, see § 1.965-8(e)(3). For rules disregarding certain assets for purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder, see § 1.965-3(b).

(9) *Aggregate foreign E&P deficit.* The term *aggregate foreign E&P deficit* means, with respect to a section 958(a) U.S. shareholder, the lesser of—

(i) The aggregate of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of each E&P deficit foreign corporation, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017, or

(ii) The aggregate of the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of each deferred foreign income corporation, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017.

(10) *Aggregate section 965(a) inclusion amount.* The term *aggregate section 965(a) inclusion amount* means, with respect to a section 958(a) U.S. shareholder, the sum of all of the section 958(a) U.S. shareholder's section 965(a) inclusion amounts.

(11) *Allocable share.* The term *allocable share* means, with respect to a deferred foreign income corporation and an aggregate foreign E&P deficit of a section 958(a) U.S. shareholder, the product of the aggregate foreign E&P deficit and the ratio determined by dividing—

(i) The section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation,

translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017, by

(ii) The amount described in paragraph (f)(9)(ii) of this section with respect to the section 958(a) U.S. shareholder.

(12) *Bona fide hedging transaction.* The term *bona fide hedging transaction* means a hedging transaction that meets (or that would meet if the specified foreign corporation were a controlled foreign corporation) the requirements of a bona fide hedging transaction described in § 1.954-2(a)(4)(ii), except that in the case of a specified foreign corporation that is not a controlled foreign corporation, the identification requirements of § 1.954-2(a)(4)(ii)(B) do not apply.

(13) *Cash-equivalent asset.* The term *cash-equivalent asset* means any of the following assets—

(i) Personal property which is of a type that is actively traded and for which there is an established financial market;

(ii) Commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government;

(iii) Any foreign currency;

(iv) A short-term obligation; or

(v) Derivative financial instruments, other than bona fide hedging transactions.

(14) *Cash-equivalent asset hedging transaction.* The term *cash-equivalent asset hedging transaction* means a bona fide hedging transaction identified on a specified foreign corporation's books and records as hedging a cash-equivalent asset.

(15) *Cash measurement dates.* The term *cash measurement dates* means, with respect to a specified foreign corporation, the first cash measurement date, the second cash measurement date, and the final cash measurement date, collectively, and each a *cash measurement date*.

(16) *Cash position*—(i) *General rule.* The term *cash position* means, with respect to a specified foreign corporation, the sum of—

(A) Cash held by the corporation;

(B) The net accounts receivable of the corporation; and

(C) The fair market value of the cash-equivalent assets held by the corporation.

(ii) *Fair market value of cash-equivalent assets.* For purposes of determining the fair market value of a cash-equivalent asset of a specified foreign corporation, the value of the cash-equivalent asset must be adjusted by the fair market value of any cash-equivalent asset hedging transaction

with respect to the cash-equivalent asset, but only to the extent that the cash-equivalent asset hedging transaction does not reduce the fair market value of the cash-equivalent asset below zero.

(iii) *Measurement of derivative financial instruments.* The amount of derivative financial instruments taken into account in determining the cash position of a specified foreign corporation is the aggregate fair market value of its derivative financial instruments that constitute cash-equivalent assets, provided such amount is not less than zero.

(iv) *Translation of cash position amounts.* The cash position of a specified foreign corporation with respect to a cash measurement date must be expressed in U.S. dollars. For this purpose, the amounts described in paragraph (f)(16)(i) must be translated (if necessary) into U.S. dollars using the spot rate on the relevant cash measurement date.

(17) *Deferred foreign income corporation*—(i) *In general.* The term *deferred foreign income corporation* means a specified foreign corporation that has accumulated post-1986 deferred foreign income greater than zero as of an E&P measurement date.

(ii) *Priority rule.* If a specified foreign corporation satisfies the definition of a deferred foreign income corporation under section 965(d)(1) and paragraph (f)(17)(i) of this section, it is classified solely as a deferred foreign income corporation and not also as an E&P deficit foreign corporation even if it otherwise satisfies the requirements of section 965(b)(3)(B) and paragraph (f)(22) of this section.

(18) *Derivative financial instrument.* The term *derivative financial instrument* includes a financial instrument that is one of the following—

(i) A notional principal contract,

(ii) An option contract,

(iii) A forward contract,

(iv) A futures contract,

(v) A short position in securities or commodities, or

(vi) Any financial instrument similar to one described in paragraphs (f)(18)(i) through (v) of this section.

(19) *Domestic pass-through entity.* The term *domestic pass-through entity* means a pass-through entity that is a United States person (as defined in section 7701(a)(30)).

(20) *Domestic pass-through owner.* The term *domestic pass-through owner* means, with respect to a domestic pass-through entity, a United States person (as defined in section 7701(a)(30)) that is a partner, shareholder, beneficiary, grantor, or owner, as the case may be,

in the domestic pass-through entity. Notwithstanding the preceding sentence, the term does not include a partner, shareholder, beneficiary, grantor, or owner of the domestic pass-through entity that is itself a domestic pass-through entity but does include any other United States person that is an indirect partner, shareholder, beneficiary, grantor, or owner of the domestic pass-through entity through one or more other pass-through entities.

(21) *Domestic pass-through owner share*. The term *domestic pass-through owner share* means, with respect to a domestic pass-through owner and a domestic pass-through entity, the domestic pass-through owner's share of the aggregate section 965(a) inclusion amount and the section 965(c) deduction amount, as applicable, of the domestic pass-through entity, including the domestic pass-through owner's share of the aggregate section 965(a) inclusion amount and section 965(c) deduction amount, as applicable, of a domestic pass-through entity owned indirectly by the domestic pass-through owner through one or more other pass-through entities.

(22) *E&P deficit foreign corporation—(i) In general*. The term *E&P deficit foreign corporation* means, with respect to a section 958(a) U.S. shareholder, a specified foreign corporation, other than a deferred foreign income corporation, if, as of November 2, 2017—

(A) The specified foreign corporation had a deficit in post-1986 earnings and profits,

(B) The corporation was a specified foreign corporation, and

(C) The shareholder was a United States shareholder of the corporation.

(ii) *Determination of deficit in post-1986 earnings and profits*. In the case of a specified foreign corporation that has post-1986 earnings and profits that include earnings and profits described in section 959(c)(1) or 959(c)(2) (or both) and a deficit in earnings and profits (including hovering deficits, as defined in § 1.367(b)-7(d)(2)(i)), the specified foreign corporation has a deficit in post-1986 earnings and profits described in paragraph (f)(2)(i)(A) of this section only to the extent the deficit in post-1986 earnings and profits exceeds the aggregate of its post-1986 earnings and profits described in section 959(c)(1) and 959(c)(2).

(23) *E&P measurement dates*. The term *E&P measurement dates* means November 2, 2017, and December 31, 2017, collectively, and each an *E&P measurement date*.

(24) *Final cash measurement date*. The term *final cash measurement date* means, with respect to a specified

foreign corporation, the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any.

(25) *First cash measurement date*. The term *first cash measurement date* means, with respect to a specified foreign corporation, the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any.

(26) *Inclusion year*. The term *inclusion year* means, with respect to a deferred foreign income corporation, the last taxable year of the deferred foreign income corporation that begins before January 1, 2018.

(27) *Net accounts receivable*. The term *net accounts receivable* means, with respect to a specified foreign corporation, the excess (if any) of—

(i) The corporation's accounts receivable, over

(ii) The corporation's accounts payable (determined consistent with the rules of section 461).

(28) *Pass-through entity*. The term *pass-through entity* means a partnership, S corporation, or any other person (whether domestic or foreign) other than a corporation to the extent that the income or deductions of the person are included in the income of one or more direct or indirect owners or beneficiaries of the person. For example, if a domestic trust is subject to federal income tax on a portion of its section 965(a) inclusion amount and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion.

(29) *Post-1986 earnings and profits—*

(i) *General rule*. The term *post-1986 earnings and profits* means, with respect to a specified foreign corporation and an E&P measurement date, the earnings and profits (including earnings and profits described in section 959(c)(1) and 959(c)(2)) of the specified foreign corporation (computed in accordance with sections 964(a) and 986, subject to § 1.965-4(f), and by taking into account only periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined—

(A) As of the E&P measurement date, except as provided in paragraph (f)(29)(ii) of this section, and

(B) Without diminution by reason of dividends distributed during the last taxable year of the foreign corporation that begins before January 1, 2018, other than dividends distributed to another

specified foreign corporation to the extent the dividends increase the post-1986 earnings and profits of the distributee specified foreign corporation.

(ii) *Foreign income taxes*. For purposes of determining a specified foreign corporation's post-1986 earnings and profits as of the E&P measurement date on November 2, 2017, in the case in which foreign income taxes (as defined in section 901(m)(5)) of the specified foreign corporation accrue after November 2, 2017, but on or before December 31, 2017, and during the specified foreign corporation's U.S. taxable year that includes November 2, 2017, the specified foreign corporation's post-1986 earnings and profits as of November 2, 2017, are reduced by the applicable portion of such foreign income taxes. For purposes of the preceding sentence, the applicable portion of the foreign income taxes is the amount of the taxes that are attributable to the portion of the taxable income (as determined under foreign law) that accrues on or before November 2, 2017.

(iii) *Deficits in earnings and profits*. Any deficit related to post-1986 earnings and profits, including a hovering deficit (as defined in § 1.367(b)-7(d)(2)(i)), of a specified foreign corporation is taken into account for purposes of determining the post-1986 earnings and profits (including a deficit) of the specified foreign corporation.

(30) *Pro rata share*. The term *pro rata share* means, with respect to a section 958(a) U.S. shareholder of a specified foreign corporation, a deferred foreign income corporation, or an E&P deficit foreign corporation, as applicable—

(i) With respect to the section 965(a) earnings amount of a deferred foreign income corporation, the portion of the section 965(a) earnings amount that would be treated as distributed to the section 958(a) U.S. shareholder under section 951(a)(2)(A) and § 1.951-1(e), determined as of the last day of the inclusion year of the deferred foreign income corporation;

(ii) With respect to the specified E&P deficit of an E&P deficit foreign corporation, the portion of the specified E&P deficit allocated to the section 958(a) U.S. shareholder by allocating the specified E&P deficit among the shareholders of the corporation's common stock and in proportion to the value of the common stock held by the shareholders, determined as of the last day of the last taxable year of the E&P deficit foreign corporation that begins before January 1, 2018; and

(iii) With respect to the cash position of a specified foreign corporation on a cash measurement date, the portion of the cash position that would be treated as distributed to the section 958(a) U.S. shareholder under section 951(a)(2)(A) and § 1.951-1(e) if the cash position were subpart F income, determined as of the close of the cash measurement date and without regard to whether the section 958(a) U.S. shareholder is a section 958(a) U.S. shareholder of the specified foreign corporation as of any other cash measurement date of the specified foreign corporation, including the final cash measurement date of the specified foreign corporation.

(31) *Second cash measurement date.* The term *second cash measurement date* means, with respect to a specified foreign corporation, the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any.

(32) *Section 958(a) stock.* The term *section 958(a) stock* means, with respect to a specified foreign corporation, a deferred foreign income corporation, or an E&P deficit foreign corporation, as applicable, stock of the corporation owned (directly or indirectly) by a United States shareholder within the meaning of section 958(a).

(33) *Section 958(a) U.S. shareholder.* The term *section 958(a) U.S. shareholder* means, with respect to a specified foreign corporation, a deferred foreign income corporation, or an E&P deficit foreign corporation, as applicable, a United States shareholder of such corporation that owns section 958(a) stock of the corporation.

(34) *Section 958(a) U.S. shareholder inclusion year.* The term *section 958(a) U.S. shareholder inclusion year* means the taxable year of a section 958(a) U.S. shareholder in which or with which the inclusion year of a deferred foreign income corporation ends.

(35) *Section 965 regulations.* The term *section 965 regulations* means the regulations under §§ 1.965-1 through 1.965-9, collectively.

(36) *Section 965(a) earnings amount.* The term *section 965(a) earnings amount* means, with respect to a deferred foreign income corporation, the greater of the accumulated post-1986 deferred foreign income of the deferred foreign income corporation as of the E&P measurement date on November 2, 2017, or the accumulated post-1986 deferred foreign income of the deferred foreign income corporation as of the E&P measurement date on December 31, 2017, determined in each case in the functional currency of the specified foreign corporation. If the functional

currency of a specified foreign corporation changes between the two E&P measurement dates, the comparison must be made in the functional currency of the specified foreign corporation as of December 31, 2017, by translating the specified foreign corporation's accumulated post-1986 deferred foreign income as of November 2, 2017, into the new functional currency using the spot rate on November 2, 2017.

(37) *Section 965(a) inclusion.* The term *section 965(a) inclusion* means, with respect to a person and a deferred foreign income corporation, an amount included in income by the person by reason of section 965 with respect to the deferred foreign income corporation, whether because the person is a section 958(a) U.S. shareholder of the deferred foreign income corporation with a section 965(a) inclusion amount with respect to the deferred foreign income corporation or because the person is a domestic pass-through owner with respect to a domestic pass-through entity that is a section 958(a) U.S. shareholder of the deferred foreign income corporation and the person includes in income its domestic pass-through owner share of the section 965(a) inclusion amount of the domestic pass-through entity with respect to the deferred foreign income corporation.

(38) *Section 965(a) inclusion amount.* The term *section 965(a) inclusion amount* has the meaning provided in paragraph (b)(1) of this section.

(39) *Section 965(a) previously taxed earnings and profits.* The term *section 965(a) previously taxed earnings and profits* has the meaning provided in § 1.965-2(c).

(40) *Section 965(b) previously taxed earnings and profits.* The term *section 965(b) previously taxed earnings and profits* has the meaning provided in § 1.965-2(d).

(41) *Section 965(c) deduction.* The term *section 965(c) deduction* means, with respect to a person, an amount allowed as a deduction to the person by reason of section 965(c), whether because the person is a section 958(a) U.S. shareholder with a section 965(c) deduction amount or because the person is a domestic pass-through owner with respect to a domestic pass-through entity that is a section 958(a) U.S. shareholder and the person takes into account its domestic pass-through owner share of the section 965(c) deduction amount of the domestic pass-through entity.

(42) *Section 965(c) deduction amount.* The term *section 965(c) deduction amount* means an amount equal to the sum of—

(i) A section 958(a) U.S. shareholder's 8 percent rate equivalent percentage of the section 958(a) U.S. shareholder's 8 percent rate amount for the section 958(a) U.S. shareholder inclusion year, plus

(ii) The section 958(a) U.S. shareholder's 15.5 percent rate equivalent percentage of the section 958(a) U.S. shareholder's 15.5 percent rate amount for the section 958(a) U.S. shareholder inclusion year.

(43) *Short-term obligation.* The term *short-term obligation* means any obligation with a term upon issuance that is less than one year and any loan that must be repaid at the demand of the lender (or that must be repaid within one year of such demand), but does not include any accounts receivable.

(44) *Specified E&P deficit.* The term *specified E&P deficit* means, with respect to an E&P deficit foreign corporation, the amount of the deficit described in paragraph (f)(22)(i)(A) of this section.

(45) *Specified foreign corporation—(i) General rule.* Except as provided in paragraph (f)(45)(iii) of this section, the term *specified foreign corporation* means—

(A) A controlled foreign corporation, or

(B) A foreign corporation of which one or more domestic corporations is a United States shareholder.

(ii) *Special attribution rule.* Solely for purposes of determining whether a foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section, stock owned, directly or indirectly, by or for a partner (*tested partner*) will not be considered as being owned by a partnership under sections 958(b) and 318(a)(3)(A) and § 1.958-2(d)(1)(i) if the tested partner owns less than five percent of the interests in the partnership's capital and profits. For purposes of the preceding sentence, an interest in the partnership owned by another partner will be considered as being owned by the tested partner under the principles of sections 958(b) and 318, as modified by this paragraph (f)(45)(ii), as if the interest in the partnership were stock.

(iii) *Passive foreign investment companies.* A foreign corporation that is a passive foreign investment company (as defined in section 1297) with respect to a United States shareholder and that is not a controlled foreign corporation is not a specified foreign corporation with respect to the United States shareholder.

(46) *Spot rate.* The term *spot rate* has the meaning provided in § 1.988-1(d).

(47) *United States shareholder*. The term *United States shareholder* has the meaning provided in section 951(b).

(g) *Examples*. The following examples illustrate the definitions and general rules set forth in this section.

*Example 1. Definition of specified foreign corporation.* (i) *Facts*. A, an individual, owns 100% of the stock of a domestic corporation, DC, and 1% of the interests in a partnership, PS. A United States citizen, USI, owns 10% of the interests in PS and 10% by vote and value of the stock of a foreign corporation, FC. The remaining 90% by vote and value of the stock of FC is owned by non-United States persons that are unrelated to A, USI, DC, and PS.

(ii) *Analysis*. (A) Absent the application of sections 958(b), 318(a)(3)(A), and 318(a)(3)(C), and § 1.958–2(d)(1)(i) and (iii), FC would not be a specified foreign corporation, because FC is not a controlled foreign corporation and there would be no domestic corporation that is a United States shareholder of FC. However, under sections 958(b) and 318(a)(3)(A) and § 1.958–2(d)(1)(i), absent the special attribution rule in paragraph (f)(45)(ii) of this section, PS would be treated as owning 100% of the stock of DC and 10% of the stock of FC. As a result, under sections 958(b), 318(a)(5)(A), and 318(a)(3)(C), and § 1.958–2(f)(1)(i) and (d)(1)(iii), DC would be treated as owning the stock of FC treated as owned by PS, and thus DC would be a United States shareholder with respect to FC, causing FC to be a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section. The results would be the same whether A or PS or both are domestic or foreign persons.

(B) Under the special attribution rule in paragraph (f)(45)(ii) of this section, solely for purposes of determining whether a foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section, the stock of DC owned by A is not considered as being owned by PS under sections 958(b) and 318(a)(3)(A) and § 1.958–2(d)(1)(i), because A owns less than 5% of the interests in PS's capital and profits. Accordingly, FC is not a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section.

*Example 2. Definition of specified foreign corporation.* (i) *Facts*. The facts are the same as in paragraph (i) of *Example 1* of this paragraph (g), except that A is a corporation wholly owned by B, and B directly owns 4% of the interests in PS.

(ii) *Analysis*. Applying the principles of sections 958(b) and 318, as modified by paragraph (f)(45)(ii) of this section, as if the interest in PS were stock, A is treated as owning the interests in PS owned by B (in addition to the 1% interest in PS that A owns directly), and thus A is not treated as owning less than 5% of the interests in PS's capital and profits. Accordingly, the special attribution rule in paragraph (f)(45)(ii) of this section does not apply, and PS is treated as owning A's stock of DC for purposes of determining whether FC is a specified foreign corporation within the meaning of section

965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section. Accordingly, under the analysis described in paragraph (ii)(A) of *Example 1* of this paragraph (g), FC is a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section.

*Example 3. Determination of accumulated post-1986 deferred foreign income.* (i) *Facts*. USP, a domestic corporation, and FP, a foreign corporation unrelated to USP, have owned 70% and 30% respectively, by vote and value, of the only class of stock of FS, a foreign corporation, from January 1, 2016, until December 31, 2017. USP and FS both have a calendar year taxable year. FS had no income until its taxable year ending December 31, 2016, in which it had 100u of income, all of which constituted subpart F income, and USP included 70u in income with respect to FS under section 951(a)(1) for such year. FS earned no income in 2017. Therefore, FS's post-1986 earnings and profits are 100u as of both E&P measurement dates.

(ii) *Analysis*. Because USP included 70u in income with respect to FS under section 951(a)(1), 70u of such post-1986 earnings and profits would, if distributed, be excluded from the gross income of USP under section 959. Thus, FS's accumulated post-1986 deferred foreign income would be reduced by 70u pursuant to section 965(d)(2)(B) and paragraph (f)(7)(i)(B) of this section. Furthermore, under paragraph (f)(7)(i)(C) of this section, the accumulated post-1986 deferred foreign income of FS is reduced by amounts that would be excluded from the gross income of FP if FP were a United States shareholder, consistent with the principles of Revenue Ruling 82–16. Accordingly, FS's accumulated post-1986 deferred foreign income is reduced by the remaining 30u of the 100u of post-1986 earnings and profits to which USP's 70u of section 951(a)(1) income inclusions were attributable. As a result, FS's accumulated post-1986 deferred foreign income is 0u (100u minus 70u minus 30u).

*Example 4. Determination of status as a deferred foreign income corporation or an E&P deficit foreign corporation; specified foreign corporation is solely a deferred foreign income corporation.* (i) *Facts*. USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of November 2, 2017, FS has a deficit in post-1986 earnings and profits of 150u. As of December 31, 2017, FS has 200u of post-1986 earnings and profits. FS does not have earnings and profits that are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1, or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959 or from the gross income of another shareholder if such shareholder were a United States shareholder.

(ii) *Analysis*. FS's accumulated post-1986 deferred foreign income is equal to its post-1986 earnings and profits because no adjustment to post-1986 earnings and profits is made under section 965(d)(2) or § 1.965–1(f)(7). Under paragraph (f)(17)(i) of this section, FS is a deferred foreign income

corporation because FS has accumulated post-1986 deferred foreign income greater than zero as of the E&P measurement date on December 31, 2017. In addition, under paragraph (f)(17)(ii) of this section, because FS is a deferred foreign income corporation, FS is not also an E&P deficit foreign corporation, notwithstanding that FS has a deficit in post-1986 earnings and profits as of the E&P measurement date on November 2, 2017.

*Example 5. Determination of status as a deferred foreign income corporation or an E&P deficit foreign corporation; specified foreign corporation is neither a deferred foreign income corporation nor an E&P deficit foreign corporation.* (i) *Facts*. USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of both November 2, 2017, and December 31, 2017, FS has 100u of earnings and profits described in section 959(c)(2) and a deficit of 90u in earnings and profits described in section 959(c)(3), all of which were accumulated in taxable years beginning after December 31, 1986, while FS was a specified foreign corporation. Accordingly, as of both November 2, 2017, and December 31, 2017, FS has 10u of post-1986 earnings and profits.

(ii) *Analysis*. (A) *Determination of status as a deferred foreign income corporation*. Under paragraph (f)(17) of this section, for purposes of determining whether FS is a deferred foreign income corporation, a determination must be made whether FS has accumulated post-1986 deferred foreign income greater than zero as of either the E&P measurement date on November 2, 2017, or the E&P measurement date on December 31, 2017. Under section 965(d)(2) and paragraph (f)(7) of this section, FS's accumulated post-1986 deferred foreign income is its post-1986 earnings and profits, except to the extent such earnings and profits are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1, or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959 or from the gross income of another shareholder if such shareholder were a United States shareholder. Disregarding FS's 100u of post-1986 earnings and profits described in paragraph (f)(7)(i)(B) of this section, FS has a 90u deficit in accumulated post-1986 deferred foreign income as of both E&P measurement dates. Accordingly, FS does not have accumulated post-1986 deferred foreign income greater than zero as of either E&P measurement date and therefore FS is not a deferred foreign income corporation.

(B) *Determination of status as an E&P deficit foreign corporation*. Under paragraph (f)(22)(i) of this section, for purposes of determining whether FS is an E&P deficit foreign corporation, a determination must be made whether FS has a deficit in post-1986 earnings and profits as of the E&P measurement date on November 2, 2017. Under paragraph (f)(22)(ii) of this section, because the deficit in the earnings and profits of FS described in section 959(c)(3) of 90u does not exceed the earnings and profits of FS described in section 959(c)(2) of 100u, FS

does not have a deficit in post-1986 earnings and profits as of the E&P measurement date on November 2, 2017, and therefore FS is not an E&P deficit foreign corporation. Accordingly, FS is neither a deferred foreign income corporation nor an E&P deficit foreign corporation.

**Example 6. Application of currency translation rules.** (i) *Facts.* As of November 2, 2017, and December 31, 2017, USP, a domestic corporation, owns all of the stock of CFC1, an E&P deficit foreign corporation with the “u” as its functional currency; CFC2, an E&P deficit foreign corporation with the “v” as its functional currency; CFC3, a deferred foreign income corporation with the “y” as its functional currency; and CFC4, a deferred foreign income corporation with the “z” as its functional currency. USP, CFC1, CFC2, CFC3, and CFC4 each have a calendar year taxable year. As of December 31, 2017, 1u = \$1, .75v = \$1, .50y = \$1, and .25z = \$1. CFC1 has a specified E&P deficit of 100u, CFC2 has a specified E&P deficit of 120v, CFC3 has a section 965(a) earnings amount of 50y, and CFC4 has a section 965(a) earnings amount of 75z.

(ii) *Analysis.* (A) Under paragraph (f)(38) of this section, for purposes of determining USP’s section 965(a) inclusion amounts with respect to CFC3 and CFC4, the section 965(a) earnings amount of each of CFC3 and CFC4 is translated into U.S. dollars at the spot rate on December 31, 2017, which equals \$100 (50y at .50y = \$1) and \$300 (75z at .25z = \$1), respectively. Furthermore, USP’s pro rata share of the section 965(a) earnings amounts, as translated, is \$100 and \$300, respectively, or 100% of each section 965(a) earnings amount.

(B) Under paragraph (f)(9) of this section, for purposes of determining USP’s aggregate foreign E&P deficit, the specified E&P deficit of each of CFC1 and CFC2 is translated into U.S. dollars at the spot rate on December 31, 2017, which equals \$100 (100u at 1u = \$1) and \$160 (120v at .75v = \$1), respectively.

Furthermore USP’s pro rata share of each specified E&P deficit, as translated, is \$100 and \$160, respectively, or 100% of each specified E&P deficit. Therefore, USP’s aggregate foreign E&P deficit is \$260.

(C) Under section 965(b)(1) and paragraph (b)(2) of this section, for purposes of determining USP’s section 965(a) inclusion amount with respect to each of CFC3 and CFC4, the U.S. dollar amount of USP’s pro rata share of the section 965(a) earnings amount of each of CFC3 and CFC4 is reduced by each of CFC3 and CFC4’s allocable share of USP’s aggregate foreign E&P deficit. Under section 965(b)(2) and paragraph (f)(11) of this section, CFC3’s allocable share of USP’s aggregate foreign E&P deficit of \$260 is \$65 ( $\$260 \times (\$100/\$400)$ ) and CFC4’s allocable share of USP’s aggregate foreign E&P deficit is \$195 ( $\$260 \times (\$300/\$400)$ ). After reduction under section 965(b)(1) and paragraph (b)(2) of this section, the section 965(a) inclusion amount of USP with respect to CFC3 is \$35 ( $\$100 - \$65$ ) and the section 965(a) inclusion amount of USP with respect to CFC4 is \$105 ( $\$300 - \$195$ ). Under § 1.965–2(c), the section 965(a) previously taxed earnings and profits of each of CFC3 and CFC4, translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are 17.5y ( $\$35$  at .50y = \$1) and 26.25z ( $\$105$  at .25z = \$1), respectively. Under § 1.965–6(b), for purposes of applying section 960(a)(1), the amounts treated as a dividend paid by each of CFC3 and CFC4, translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are 17.5y ( $\$35$  at .50y = \$1) and 26.25z ( $\$105$  at .25z = \$1).

(D) For purposes of determining the section 965(b) previously taxed earnings and profits of each of CFC3 and CFC4 under section 965(b)(4)(A) and § 1.965–2(d)(1) as a result of the reduction to USP’s section 965(a) inclusion amounts with respect to CFC3 and CFC4, the amount of the aggregate foreign

E&P deficit of USP allocated to each of CFC3 and CFC4 under section 965(b)(2) and paragraph (f)(11) of this section, translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, is 32.5y ( $\$65$  at .50y = \$1) and 48.75z ( $\$195$  at .25z = \$1), respectively.

**Example 7. Determination of cash measurement dates and pro rata shares of cash positions.** (i) *Facts.* Except as otherwise provided, for all relevant periods, USP, a domestic corporation, has owned directly at least 10% of the stock of CFC1, CFC2, CFC3, and CFC4, each a foreign corporation. CFC1 and CFC2 have calendar year taxable years. CFC3 and CFC4 have taxable years that end on November 30. No entity has a short taxable year, except as a result of the transactions described below.

(A) USP transferred all of its stock of CFC2 to an unrelated person on June 30, 2016, at which point USP ceased to be a United States shareholder with respect to CFC2.

(B) CFC4 dissolved on December 30, 2010, and, as a result, its final taxable year ended on December 30, 2010.

(ii) *Analysis.* Each of CFC1, CFC2, CFC3, and CFC4 is a specified foreign corporation with respect to USP, subject to the sale of CFC2 on June 30, 2016, and the dissolution of CFC4 on December 30, 2010. Under the definition of aggregate foreign cash position in paragraph (f)(8)(i) of this section, the definition of pro rata share of a cash position in paragraph (f)(30)(iii) of this section, and the definitions of the final cash measurement date, second cash measurement date, and first cash measurement date in paragraphs (f)(24), (25), and (31) of this section, the cash measurement dates of the specified foreign corporations to be taken into account by USP in determining its aggregate foreign cash position are summarized in the following table:

CASH MEASUREMENT DATES

	Final	Second	First
CFC1 .....	December 31, 2017 .....	December 31, 2016 .....	December 31, 2015.
CFC2 .....	N/A .....	N/A .....	December 31, 2015.
CFC3 .....	November 30, 2018 .....	November 30, 2016 .....	November 30, 2015.
CFC4 .....	N/A .....	N/A .....	N/A.

**Example 8. Determination of section 958(a) U.S. shareholder in case of a controlled domestic partnership.** (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1 and CFC2. CFC1 and CFC2 own 60% and 40%, respectively, of the interests in the capital and profits of DPS, a domestic partnership. DPS owns all of the stock of CFC3 and CFC4. This ownership structure has existed since the date of formation of CFC1, CFC2, CFC3, and CFC4. CFC1, CFC2, CFC3, and CFC4 are each a foreign corporation. USP, DPS, CFC1, CFC2, CFC3, and CFC4 have calendar year taxable years. On both E&P measurement dates, CFC3 has 50u of accumulated post-1986 deferred foreign income. On both E&P measurement dates, CFC4 has a deficit in post-1986

earnings and profits of 30u. On all cash measurement dates, CFC1, CFC2, and CFC3 each have a cash position of 0u, and CFC4 has a cash position of 200u.

(ii) *Analysis.* DPS is a controlled domestic partnership with respect to USP within the meaning of paragraph (e)(2) of this section, because more than 50% of the interests in its capital and profits are owned by persons related to USP within the meaning of section 267(b), CFC1 and CFC2, and thus DPS is controlled by USP and related persons. Without regard to paragraph (e) of this section, DPS is a section 958(a) U.S. shareholder of CFC3 and CFC4, each of which is a controlled foreign corporation. If DPS were treated as foreign, CFC3 and CFC4 would each continue to be a controlled

foreign corporation, and USP would be treated as a section 958(a) U.S. shareholder of each of CFC3 and CFC4, and would be treated as owning (within the meaning of section 958(a)) tested section 958(a) stock of each of CFC3 and CFC4 through CFC1 and CFC2, which are both partners in DPS. Thus, under paragraph (e)(1) of this section, DPS is treated as a foreign partnership for purposes of determining the section 958(a) U.S. shareholder of both CFC3 and CFC4 and the section 958(a) stock of both CFC3 and CFC4 owned by the section 958(a) U.S. shareholder. Thus, USP’s pro rata share of CFC3’s section 965(a) earnings amount is 50u, and its pro rata share of CFC4’s specified E&P deficit is 30u. USP’s aggregate foreign cash position is 200u. DPS is not a

section 958(a) shareholder with respect to either CFC3 or CFC4.

■ **Par. 6.** Section 1.965–2 is added to read as follows:

**§ 1.965–2 Adjustments to earnings and profits and basis.**

(a) *Scope.* This section provides rules relating to adjustments to earnings and profits and basis to determine and account for the application of section 965(a) and (b) and § 1.965–1(b) and a rule that limits the amount of gain recognized under section 961(b)(2) by reason of distributions attributable to section 965 previously taxed earnings and profits (as defined in paragraph (g)(1)(ii) of this section) in the inclusion year. Paragraph (b) of this section provides rules relating to adjustments to earnings and profits of a specified foreign corporation in its last taxable year that begins before January 1, 2018, for purposes of applying sections 959 and 965. Paragraph (c) of this section provides rules regarding adjustments to earnings and profits by reason of section 965(a). Paragraph (d) of this section provides rules regarding adjustments to earnings and profits by reason of section 965(b). Paragraph (e) provides rules regarding adjustments to basis by reason of section 965(a). Paragraph (f) of this section provides an election to make certain adjustments to basis corresponding to adjustments to earnings and profits by reason of section 965(b). Paragraph (g) of this section provides rules that limit the amount of gain recognized in connection with the application of section 961(b)(2) and that require related reductions in basis. Paragraph (h) of this section provides rules regarding basis adjustments. Paragraph (i) of this section provides definitions that apply for purposes of this section. Paragraph (j) of this section provides examples illustrating the application of this section.

(b) *Determination of and adjustments to earnings and profits in the last taxable year of a specified foreign corporation that begins before January 1, 2018, for purposes of applying sections 959 and 965.* For the last taxable year of a specified foreign corporation that begins before January 1, 2018, and the taxable year of a section 958(a) U.S. shareholder in which or with which such year ends, the adjustments to earnings and profits described in paragraphs (b)(1) through (b)(5) of this section are applied in sequence.

(1) The subpart F income of the specified foreign corporation is determined without regard to section 965(a), and earnings and profits of the specified foreign corporation that are

described in section 959(c)(2) with respect to the section 958(a) U.S. shareholder are increased to the extent of the section 958(a) U.S. shareholder's inclusion under section 951(a)(1)(A) without regard to section 965(a).

(2) The treatment of a distribution by the specified foreign corporation to another specified foreign corporation that is made before January 1, 2018, is determined under section 959.

(3) Each of the post-1986 earnings and profits (including a deficit) of the specified foreign corporation, the accumulated post-1986 deferred foreign income of the specified foreign corporation, the section 965(a) earnings amount of the specified foreign corporation, and the section 965(a) inclusion amount with respect to the specified foreign corporation, if any, is determined, and the earnings and profits (including a deficit) of the specified foreign corporation are adjusted as provided in paragraphs (c) and (d) of this section. For a rule disregarding subpart F income earned after an E&P measurement date for purposes of calculating accumulated post-1986 deferred foreign income as of the E&P measurement date, see § 1.965–1(f)(7)(ii).

(4) The treatment of all distributions from the specified foreign corporation other than those described in paragraph (b)(2) of this section is determined under section 959.

(5) An amount is determined under section 956 with respect to the specified foreign corporation and the section 958(a) U.S. shareholder; earnings and profits of the specified foreign corporation described in sections 959(c)(2) with respect to the section 958(a) U.S. shareholder are reclassified as earnings and profits described in section 959(c)(1) with respect to the section 958(a) U.S. shareholder to the extent the amount determined under section 956 would, but for section 959(a)(2), be included by the section 958(a) U.S. shareholder under section 951(a)(1)(B); and earnings and profits described in section 959(c)(1) with respect to the section 958(a) U.S. shareholder are further increased to the extent of the section 958(a) U.S. shareholder's inclusion under section 951(a)(1)(B).

(c) *Adjustments to earnings and profits by reason of section 965(a).* The earnings and profits of a deferred foreign income corporation described in section 959(c)(2) with respect to a section 958(a) U.S. shareholder are increased by an amount equal to the section 965(a) inclusion amount of the section 958(a) U.S. shareholder with respect to the deferred foreign income

corporation, if any, translated (if necessary) into the functional currency of the deferred foreign income corporation using the spot rate on December 31, 2017, provided the section 965(a) inclusion amount is included in income by the section 958(a) U.S. shareholder. For purposes of the section 965 regulations, the earnings and profits described in section 959(c)(2) by reason of this paragraph (c) and the earnings and profits initially described in section 959(c)(2) by reason of this paragraph (c) but subsequently reclassified as earnings and profits described in section 959(c)(1), if any, are referred to as *section 965(a) previously taxed earnings and profits*. Furthermore, the earnings and profits (including a deficit) of the deferred foreign income corporation that are described in section 959(c)(3) (or that would be described in section 959(c)(3) but for the application of section 965(a) and the section 965 regulations) are reduced (or, in the case of a deficit, increased) by an amount equal to the section 965(a) previously taxed earnings and profits.

(d) *Adjustments to earnings and profits by reason of section 965(b)—(1) Adjustments to earnings and profits described in section 959(c)(2) and (c)(3) of deferred foreign income corporations.* The earnings and profits of a deferred foreign income corporation described in section 959(c)(2) with respect to a section 958(a) U.S. shareholder are increased by an amount equal to the reduction to the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation under section 965(b), § 1.965–1(b)(2), and § 1.965–8(b), as applicable, translated (if necessary) into the functional currency of the deferred foreign income corporation using the spot rate on December 31, 2017, provided the section 958(a) U.S. shareholder includes the section 965(a) inclusion amount with respect to the deferred foreign income corporation in income. For purposes of the section 965 regulations, the earnings and profits described in section 959(c)(2) by reason of this paragraph (d) and the earnings and profits initially described in section 959(c)(2) by reason of this paragraph (d) but subsequently reclassified as earnings and profits described in section 959(c)(1) are referred to as *section 965(b) previously taxed earnings and profits*. Furthermore, the earnings and profits (including a deficit) described in section 959(c)(3) of the deferred foreign income corporation (or that would be described in section 959(c)(3) but for the application of section 965(b) and the

section 965 regulations) are reduced (or, in the case of a deficit, increased) by an amount equal to the section 965(b) previously taxed earnings and profits.

(2) *Adjustments to earnings and profits described in section 959(c)(3) of E&P deficit foreign corporations—(i) Increase in earnings and profits by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit taken into account—(A) In general.* For an E&P deficit foreign corporation's last taxable year that begins before January 1, 2018, the earnings and profits of the E&P deficit foreign corporation described in section 959(c)(3) are increased by an amount equal to the portion of a section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under section 965(b), § 1.965-1(b)(2), and § 1.965-8(b), as determined under paragraph (d)(2)(ii) of this section, translated (if necessary) into the functional currency of the E&P deficit foreign corporation using the spot rate on December 31, 2017. For purposes of section 316, the earnings and profits of the E&P deficit foreign corporation attributable to the increase described in the preceding sentence are not treated as earnings and profits of the taxable year described in section 316(a)(2). See also § 1.965-6(c)(3) for the timing of this adjustment for purposes of determining a deemed paid credit allowed under sections 902 and 960.

(B) *Reduction of a qualified deficit.* For purposes of section 952, a section 958(a) U.S. shareholder's pro rata share of the earnings and profits of an E&P deficit foreign corporation is increased by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under section 965(b), § 1.965-1(b)(2), or § 1.965-8(b), as applicable, as determined under paragraph (d)(2)(ii) of this section, translated (if necessary) into the functional currency of the E&P deficit foreign corporation using the spot rate on December 31, 2017, and such increase is attributable to the same activity to which the deficit so taken into account was attributable.

(ii) *Determination of portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit taken into account—(A) In general.* The portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit of an E&P deficit foreign corporation taken into account under section 965(b), § 1.965-1(b)(2), or § 1.965-8(b), as applicable, is 100

percent of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit if either of the following conditions is satisfied:

(1) The section 958(a) U.S. shareholder (including a consolidated group of which the section 958(a) U.S. shareholder is a member) does not have an excess aggregate foreign E&P deficit (as defined in § 1.965-8(f)(7)(i)), or

(2) If the section 958(a) U.S. shareholder is a member of an affiliated group in which not all members are members of the same consolidated group, the amount described in § 1.965-8(f)(1)(i)(B) with respect to the affiliated group is equal to or greater than the amount described in § 1.965-8(f)(1)(i)(A).

(B) *Designation of portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit taken into account.* If neither the condition in paragraph (d)(2)(ii)(A)(1) nor the condition in paragraph (d)(2)(ii)(A)(2) is satisfied with respect to a section 958(a) U.S. shareholder, then the section 958(a) U.S. shareholder must designate the portion taken into account by reporting to each E&P deficit foreign corporation of the section 958(a) U.S. shareholder, and maintaining in its books and records a statement setting forth, the following information—

(1) The portion of the section 958(a) shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under section 965(b), § 1.965-1(b)(2), or § 1.965-8(b), as designated under § 1.965-8(c), as applicable, and

(2) In the case of an E&P deficit foreign corporation that has a qualified deficit (as determined under section 952 and § 1.952-1), the portion (if any) of the section 958(a) shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under paragraph (d)(2)(ii)(B)(1) of this section that is attributable to a qualified deficit, including the qualified activities to which such portion is attributable.

(e) *Adjustments to basis by reason of section 965(a)—(1) General rule.* Except as provided in paragraph (e)(2) of this section, a section 958(a) U.S. shareholder's basis in section 958(a) stock of a deferred foreign income corporation, or a section 958(a) U.S. shareholder's basis in applicable property with respect to a deferred foreign income corporation, is increased by the section 958(a) U.S. shareholder's section 965(a) inclusion amount with respect to the deferred foreign income corporation included in income by the section 958(a) U.S. shareholder. See section 961(a).

(2) [Reserved]

(f) *Adjustments to basis by reason of section 965(b)—(1) In general.* Except as provided in paragraph (f)(2) of this section, no adjustments to basis of stock or property are made under section 961 (or any other provision of the Code) to take into account the reduction to a section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of a deferred foreign income corporation under section 965(b), § 1.965-1(b)(2), or § 1.965-8(b), as applicable.

(2) *Election to make adjustments to basis to account for the application of section 965(b)—(i) In general.* If a section 958(a) U.S. shareholder makes the election as provided in this paragraph (f)(2), the adjustments to basis described in paragraph (f)(2)(ii) of this section are made with respect to each deferred foreign income corporation and each E&P deficit foreign corporation in which the section 958(a) U.S. shareholder owns section 958(a) stock.

(ii) *Basis adjustments—(A) Increase in basis with respect to a deferred foreign income corporation.* Except as provided in paragraph (f)(2)(ii)(C) of this section, a section 958(a) U.S. shareholder's basis in section 958(a) stock of a deferred foreign income corporation, or a section 958(a) U.S. shareholder's basis in applicable property with respect to a deferred foreign income corporation, is increased by an amount equal to the section 965(b) previously taxed earnings and profits of the deferred foreign income corporation with respect to the section 958(a) U.S. shareholder, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017.

(B) *Reduction in basis with respect to an E&P deficit foreign corporation.* Except as provided in paragraph (f)(2)(ii)(C) of this section, a section 958(a) U.S. shareholder's basis in section 958(a) stock of an E&P deficit foreign corporation, or a section 958(a) U.S. shareholder's basis in applicable property with respect to an E&P deficit foreign corporation, is reduced by an amount equal to the portion of the section 958(a) U.S. shareholder's pro rata share of the specified E&P deficit of the E&P deficit foreign corporation taken into account under section 965(b), § 1.965-1(b)(2), and § 1.965-8(b), as applicable, as determined under paragraph (d)(2)(ii) of this section, translated (if necessary) into U.S. dollars using the spot rate on December 31, 2017.

(C) *Section 962 election.* [Reserved]

(iii) *Rules regarding the election—(A) Consistency requirement.* In order for the election described in this paragraph (f)(2) to be effective, a section 958(a)

U.S. shareholder and each person that is a section 958(a) U.S. shareholder that is related to the section 958(a) U.S. shareholder must make the election described in this paragraph (f)(2). For purposes of this paragraph (f)(2)(iii)(A), a person is treated as related to a section 958(a) U.S. shareholder if the person bears a relationship to the section 958(a) U.S. shareholder described in section 267(b) or 707(b).

(B) *Manner of making election*—(1) *Timing*—(i) *In general*. Except as provided in paragraph (f)(2)(iii)(B)(1)(ii) of this section, the election provided in this paragraph (f)(2) must be made no later than the due date (taking into account extensions, if any) for the section 958(a) U.S. shareholder's return for the first taxable year that includes the last day of the last taxable year of a deferred foreign income corporation or E&P deficit foreign corporation of the shareholder that begins before January 1, 2018. Relief is not available under § 301.9100–2 or 301.9100–3 to file a late election.

(ii) *Transition rule*. If the due date referred to in paragraph (f)(2)(iii)(B)(1)(i) of this section occurs before September 10, 2018, the election must be made by October 9, 2018.

(2) *Election statement*. Except as otherwise provided in publications, forms, instructions, or other guidance, to make the election provided in this paragraph (f)(2), a section 958(a) U.S. shareholder must attach a statement, signed under penalties of perjury, to its return for the first taxable year that includes the last day of the last taxable year of a deferred foreign income corporation or E&P deficit foreign corporation of the shareholder that begins before January 1, 2018. The statement must include the section 958(a) U.S. shareholder's name and taxpayer identification number and a statement that the section 958(a) U.S. shareholder and all related persons, as defined in paragraph (f)(2)(iii)(A) of this section, make the election provided in this paragraph (f)(2).

(g) *Gain reduction rule*—(1) *Reduction in gain recognized under section 961(b)(2) by reason of distributions attributable to section 965 previously taxed earnings and profits in the inclusion year*—(i) *In general*. If a section 958(a) U.S. shareholder receives a distribution from a deferred foreign income corporation (including through a chain of ownership described under section 958(a)) during the inclusion year of the deferred foreign income corporation that is attributable to section 965 previously taxed earnings and profits of the deferred foreign income corporation, then the amount of

gain that otherwise would be recognized under section 961(b)(2) by the section 958(a) U.S. shareholder with respect to the section 958(a) U.S. shareholder's section 958(a) stock of the deferred foreign income corporation or interest in applicable property with respect to the deferred foreign income corporation is reduced (but not below zero) by an amount equal to the section 965 previously taxed earnings and profits of the deferred foreign income corporation with respect to the section 958(a) U.S. shareholder.

(ii) *Definition of section 965 previously taxed earnings and profits*. For purposes of paragraph (g)(1)(i) of this section, the term *section 965 previously taxed earnings and profits* means, with respect to a deferred foreign income corporation and a section 958(a) U.S. shareholder, the sum of the section 965(a) previously taxed earnings and profits of the deferred foreign income corporation with respect to the section 958(a) U.S. shareholder, and, if the section 958(a) U.S. shareholder has made the election described in paragraph (f)(2) of this section, the section 965(b) previously taxed earnings and profits of the deferred foreign income corporation with respect to the section 958(a) U.S. shareholder.

(2) *Reduction in basis by an amount equal to the gain reduction amount*. If a section 958(a) U.S. shareholder does not recognize gain under section 961(b)(2) by reason of paragraph (g)(1) of this section with respect to a distribution from a deferred foreign income corporation (including through a chain of ownership described under section 958(a)), the section 958(a) U.S. shareholder's basis in the section 958(a) stock of the deferred foreign income corporation, or the section 958(a) U.S. shareholder's basis in the applicable property with respect to the deferred foreign income corporation, is reduced by the amount of gain that would otherwise be recognized by the section 958(a) U.S. shareholder without regard to paragraph (g)(1) of this section.

(h) *Rules of application for specified basis adjustments*. This paragraph (h) applies for purposes of making any adjustment to the basis of section 958(a) stock or applicable property with respect to a specified foreign corporation described in paragraph (e), (f)(2), or (g)(2) of this section (collectively, *specified basis adjustments*), and each a *specified basis adjustment*.

(1) *Timing of basis adjustments*. A specified basis adjustment to section 958(a) stock or applicable property with respect to a specified foreign

corporation is made as of the close of the last day of the last taxable year of the specified foreign corporation that begins before January 1, 2018.

(2) *Netting of basis adjustments*. If one or more specified basis adjustments occur on the same day with respect to the same section 958(a) stock or applicable property, a single basis adjustment is made as of the close of such day with respect to such stock or applicable property in an amount equal to the net amount, if any, of the increase or reduction, as applicable.

(3) *Gain recognition for reduction in excess of basis*. The excess (if any) of a net reduction in basis with respect to section 958(a) stock or applicable property of a section 958(a) U.S. shareholder by reason of one or more specified basis adjustments, over the section 958(a) U.S. shareholder's basis in such stock or applicable property without regard to the specified basis adjustments is treated as gain from the sale or exchange of property.

(4) *Adjustments with respect to each share*—(i) *Section 958(a) stock*. If a specified basis adjustment is made with respect to section 958(a) stock, the specified basis adjustment is made with respect to each share of the section 958(a) stock in a manner consistent with the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount or specified E&P deficit, as applicable, by reason of such share.

(ii) *Applicable property*. If a specified basis adjustment is made with respect to applicable property, the adjustment is made with respect to the applicable property in a manner consistent with the application of paragraph (h)(4)(i) of this section.

(5) *Stock or property for which adjustments are made*—(i) *In general*. Except as provided in paragraph (h)(5)(ii) of this section, a specified basis adjustment is made solely with respect to section 958(a) stock owned by the section 958(a) U.S. shareholder within the meaning of section 958(a)(1)(A) or applicable property owned directly by the section 958(a) U.S. shareholder.

(ii) *Special rule for an interest in a foreign pass-through entity*. If the applicable property of the section 958(a) U.S. shareholder described in paragraph (h)(5)(i) of this section is an interest in a foreign pass-through entity, then, for purposes of determining the foreign pass-through entity's basis in section 958(a) stock or applicable property, as applicable, with respect to the section 958(a) U.S. shareholder, a specified basis adjustment is made with respect to section 958(a) stock or applicable property of the section 958(a) U.S. shareholder owned through the foreign



pass-through entity in the same manner as if the section 958(a) stock or applicable property were owned directly by the section 958(a) U.S. shareholder. In the case of tiered foreign pass-through entities, this paragraph (h)(5)(ii) applies with respect to each foreign pass-through entity.

(i) *Definitions.* This paragraph (i) provides definitions that apply for purposes of this section.

(1) *Applicable property.* The term *applicable property* means, with respect to a section 958(a) U.S. shareholder and a specified foreign corporation, property owned by the section 958(a) U.S. shareholder (including through one or more foreign pass-through entities) by reason of which the section 958(a) U.S. shareholder is considered under section 958(a)(2) as owning section 958(a) stock of the specified foreign corporation.

(2) *Foreign pass-through entity.* The term *foreign pass-through entity* means a foreign partnership or a foreign estate or trust (as defined in section 7701(a)(31)).

(3) *Property.* The term *property* has the meaning provided in § 1.961–1(b)(1).

(j) *Examples.* The following examples illustrate the application of this section.

*Example 1. Determination of accumulated post-1986 deferred foreign income with subpart F income earned before E&P measurement date on November 2, 2017.* (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 all have taxable years ending December 31, 2017. As of January 1, 2017, CFC1 has no earnings and profits, and CFC2 has 100u of earnings and profits described in section 959(c)(3) that were accumulated in taxable years beginning after December 31, 1986, while CFC2 was a specified foreign corporation. On March 1, 2017, CFC1 earns 30u of subpart F income (as defined in section 952), and CFC2 earns 20u of subpart F income. On July 1, 2017, CFC2 distributes 40u to CFC1. On November 1, 2017, CFC1 distributes 60u to USP. USP does not have an aggregate foreign E&P deficit.

(ii) *Analysis.* (A) *Adjustments to section 959(c) classification of earnings and profits without regard to section 965.* USP determines its inclusion under section 951(a)(1)(A) without regard to section 965(a), which is 30u with respect to CFC1 and 20u with respect to CFC2 for their taxable years ending December 31, 2017. As a result of the inclusions under section 951(a)(1)(A), CFC1 and CFC2 increase their earnings and profits described in section 959(c)(2) by 30u and 20u, respectively.

(B) *Distributions between specified foreign corporations before January 1, 2018.* The distribution of 40u from CFC2 to CFC1 is treated as a distribution of 20u out of earnings and profits described in section 959(c)(2) (attributable to inclusions under section 951(a)(1)(A) without regard to section

965(a) and 20u out of earnings and profits described in section 959(c)(3).

(C) *Section 965(a) inclusion amount.* USP determines whether CFC1 and CFC2 are deferred foreign income corporations, and, if they are, determines its section 965(a) inclusion amounts with respect to CFC1 and CFC2. Because USP wholly owns CFC1 and CFC2 under section 958(a) and USP does not have an aggregate foreign E&P deficit, USP's section 965(a) inclusion amount with respect to each of CFC1 and CFC2, respectively, equals the section 965(a) earnings amount of CFC1 and CFC2, respectively.

(1) *CFC1 section 965(a) earnings amount.* The section 965(a) earnings amount with respect to CFC1 is 20u, the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, which is equal to 70u of post-1986 earnings and profits (30u earned and 40u attributable to the CFC2 distribution) reduced by 50u of such post-1986 earnings and profits described in section 959(c)(2) (30u earned and 20u attributable to the CFC2 distribution) under section 965(d)(2)(B) and § 1.965–1(f)(7)(i)(B). Under section 965(d)(3)(B) and § 1.965–1(f)(29)(i)(B), the post-1986 earnings and profits of CFC1 are not reduced by the 60u distribution to USP.

(2) *CFC2 section 965(a) earnings amount.* The section 965(a) earnings amount with respect to CFC2 is 80u, the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, which is equal to the amount of CFC2's post-1986 earnings and profits of 80u. CFC2's accumulated post-1986 deferred foreign income is equal to its post-1986 earnings and profits because CFC2 does not have earnings and profits that are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1, or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959 or from the gross income of another shareholder if such shareholder were a United States shareholder, and therefore no adjustment is made under section 965(d)(2) or § 1.965–1(f)(7). CFC2's 80u of post-1986 earnings and profits consists of 120u of earnings and profits that it earned, reduced by the 40u distribution to CFC1 under section 965(d)(3)(B) and § 1.965–1(f)(29)(i)(B). The amount of the reduction to the post-1986 earnings and profits of CFC2 for the 40u distribution is not limited by § 1.965–1(f)(29)(i)(B) because CFC1's post-1986 earnings and profits are increased by 40u as a result of the distribution. Furthermore, because the 40u distribution was made on July 1, 2017, which is before the E&P measurement date on November 2, 2017, § 1.965–4(f) is not relevant.

(3) *Effect on earnings and profits described in section 959(c)(2) and (3).* CFC1 and CFC2 increase their earnings and profits described in section 959(c)(2) by USP's section 965(a) inclusion amounts with respect to CFC1 and CFC2, 20u and 80u, respectively, and reduce their earnings and profits described in section 959(c)(3) by an equivalent amount.

(D) *Distribution to United States shareholder.* The distribution from CFC1 to

USP is treated as a distribution of 60u out of the earnings and profits of CFC1 described in section 959(c)(2), which include earnings and profits attributable to the section 965(a) inclusion amount taken into account by USP.

*Example 2. Determination of accumulated post-1986 deferred foreign income with subpart F income earned after E&P measurement date on November 2, 2017.* (i) *Facts.* The facts are the same as in paragraph (i) of Example 1 of this paragraph (j), except that on December 1, 2017, CFC1 earns an additional 50u of subpart F income (as defined in section 952).

(ii) *Analysis.* (A) *Adjustments to section 959(c) classification of earnings and profits without regard to section 965.* USP determines its inclusion under section 951(a)(1)(A) without regard to section 965(a), which is 80u with respect to CFC1 and 20u with respect to CFC2 for their taxable years ending December 31, 2017. As a result of the inclusions under section 951(a)(1)(A), CFC1 and CFC2 increase their earnings and profits described in section 959(c)(2) by 80u and 20u, respectively.

(B) *Distributions between specified foreign corporations before January 1, 2018.* The analysis is the same as in paragraph (ii)(B) of Example 1 of this paragraph (j).

(C) *Section 965(a) inclusion amount.* USP determines whether CFC1 and CFC2 are deferred foreign income corporations, and, if they are, determines its section 965(a) inclusion amounts with respect to CFC1 and CFC2. Because USP wholly owns CFC1 and CFC2 under section 958(a) and USP does not have an aggregate foreign E&P deficit, USP's section 965(a) inclusion amount with respect to each of CFC1 and CFC2, respectively, equals the section 965(a) earnings amount of CFC1 and CFC2, respectively.

(1) *CFC1 section 965(a) earnings amount.* The section 965(a) earnings amount with respect to CFC1 is 20u, the greater of—

(i) The amount of its accumulated post-1986 deferred foreign income as of November 2, 2017, 20u, which is equal to 70u of post-1986 earnings and profits (30u earned and 40u attributable to the CFC2 distribution) reduced by 50u of such post-1986 earnings and profits described in section 959(c)(2) without regard to the subpart F income earned after November 2, 2017 (30u earned and 20u attributable to the CFC2 distribution) under section 965(d)(2)(B) and § 1.965–1(f)(7)(i)(B) and (ii), and

(ii) The amount of its accumulated post-1986 deferred foreign income as of December 31, 2017, 20u, which is equal to 120u of post-1986 earnings and profits (80u earned and 40u attributable to the CFC2 distribution) reduced by 100u of such post-1986 earnings and profits described in section 959(c)(2) with regard to the subpart F income earned on or before December 31, 2017 (80u earned and 20u attributable to the CFC2 distribution) under section 965(d)(2)(B) and § 1.965–1(f)(7)(i)(B) and (ii).

(2) *CFC2 section 965(a) earnings amount.* The analysis is the same as in paragraph (ii)(C)(2) of Example 1 of this paragraph (j).

(3) *Effect on earnings and profits described in section 959(c)(2) and (3).* The analysis is the same as in paragraph (ii)(C)(3) of Example 1 of this paragraph (j).

(D) *Distribution to United States shareholder.* The analysis is the same as in paragraph (ii)(D) of *Example 1* of this paragraph (j).

*Example 3. Determination of accumulated post-1986 deferred foreign income with subpart F income earned after E&P measurement date on November 2, 2017, but previously taxed earnings and profits attributable to the subpart F income distributed before E&P measurement date on November 2, 2017.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (j), except that on December 1, 2017, CFC2 earns an additional 50u of subpart F income (as defined in section 952).

(ii) *Analysis.* (A) *Adjustments to section 959(c) classification of earnings and profits without regard to section 965.* USP determines its inclusion under section 951(a)(1)(A) without regard to section 965(a), which is 30u with respect to CFC1 and 70u with respect to CFC2 for their taxable years ending December 31, 2017. As a result of the inclusions under section 951(a)(1)(A), CFC1 and CFC2 increase their earnings and profits described in section 959(c)(2) by 30u and 70u, respectively.

(B) *Distributions between specified foreign corporations before January 1, 2018.* The distribution of 40u from CFC2 to CFC1 is treated as a distribution of 40u out of earnings and profits described in section 959(c)(2) (attributable to inclusions under section 951(a)(1)(A) without regard to section 965(a)).

(C) *Section 965(a) inclusion amount.* USP determines whether CFC1 and CFC2 are deferred foreign income corporations, and, if they are, determines its section 965(a) inclusion amounts with respect to CFC1 and CFC2. Because USP wholly owns CFC1 and CFC2 under section 958(a) and USP does not have an aggregate foreign E&P deficit, USP's section 965(a) inclusion amount with respect to each of CFC1 and CFC2, respectively, equals the section 965(a) earnings amount, if any, of CFC1 and CFC2, respectively.

(1) *CFC1 section 965(a) earnings amount.* CFC1 is not a deferred foreign income corporation and does not have a section 965(a) earnings amount, because the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, is 0u, which is equal to 70u of post-1986 earnings and profits (30u earned and 40u attributable to the CFC2 distribution) reduced by 70u of such post-1986 earnings and profits described in section 959(c)(2) (30u earned and 40u attributable to the CFC2 distribution) under section 965(d)(2)(B) and § 1.965-1(f)(7)(i)(B).

(2) *CFC2 section 965(a) earnings amount.* The section 965(a) earnings amount with respect to CFC2 is 100u, the greater of—

(i) The amount of its accumulated post-1986 deferred foreign income as of November 2, 2017, 80u. CFC2's 80u of accumulated post-1986 deferred foreign income as of November 2, 2017 is equal to its 80u of post-1986 earnings and profits because no adjustment is made under section 965(d)(2) or § 1.965-1(f)(7), as CFC2 does not have earnings and profits that are attributable to income of the specified foreign corporation that is effectively connected with the conduct

of a trade or business within the United States and subject to tax under chapter 1, or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959 or from the gross income of another shareholder if such shareholder were a United States shareholder, without regard to the subpart F income earned after November 2, 2017. CFC2's 80u of post-1986 earnings and profits consists of 120u of earnings and profits that it earned, reduced by the 40u distribution to CFC1 under section 965(d)(3)(B) and § 1.965-1(f)(29)(i)(B). The amount of the reduction to the post-1986 earnings and profits of CFC2 for the 40u distribution is not limited by § 1.965-1(f)(29)(i)(B) because CFC1's post-1986 earnings and profits are increased by 40u as a result of the distribution. Furthermore, because the 40u distribution was made on July 1, 2017, which is before any E&P measurement date, § 1.965-4(f) is not relevant.

(ii) The amount of its accumulated post-1986 deferred foreign income as of December 31, 2017, 100u, which is equal to 130u of post-1986 earnings and profits reduced by 30u of such post-1986 earnings and profits described in section 959(c)(2) with regard to the subpart F income earned before December 31, 2017, under section 965(d)(2)(B) and § 1.965-1(f)(7)(i)(B) and (ii). CFC2's 130u of post-1986 earnings and profits consists of 170u of earnings and profits that it earned, reduced by the 40u distribution to CFC1 under section 965(d)(3)(B) and § 1.965-1(f)(29)(i)(B).

(3) *Effect on earnings and profits described in section 959(c)(2) and (3).* CFC2 increases its earnings and profits described in section 959(c)(2) by USP's section 965(a) inclusion amount with respect to CFC2, 100u, and reduces its earnings and profits described in section 959(c)(3) by an equivalent amount.

(D) *Distribution to United States shareholder.* The analysis is the same as in paragraph (ii)(D) of *Example 1* of this paragraph (j).

*Example 4. Distribution attributable to section 965(a) previously taxed earnings and profits.* (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a specified foreign corporation that has no post-1986 earnings and profits (or deficit in post-1986 earnings and profits), and CFC1 owns all the stock of CFC2, a deferred foreign income corporation. USP is a calendar year taxpayer. CFC1's last taxable year beginning before January 1, 2018, ends on November 30, 2018; CFC2 has an inclusion year that ends on November 30, 2018. The functional currency of CFC1 and CFC2 is the U.S. dollar. USP's adjusted basis in the stock of CFC1 is zero, and CFC1's adjusted basis in the stock of CFC2 is zero. On January 1, 2018, CFC2 distributes \$100x to CFC1, and CFC1 distributes \$100x to USP. USP has a section 965(a) inclusion amount of \$100x with respect to CFC2 that is taken into account for USP's taxable year ending December 31, 2018. CFC2 has no earnings and profits described in section 959(c)(1) or (2) other than section 965(a) previously taxed earnings and profits.

(ii) *Analysis.* Under paragraph (c) of this section, CFC2 has \$100x of section 965(a)

previously taxed earnings and profits with respect to USP. USP receives a distribution from CFC2 through a chain of ownership described in section 958(a) during the inclusion year of CFC2 that is attributable to the \$100x of section 965(a) previously taxed earnings and profits of CFC2. Under paragraph (g)(1) of this section, the amount of gain that USP otherwise would recognize with respect to the stock of CFC1 under section 961(b)(2) is reduced (but not below zero) by \$100x, the amount of CFC2's section 965(a) previously taxed earnings and profits with respect to USP. As of the close of November 30, 2018, USP's basis in CFC1 is increased under paragraph (e) of this section by USP's section 965(a) inclusion amount with respect to CFC2 (\$100x), and is reduced under paragraph (g)(2) of this section by the amount of gain that would have been recognized by USP under section 961(b)(2) but for the application of paragraph (g)(1) of this section (\$100x).

*Example 5. Distribution attributable to section 965(b) previously taxed earnings and profits; parent-subsidiary.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 4* of this paragraph (j), except that CFC1 has a specified E&P deficit of \$100x. Because of the specified E&P deficit of CFC1, USP's section 965(a) inclusion amount with respect to CFC2 is reduced to zero pursuant to section 965(b)(1) and § 1.965-1(b)(2). USP makes the election described in paragraph (f)(2) of this section.

(ii) *Analysis.* (A) *Application of the gain reduction rule.* Under paragraph (d)(1) of this section, CFC2 has \$100x of section 965(b) previously taxed earnings and profits with respect to USP, and, under paragraph (d)(2) of this section, CFC1's earnings and profits described in section 959(c)(3) are increased by \$100x to \$0. USP receives a distribution from CFC2 through a chain of ownership described in section 958(a) during the inclusion year of CFC2 that is attributable to the \$100x of section 965(b) previously taxed earnings and profits of CFC2. Under paragraph (g)(1) of this section, the amount of gain that USP otherwise would recognize with respect to the stock of CFC1 under section 961(b)(2) is reduced (but not below zero) by \$100x, the amount of CFC2's section 965(b) previously taxed earnings and profits with respect to USP under paragraph (d)(1) of this section.

(B) *Adjustments to the basis of CFC1.* Because USP makes the election described in paragraph (f)(2) of this section, as of the close of November 30, 2018, USP's basis in CFC1 is increased under paragraph (f)(2)(ii)(A) of this section by an amount equal to CFC2's section 965(b) previously taxed earnings and profits with respect to USP under paragraph (d)(1) of this section (\$100x), reduced under paragraph (f)(2)(ii)(B) of this section by an amount equal to the portion of the specified E&P deficit of CFC1 taken into account in determining USP's section 965(a) inclusion amount with respect to CFC2 (\$100x), and reduced under paragraph (g)(2) of this section by the amount of gain that would have been recognized by USP with respect to the stock of CFC1 under section 961(b)(2) but for the application of paragraph (g)(1) of this section (\$100x). Under paragraph (h)(2) and (3) of

this section, the excess of the net reduction from the adjustments under paragraphs (f) and (g) of this section over USP's basis in the stock of CFC1 (in this case, \$100x) is treated as gain recognized by USP from the sale or exchange of property.

*Example 6. Distribution attributable to section 965(b) previously taxed earnings and profits; brother-sister.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 5* of this paragraph (j), except that USP owns all the stock of CFC2, USP's adjusted basis in the stock of CFC2 is zero, CFC1 made no distributions, and on January 1, 2018, CFC2 distributes \$100x to USP.

(ii) *Analysis.* (A) *Application of the gain reduction rule.* Under paragraph (d)(1) of this section, CFC2 has \$100x of section 965(b) previously taxed earnings and profits with respect to USP, and, under paragraph (d)(2) of this section, CFC1's earnings and profits described in section 959(c)(3) (deficit of \$100x) are increased by \$100x to \$0. USP receives a distribution from CFC2 during the inclusion year of CFC2 that is attributable to the \$100x of section 965(b) previously taxed earnings and profits of CFC2. Under paragraph (g)(1) of this section, the amount of gain that USP otherwise would recognize with respect to the stock of CFC2 under section 961(b)(2) is reduced (but not below zero) by \$100x, the amount of CFC2's section 965(b) previously taxed earnings and profits with respect to USP under paragraph (d)(1) of this section.

(B) *Adjustments to the basis of CFC1 and CFC2.* Because USP makes the election described in paragraph (f)(2) of this section, as of the close of November 30, 2018, USP's basis in the stock of CFC2 is increased under paragraph (f)(2)(ii)(A) of this section by the amount of CFC2's section 965(b) previously taxed earnings and profits with respect to USP under paragraph (d)(1) of this section (\$100x) and reduced under paragraph (g)(2) of this section by the amount of gain that would have been recognized by USP with respect to the stock of CFC2 under section 961(b)(2) but for the application of paragraph (g)(1) of this section (\$100x). As of the close of November 30, 2018, USP's basis in CFC1 is reduced under paragraph (f)(2)(ii)(B) of this section by an amount equal to the portion of USP's pro rata share of the specified E&P deficit of CFC1 taken into account in determining USP's section 965(a) inclusion amount with respect to CFC2 (\$100x). Under paragraph (h)(3) of this section, the excess of the reduction under paragraph (f) of this section over USP's basis in the stock of CFC1 (in this case, \$100x) is treated as gain recognized by USP from the sale or exchange of property.

■ **Par. 7.** Section 1.965–3 is added to read as follows:

**§ 1.965–3 Section 965(c) deductions.**

(a) *Scope.* This section provides rules regarding section 965(c) deductions and section 965(c) deduction amounts. Paragraph (b) of this section provides rules for disregarding certain assets for purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder. Paragraph (c) of this

section provides rules for determining the aggregate foreign cash position for a section 958(a) U.S. shareholder inclusion year. Paragraph (d) of this section provides a rule regarding certain expatriated entities. Paragraph (e) of this section provides a rule for the treatment of section 965(c) deductions in connection with an election under section 962. Paragraph (f) of this section provides rules regarding the treatment of a section 965(c) deduction under certain provisions of the Internal Revenue Code. Paragraph (g) of this section provides a rule for domestic pass-through entities.

(b) *Rules for disregarding certain assets for determining aggregate foreign cash position—*(1) *Disregard of certain obligations between related specified foreign corporations.* In determining the aggregate foreign cash position of a section 958(a) U.S. shareholder, any account receivable, account payable, short-term obligation, or derivative financial instrument between a specified foreign corporation with respect to which the section 958(a) U.S. shareholder owns section 958(a) stock and a related specified foreign corporation on a cash measurement date is disregarded to the extent of the smallest of the product of the amount of the item on such cash measurement date of each specified foreign corporation and the section 958(a) U.S. shareholder's ownership percentage of section 958(a) stock of the specified foreign corporation owned by the section 958(a) U.S. shareholder on such date. For purposes of this paragraph (b)(1)(i), a specified foreign corporation is treated as a related specified foreign corporation with respect to another specified foreign corporation if, as of the cash measurement date referred to in the preceding sentence of each specified foreign corporation, the specified foreign corporations are related persons within the meaning of section 954(d)(3), substituting the term "specified foreign corporation" for "controlled foreign corporation" in each place that it appears.

(2) *Disregard of other assets upon demonstration of double-counting.* For purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder, the section 958(a) U.S. shareholder's pro rata share of the cash position of a specified foreign corporation on a cash measurement date is reduced by amounts of net accounts receivable, actively traded property, and short-term obligations to the extent such amounts are attributable to amounts taken into account in determining the section 958(a) U.S. shareholder's pro rata share of the cash position of another

specified foreign corporation on such cash measurement date and to the extent not disregarded pursuant to paragraph (b)(1) of this section. However, the preceding sentence applies only if the section 958(a) U.S. shareholder attaches a statement containing the information outlined in paragraphs (b)(2)(i) through (v) of this section to its timely filed return (taking into account extensions, if any) for the section 958(a) U.S. shareholder inclusion year, or, if the section 958(a) U.S. shareholder has multiple section 958(a) U.S. shareholder inclusion years, the later of such years. Relief is not available under § 301.9100–2 or § 301.9100–3 to allow late filing of the statement. The statement must contain the following information with respect to each specified foreign corporation for which the cash position is reduced under this paragraph (b)(2)—

(i) A description of the asset that would be taken into account with respect to both specified foreign corporations,

(ii) A statement of the amount by which its pro rata share of the cash position of one specified foreign corporation is reduced,

(iii) A detailed explanation of why there would otherwise be double-counting, including the computation of the amount taken into account with respect to the other specified foreign corporation, and

(iv) An explanation of why paragraph (b)(1) of this section does not apply to disregard such amount.

(3) *Examples.* The following examples illustrate the application of this paragraph (b).

*Example 1.* (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation. CFC1 owns 95% of the only class of stock of CFC2, also a foreign corporation, and 40% of the only class of stock of CFC3, also a foreign corporation. The remaining 5% of the only class of stock of CFC2 is owned by a person unrelated to USP, CFC1, and CFC2; and the remaining 60% of the only class of stock of CFC3 is owned by a person unrelated to USP and CFC1. USP, CFC1, and CFC3 have calendar year taxable years. CFC2 has a taxable year ending on November 30. On November 15, 2015, CFC1 makes a loan of \$100x to CFC2, which is required to be and is, in fact, repaid on January 1, 2016. On November 15, 2016, CFC2 sells inventory to CFC1 in exchange for an account receivable of \$200x, which is required to be and is, in fact, repaid on December 15, 2016. On August 1, 2017, CFC1 makes a loan of \$300x to CFC3, which is required to be and is, in fact, repaid on January 31, 2018.

(ii) *Analysis—*(A) *Loan from CFC1 to CFC2.* For purposes of determining the aggregate foreign cash position of USP, a section 958(a) U.S. shareholder of CFC1, under paragraph

(b)(1) of this section, because CFC1 and CFC2 are related within the meaning of paragraph (b)(1) of this section, the short-term obligation of CFC2 held by CFC1 outstanding on the first cash measurement date of each specified foreign corporation, November 30, 2015, and December 31, 2015, respectively, is disregarded to the extent of 95%, the smallest ownership percentage of section 958(a) stock of CFC1 and CFC2 owned by USP on such first cash measurement dates. Accordingly, USP only takes into account \$5 (\$100 – 95% of \$100) of the short-term obligation in determining CFC1's cash position for purposes of determining its aggregate foreign cash position.

(B) *Account receivable of CFC1 held by CFC2.* Because the account receivable of CFC1 held by CFC2 on its second cash measurement date, November 30, 2016, is not outstanding on CFC1's second cash measurement date, December 31, 2016, paragraph (b)(1) of this section does not apply to disregard any portion of such account receivable.

(C) *Loan from CFC1 to CFC3.* Because CFC3 is not related to CFC1 within the meaning of paragraph (b)(1) of this section, paragraph (b)(1) of this section does not apply to disregard any portion of such short-term obligation.

*Example 2. (i) Facts.* The facts are the same as in *Example 1*, except that on December 1, 2015, CFC1 sells 5% of the stock of CFC2 to an unrelated person.

(ii) *Analysis.* The analysis is the same as in *Example 1*, except that the short-term obligation of CFC2 held by CFC1 outstanding on both of their first cash measurement dates, November 30, 2015, and December 31, 2015, respectively, is disregarded under paragraph (b)(1) of this section to the extent of 90%, the smallest ownership percentage of section 958(a) stock of CFC1 and CFC2 by USP on such first cash measurement dates. Accordingly, USP takes into account \$10 (\$100 – 90% of \$100) of the short-term obligation in determining CFC1's cash position for purposes of determining its aggregate foreign cash position.

*Example 3. (i) Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns 45% of the only class of stock of CFC2, also a foreign corporation. The remainder of the CFC2 stock is actively traded on an established financial market but is not owned by any person related to USP or CFC1. USP, CFC1, and CFC2 have calendar year taxable years. The value of the CFC2 stock owned by CFC1 is \$500x on each of the cash measurement dates. Also on each of the cash measurement dates, CFC2 has \$300x of assets described in section 965(c)(3)(B) and § 1.965–1(f)(16) that are taken into account in determining its cash position.

(ii) *Analysis.* For purposes of determining USP's aggregate foreign cash position, USP's pro rata share of the cash position of CFC1 on each cash measurement date may be reduced by the amount of the stock of CFC2 to the extent attributable to amounts taken into account in determining USP's pro rata share of the cash position of CFC2 on such cash measurement date (that is, to the extent of the \$135x taken into account with respect

to CFC2), provided USP attaches a statement to its timely filed return (taking into account extensions, if any) containing the following: A description of the CFC2 stock and the assets of CFC2 taken into account in determining its cash position; a statement that USP's pro rata share of the cash position of CFC1 is being reduced by \$135x; the computation of the \$135x taken into account with respect to CFC2; and an explanation of why paragraph (b)(1) of this section does not apply to disregard such amount.

*Example 4. (i) Facts.* USP, a domestic corporation, owns all of the stock of CFC1 and CFC2, each a foreign corporation. USP, CFC1, and CFC2 have calendar year taxable years. CFC1 buys goods on credit from a third party for \$100x and thus has an account payable of \$100x. CFC1 modifies the goods and sells to CFC2 for \$105x in exchange for an account receivable of \$105x. CFC2 modifies the goods and sells to another third party for \$110x in exchange for an account receivable of \$110x. All of the accounts payable and accounts receivable are outstanding on the final cash measurement date.

(ii) *Analysis.* For purposes of determining USP's aggregate foreign cash position, on the final cash measurement date, CFC1 has net accounts receivable of \$0, because, pursuant to paragraph (b)(1) of this section, CFC1's account receivable from CFC2 is disregarded, and CFC2 has net accounts receivable of \$110, because, pursuant to paragraph (b)(1) of this section, CFC2's account payable to CFC1 is disregarded. USP cannot rely on the rule in paragraph (b)(2) of this section because no amounts attributable to CFC2's net accounts receivable are taken into account with respect to another specified foreign corporation.

(c) *Determination of aggregate foreign cash position for a section 958(a) U.S. shareholder inclusion year—(1) Single section 958(a) U.S. shareholder inclusion year.* If a section 958(a) U.S. shareholder has a single section 958(a) U.S. shareholder inclusion year, then the section 958(a) U.S. shareholder's aggregate foreign cash position for the section 958(a) U.S. shareholder inclusion year is equal to the aggregate foreign cash position of the section 958(a) U.S. shareholder.

(2) *Multiple section 958(a) U.S. shareholder inclusion years.* If a section 958(a) U.S. shareholder has multiple section 958(a) U.S. shareholder inclusion years, then the section 958(a) U.S. shareholder's aggregate foreign cash position for each section 958(a) U.S. shareholder inclusion year is determined by allocating the aggregate foreign cash position to a section 958(a) U.S. shareholder inclusion year under paragraphs (c)(2)(i) and (c)(2)(ii) of this section.

(i) *Allocation to first section 958(a) U.S. shareholder inclusion year.* A portion of the aggregate foreign cash position of the section 958(a) U.S.

shareholder is allocated to the first section 958(a) U.S. shareholder inclusion year in an amount equal to the lesser of the section 958(a) U.S. shareholder's aggregate foreign cash position, or the section 958(a) U.S. shareholder's aggregate section 965(a) inclusion amount for the section 958(a) U.S. shareholder inclusion year.

(ii) *Allocation to succeeding section 958(a) U.S. shareholder inclusion years.* The amount of the section 958(a) U.S. shareholder's aggregate foreign cash position allocated to any succeeding section 958(a) U.S. shareholder inclusion year equals the lesser of the excess, if any, of the section 958(a) U.S. shareholder's aggregate foreign cash position over the aggregate amount of its aggregate foreign cash position allocated to preceding section 958(a) U.S. shareholder inclusion years under paragraph (c)(2)(i) of this section and this paragraph (c)(2)(ii), or the section 958(a) U.S. shareholder's aggregate section 965(a) inclusion amount for such succeeding section 958(a) U.S. shareholder inclusion year.

(3) *Estimation of aggregate foreign cash position.* For purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder, the section 958(a) U.S. shareholder may assume that its pro rata share of the cash position of any specified foreign corporation whose last taxable year beginning before January 1, 2018, ends after the date the return for such section 958(a) U.S. shareholder inclusion year (*the estimated section 958(a) U.S. shareholder inclusion year*) is timely filed (taking into account extensions, if any) is zero as of the cash measurement date with which the taxable year of such specified foreign corporation ends. If a section 958(a) U.S. shareholder's pro rata share of the cash position of a specified foreign corporation is treated as zero pursuant to the preceding sentence, the amount described in § 1.965–1(f)(8)(i)(A) with respect to such section 958(a) U.S. shareholder in fact exceeds the amount described in § 1.965–1(f)(8)(i)(B) with respect to such section 958(a) U.S. shareholder, and the aggregate section 965(a) inclusion amount for the estimated section 958(a) U.S. shareholder inclusion year exceeds the amount described in § 1.965–1(f)(8)(i)(B) with respect to such section 958(a) U.S. shareholder, interest and penalties will not be imposed if such section 958(a) U.S. shareholder amends the return for the estimated section 958(a) U.S. shareholder inclusion year to account for the correct aggregate foreign cash position for the year. The amended return must be filed by the due date

(taking into account extensions, if any) for the return for the year after the estimated section 958(a) U.S. shareholder inclusion year.

(4) *Examples.* The following examples illustrate the application of this paragraph (c).

*Example 1. Estimation of aggregate foreign cash position for a section 958(a) U.S. shareholder inclusion year—(i) Facts.*

USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP is a calendar year taxpayer. CFC1 has a taxable year ending on December 31, and CFC2 has a taxable year ending on November 30. The cash position of CFC1 on each of December 31, 2015, December 31, 2016, and December 31, 2017, is \$100x. The cash position of CFC2 on each of November 30, 2015, and November 30, 2016, is \$200x. USP has a section 965(a) inclusion amount of \$300x with respect to CFC1.

(ii) *Analysis.* In determining its aggregate foreign cash position for its 2017 taxable year, USP may assume that its pro rata share of the cash position of CFC2 will be zero as of November 30, 2018, for purposes of filing its return due on April 18, 2018 (or due on October 15, 2018, with extension). Therefore, USP's aggregate foreign cash position is treated as \$300, which is the greater of (a) \$300x, 50% of the sum of USP's pro rata shares of the cash position of CFC1 as of December 31, 2015, and December 31, 2016, and of the cash position of CFC2 as of November 30, 2015, and November 30, 2016, and (b) \$100x, USP's pro rata share of the cash position of CFC1 as of December 31, 2017. If USP's pro rata share of the cash position of CFC2 as of November 30, 2018, in fact exceeds \$200, USP must amend its return for its 2017 taxable year to reflect the correct aggregate foreign cash position by the due date for its return for its 2018 taxable year, April 15, 2019 (or October 15, 2019, with extension).

*Example 2. Allocation of aggregate foreign cash position among section 958(a) U.S. shareholder inclusion years—(i) Facts.*

The facts are the same as in paragraph (i) of *Example 1* of this paragraph (c)(4), except that the cash position of each of CFC1 and CFC2 on all relevant cash measurement dates is \$200, with the result that USP has an aggregate foreign cash position determined under § 1.965-1(f)(8)(i) of \$400. For its 2017 taxable year, USP has a section 965(a) inclusion amount with respect to CFC1 of \$300, and for its 2018 taxable year, USP has a section 965(a) inclusion amount with respect to CFC2 of \$300.

(ii) *Analysis.* Under paragraph (c)(2)(i) of this section, USP's aggregate foreign cash position for 2017 is \$300, which is the lesser of USP's aggregate foreign cash position determined under § 1.965-1(f)(8)(i) (\$400) or the section 965(a) inclusion amount (\$300) that USP takes into account in 2017. Under paragraph (c)(2)(ii) of this section, the amount of USP's aggregate foreign cash position for 2018 is \$100, USP's aggregate foreign cash position determined under § 1.965-1(f)(8)(i) (\$400) reduced by the amount of its aggregate foreign cash position

for 2017 (\$300) under paragraph (c)(2)(i) of this section.

(d) *Increase of income by section 965(c) deduction of an expatriated entity—(1) In general.* If a person is allowed a section 965(c) deduction and the person (or a successor) first becomes an expatriated entity, with respect to a surrogate foreign corporation, at any time during the 10-year period beginning on December 22, 2017, then the tax imposed by chapter 1 of the Internal Revenue Code is increased for the first taxable year in which such person becomes an expatriated entity by an amount equal to 35 percent of the person's section 965(c) deductions, and no credits are allowed against such increase in tax. The preceding sentence applies only if the surrogate foreign corporation first becomes a surrogate foreign corporation on or after December 22, 2017.

(2) *Definition of expatriated entity.* For purposes of paragraph (d)(1) of this section, the term *expatriated entity* has the same meaning given such term under section 7874(a)(2), except that such term does not include an entity if the surrogate foreign corporation with respect to the entity is treated as a domestic corporation under section 7874(b).

(3) *Definition of surrogate foreign corporation.* For purposes of paragraph (d)(1) of this section, the term *surrogate foreign corporation* has the meaning given such term in section 7874(a)(2)(B).

(e) *Section 962 election—(1) In general.* In the case of an individual (including a trust or estate) that makes an election under section 962, any section 965(c) deduction taken into account under § 1.962-1(b)(1)(i)(B) in determining taxable income as used in section 11 is not taken into account for purposes of determining the individual's taxable income under section 11.

(2) *Example.* The following example illustrates the application of the rule in this paragraph (e).

*Example.* (i) *Facts.* USI, a United States citizen, owns 10% of the capital and profits of USPRS, a domestic partnership that has a calendar year taxable year, the remainder of which is owned by foreign persons unrelated to USI or USPRS. USPRS owns all of the stock of FS, a foreign corporation that is a controlled foreign corporation with a calendar year taxable year. USPRS has a section 965(a) inclusion amount with respect to FS of \$1,000 and has a section 965(c) deduction amount of \$700. FS has no post-1986 foreign income taxes (as defined in section 902(c)(1) as in effect before December 22, 2017). USI makes a valid election under section 962 for 2017.

(ii) *Analysis.* USI's "taxable income" described in § 1.962-1(b)(1)(i) equals \$100

(USI's domestic pass-through owner share of USPRS's section 965(a) inclusion amount) minus \$70 (USI's domestic pass-through owner share of USPRS's section 965(c) deduction amount), or \$30. No other deductions are allowed in determining this amount. USI's tax on the \$30 section 965(a) inclusion will be equal to the tax that would be imposed on such amount under section 11 if USI were a domestic corporation. Under paragraph (e)(1) of this section, USI cannot deduct \$70 for purposes of determining USI's taxable income that is subject to tax under section 1.

(f) *Treatment of section 965(c) deduction under certain provisions of the Internal Revenue Code—(1) Section 63(d).* A section 965(c) deduction is not treated as an itemized deduction for any purpose of the Internal Revenue Code.

(2) *Sections 705, 1367, and 1368—(i) Adjustments to basis.* In the case of a domestic partnership or S corporation—

(A) The aggregate amount of its section 965(a) inclusions net the aggregate amount of its section 965(c) deductions is treated as a separately stated item of net income solely for purposes of calculating basis under section 705(a) and § 1.705-1(a) and section 1367(a)(1) and § 1.1367-1(f), and

(B) The aggregate amount of its section 965(a) inclusions equal to the aggregate amount of its section 965(c) deductions is treated as income exempt from tax solely for purposes of calculating basis under sections 705(a)(1)(B), 1367(a)(1)(A), and § 1.1367-1(f).

(ii) *S corporation accumulated adjustments account.* In the case of an S corporation, the aggregate amount of its section 965(a) inclusions equal to the aggregate amount of its section 965(c) deductions is treated as income not exempt from tax solely for purposes of determining whether an adjustment is made to an accumulated adjustments account under section 1368(e)(1)(A) and § 1.1368-2(a)(2).

(iii) *Example.* The following example illustrates the application of this paragraph (f)(2).

*Example.* (i) *Facts.* USI, a United States citizen, owns all of the stock of S Corp, an S corporation, which owns all of the stock of FS, a foreign corporation. S Corp has a section 965(a) inclusion of \$1,000 with respect to FS and has a \$700 section 965(c) deduction.

(ii) *Analysis.* As a result of the application of paragraph (f)(2)(i)(A) of this section, solely for purposes of calculating basis under section 1367(a)(1) and § 1.1367-1(f), USI treats as a separately stated item of net income \$300 (its pro rata share of the net of S Corp's \$1,000 aggregate section 965(a) inclusion and S Corp's \$700 aggregate section 965(c) deduction). Accordingly, USI's basis in S Corp is increased under section 1367(a)(1) by \$300. As a result of the

application of paragraph (f)(2)(i)(B) of this section, an amount of S Corp's aggregate section 965(a) inclusion equal to its aggregate section 965(c) deduction, \$700, is treated as tax exempt income solely for purposes of calculating basis under section 1367(a)(1)(A) and § 1.1367-1(f), and accordingly, USI's basis in S Corp is further increased by its pro rata share of such amount, \$700. S Corp's accumulated adjustments account (AAA) is increased under section 1368(e)(1)(A) by the \$1,000 section 965(a) inclusion taken into account and reduced by the \$700 section 965(c) deduction taken into account. In addition, as a result of the application of paragraph (f)(2)(ii) of this section, S Corp's AAA is further increased by an amount of S Corp's aggregate section 965(a) inclusion equal to its aggregate section 965(c) deduction, \$700, which is not treated as tax-exempt income for purposes of § 1.1368-2(a)(2).

(3) *Section 1411.* For purposes of section 1411 and § 1.1411-4(f)(6), a section 965(c) deduction is not treated as being properly allocable to any section 965(a) inclusion.

(4) *Section 4940.* For purposes of section 4940(c)(3)(A), a section 965(c) deduction is not treated as an ordinary and necessary expense paid or incurred for the production or collection of gross investment income.

(g) *Domestic pass-through entities.* For purposes of determining a domestic pass-through owner share, a section 965(c) deduction amount of a domestic pass-through entity must be allocated to a domestic pass-through owner in the same proportion as an aggregate section 965(a) inclusion amount of the domestic pass-through entity for a section 958(a) U.S. shareholder inclusion year is allocated to the domestic pass-through owner.

■ **Par. 8.** Section 1.965-4 is added to read as follows:

**§ 1.965-4 Disregard of certain transactions.**

(a) *Scope.* This section provides rules that disregard certain transactions for purposes of applying section 965 to a United States shareholder. Paragraph (b) of this section provides rules that disregard transactions undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder. Paragraph (c) of this section provides rules that disregard certain changes in method of accounting and entity classification elections that would otherwise change the amount of a section 965 element. Paragraph (d) of this section defines the term *section 965 element*. Paragraph (e) of this section provides rules of application concerning paragraphs (b) and (c) of this section. Paragraph (f) of this section provides rules that disregard certain transactions occurring

between E&P measurement dates. Paragraph (g) of this section provides examples illustrating the application of this section.

(b) *Transactions undertaken with a principal purpose of changing the amount of a section 965 element—(1) General rule.* A transaction is disregarded for purposes of determining the amounts of all section 965 elements of a United States shareholder if each of the following conditions is satisfied with respect to any section 965 element of the United States shareholder—

(i) The transaction occurs, in whole or in part, on or after November 2, 2017 (the *specified date*);

(ii) The transaction is undertaken with a principal purpose of changing the amount of a section 965 element of the United States shareholder; and

(iii) The transaction would, without regard to this paragraph (b)(1), change the amount of the section 965 element of the United States shareholder.

(2) *Presumptions and exceptions for the application of the general rule—(i) Overview.* Under paragraphs (b)(2)(iii) through (v) of this section, certain transactions are presumed to be undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder for purposes of paragraph (b)(1) of this section. The presumptions described in paragraphs (b)(2)(iii) through (v) of this section may be rebutted only if facts and circumstances clearly establish that the transaction was not undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder. A taxpayer that takes the position that the presumption is rebutted must attach a statement to its return for its taxable year in which or with which the relevant taxable year of the relevant specified foreign corporation ends disclosing that it has rebutted the presumption. In the case of a transaction described in paragraph (b)(2)(iii) or (iv) of this section, if the presumption does not apply because the transaction occurs in the ordinary course of business, whether the transaction was undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder must be determined under all the facts and circumstances. Under paragraphs (b)(2)(iii) through (v) of this section, certain transactions are treated per se as being undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder and therefore such transactions are disregarded under paragraph (b)(1) of this section if the conditions of paragraphs (b)(1)(i) and

(iii) of this section are satisfied. Further, under paragraph (b)(2)(iii) of this section, certain distributions are treated per se as not being undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder and therefore are not disregarded under paragraph (b)(1) of this section.

(ii) *Definitions—(A) Relatedness.* For purposes of paragraphs (b)(2)(iii) through (v) of this section, a person is treated as related to a United States shareholder if, either immediately before or immediately after the transaction (or series of related transactions), the person bears a relationship to the United States shareholder described in section 267(b) or section 707(b).

(B) *Transfer—(1) In general.* For purposes of paragraphs (b)(2)(iii) and (v) of this section, the term *transfer* includes any disposition of stock or property, including a sale or exchange, contribution, distribution, issuance, redemption, recapitalization, or loan of stock or property, and includes an indirect transfer of stock or property.

(2) *Indirect transfer.* For purposes of paragraph (b)(2)(ii)(B)(1) of this section, the term *indirect transfer* includes a transfer of property or stock owned by an entity through a transfer of an interest in such entity (or an interest in an entity that has a direct or indirect interest in such entity), and a transfer of property or stock to a person through a transfer of property or stock to a pass-through entity of which such person is a direct or indirect owner.

(iii) *Cash reduction transactions—(A) General rule.* For purposes of paragraph (b)(1) of this section, a cash reduction transaction is presumed to be undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder. For this purpose, the term *cash reduction transaction* means a transfer of cash, accounts receivable, or cash-equivalent assets by a specified foreign corporation to a United States shareholder of the specified foreign corporation or a person related to a United States shareholder of the specified foreign corporation, or an assumption by a specified foreign corporation of an account payable of a United States shareholder of the specified foreign corporation or a person related to a United States shareholder of the specified foreign corporation, if such transfer or assumption would, without regard to paragraph (b)(1) of this section, reduce the aggregate foreign cash position of the United States shareholder. The presumption described in this paragraph (b)(2)(iii) does not

apply to a cash reduction transaction that occurs in the ordinary course of business.

(B) *Per se rules for certain distributions.* Notwithstanding the presumption described in paragraph (b)(2)(iii)(A) of this section, except in the case of a specified distribution, a cash reduction transaction that is a distribution by a specified foreign corporation to a United States shareholder of the specified foreign corporation is treated per se as not being undertaken with a principal purpose of changing the amount of a section 965 element of the United States shareholder for purposes of paragraph (b)(1) of this section. A specified distribution is treated per se as being undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder for purposes of paragraph (b)(1) of this section. For purposes of this paragraph (b)(2)(iii)(B), the term *specified distribution* means a cash reduction transaction that is a distribution by a specified foreign corporation of a United States shareholder if and to the extent that, at the time of the distribution, there was a plan or intention for the distributee to transfer cash, accounts receivable, or cash-equivalent assets to any specified foreign corporation of the United States shareholder or the distribution is a non pro rata distribution to a foreign person that is related to the United States shareholder.

(iv) *E&P reduction transactions—(A) General rule.* For purposes of paragraph (b)(1) of this section, an E&P reduction transaction is presumed to be undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder. For purposes of this paragraph (b)(2)(iv), the term *E&P reduction transaction* means a transaction between a specified foreign corporation and any of a United States shareholder of the specified foreign corporation, another specified foreign corporation of a United States shareholder of the specified foreign corporation, or any person related to a United States shareholder of the specified foreign corporation, if the transaction would, without regard to paragraph (b)(1) of this section, reduce either the accumulated post-1986 deferred foreign income or the post-1986 undistributed earnings (as defined in section 902(c)(1)) of the specified foreign corporation or another specified foreign corporation of any United States shareholder of such specified foreign corporation. The presumption described in this paragraph (b)(2)(iv)(A) does not apply to an E&P reduction transaction

that occurs in the ordinary course of business.

(B) *Per se rule for specified transactions.* A specified transaction is treated per se as being undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder for purposes of paragraph (b)(1) of this section. For purposes of the preceding sentence, the term *specified transaction* means an E&P reduction transaction that involves one or more of the following: A complete liquidation of a specified foreign corporation to which section 331 applies; a sale or other disposition of stock by a specified foreign corporation; or a distribution by a specified foreign corporation that reduces the earnings and profits of the specified foreign corporation pursuant to section 312(a)(3).

(v) *Pro rata share transactions—(A) General rule.* For purposes of paragraph (b)(1) of this section, a pro rata share transaction is presumed to be undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder. For this purpose, the term *pro rata share transaction* means either a pro rata share reduction transaction or an E&P deficit transaction.

(1) *Definition of pro rata share reduction transaction.* For purposes of this paragraph (b)(2)(v)(A), the term *pro rata share reduction transaction* means a transfer of the stock of a specified foreign corporation by either a United States shareholder of the specified foreign corporation or a person related to a United States shareholder of the specified foreign corporation (including by the specified foreign corporation itself) to a person related to the United States shareholder if the transfer would, without regard to paragraph (b)(1) of this section, reduce the United States shareholder's pro rata share of the section 965(a) earnings amount of the specified foreign corporation, reduce the United States shareholder's pro rata share of the cash position of the specified foreign corporation, or both.

(2) *Definition of E&P deficit transaction.* For purposes of this paragraph (b)(2)(v)(A), an *E&P deficit transaction* means a transfer to either a United States shareholder or a person related to the United States shareholder of the stock of an E&P deficit foreign corporation by a person related to the United States shareholder (including by the E&P deficit foreign corporation itself) if the transfer would, without regard to paragraph (b)(1) of this section, increase the United States shareholder's pro rata share of the specified E&P

deficit of the E&P deficit foreign corporation.

(B) *Per se rule for internal group transactions.* An internal group transaction is treated per se as being undertaken with a principal purpose of changing the amount of a section 965 element of a United States shareholder for purposes of paragraph (b)(1) of this section. For purposes of the preceding sentence, the term *internal group transaction* means a pro rata share transaction if, immediately before or after the transfer, the transferor of the stock of the specified foreign corporation and the transferee of such stock are members of an affiliated group in which the United States shareholder is a member. For this purpose, the term *affiliated group* has the meaning set forth in section 1504(a), determined without regard to paragraphs (1) through (8) of section 1504(b), and the term *members of an affiliated group* means entities included in the same affiliated group. For purposes of identifying an affiliated group and the members of such group, each partner in a partnership, as determined without regard to this sentence, is treated as holding its proportionate share of the stock held by the partnership, as determined under the rules and principles of sections 701 through 777, and if one or more members of an affiliated group own, in the aggregate, at least 80 percent of the interests in a partnership's capital or profits, the partnership will be treated as a corporation that is a member of the affiliated group.

(C) *Example.* The following example illustrates the application of the rules in this paragraph (b)(2)(v).

*Example.* (i) *Facts.* FP, a foreign corporation, owns all of the stock of USP, a domestic corporation. USP owns all of the stock of FS, a foreign corporation. USP has a calendar year taxable year; FS's taxable year ends November 30. On January 2, 2018, USP transfers all of the stock of FS to FP in exchange for cash. On January 3, 2018, FS makes a distribution with respect to the stock transferred to FP. USP treats the transaction as a taxable sale of the FS stock and claims a dividends received deduction under section 245A with respect to its deemed dividend under section 1248(j) as a result of the sale. FS has post-1986 earnings and profits as of December 31, 2017, and no post-1986 earnings and profits that are attributable to income effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1 or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959.

(ii) *Analysis.* The transfer of the stock of FS is a pro rata share reduction transaction and thus a pro rata share transaction because such transfer is by USP, a United States

shareholder, to FP, a person related to USP, and the transfer would, without regard to the rule in paragraph (b)(1) of this section, reduce USP's pro rata share of the section 965(a) earnings amount of FS. Because USP and FP are also members of an affiliated group within the meaning of paragraph (b)(2)(v)(B) of this section, the transfer of the stock of FS is also an internal group transaction and is treated per se as being undertaken with a principal purpose of changing the amount of a section 965 element of USP. Accordingly, because the transfer occurs after the specified date and reduces USP's section 965(a) inclusion amount with respect to FS, the transfer is disregarded for purposes of determining any section 965 element of USP with the result that, among other things, USP's pro rata share of FS's section 965(a) earnings amount is determined as if USP owned (within the meaning of section 958(a)) 100% of the stock of FS on the last day of FS's inclusion year and no other person received a distribution with respect to such stock during such year. See section 951(a)(2)(A) and (B).

(c) *Disregard of certain changes in method of accounting and entity classification elections*—(1) *Changes in method of accounting.* Any change in method of accounting made for a taxable year of a specified foreign corporation that ends in 2017 or 2018 is disregarded for purposes of determining the amounts of all section 965 elements with respect to a United States shareholder if the change in method of accounting would, without regard to this paragraph (c)(1), change the amount of any section 965 element with respect to the United States shareholder, regardless of whether the change in method of accounting is made with a principal purpose of changing the amount of a section 965 element with respect to the United States shareholder. The rule described in the preceding sentence applies regardless of whether the change in method of accounting was made in accordance with the procedures described in Rev. Proc. 2015-13, 2015-5 I.R.B. 419 (or successor), and regardless of whether the change in method of accounting was properly made, but it does not apply to a change in method of accounting for which the original and/or duplicate copy of any Form 3115, "Application for Change in Accounting Method," requesting the change was filed before the specified date (as defined in paragraph (b)(1) of this section).

(2) *Entity classification elections.* An election under § 301.7701-3 to change the classification of an entity that is filed on or after the specified date (as defined in paragraph (b)(1) of this section) is disregarded for purposes of determining the amounts of all section 965 elements of a United States shareholder if the election would,

without regard to this paragraph (c)(2) of this section, change the amount of any section 965 element of the United States shareholder, regardless of whether the election is made with a principal purpose of changing the amount of a section 965 element of the United States shareholder. An election filed on or after the specified date is subject to the preceding sentence even if the election was filed with an effective date that is before the specified date.

(d) *Definition of a section 965 element.* For purposes of paragraphs (b) and (c) of this section, the term *section 965 element* means, with respect to a United States shareholder, any of the following amounts (collectively, *section 965 elements*)—

(1) The United States shareholder's section 965(a) inclusion amount with respect to a specified foreign corporation;

(2) The aggregate foreign cash position of the United States shareholder; or

(3) The amount of foreign income taxes of a specified foreign corporation deemed paid by the United States shareholder under section 960 as a result of a section 965(a) inclusion.

(e) *Rules for applying paragraphs (b) and (c) of this section*—(1)

*Determination of whether there is a change in the amount of a section 965 element.* For purposes of paragraph (b) and (c) of this section, there is a change in the amount of a section 965 element of a United States shareholder as a result of a transaction, change in accounting method, or election to change an entity's classification, if, without regard to paragraph (b)(1), (c)(1), or (c)(2) of this section, the transaction, change in accounting method, or change in entity classification would—

(i) Reduce the amount described in paragraph (d)(1) of this section,

(ii) Reduce the amount described in paragraph (d)(2) of this section, but only if such amount is less than the United States shareholder's aggregate section 965(a) inclusion amount, or

(iii) Increase the amount described in paragraph (d)(3) of this section.

(2) *Treatment of domestic pass-through owners as United States shareholders.* For purposes of paragraph (b) and (c) of this section, if a domestic pass-through entity is a United States shareholder, then a domestic pass-through owner, with respect to the domestic pass-through entity, that is not otherwise a United States shareholder is treated as a United States shareholder.

(f) *Disregard of certain transactions occurring between E&P measurement dates*—(1) *Disregard of specified payments.* A specified payment made by

a specified foreign corporation (*payor specified foreign corporation*) to another specified foreign corporation (*payee specified foreign corporation*) is disregarded for purposes of determining the post-1986 earnings and profits of each of the payor specified foreign corporation and the payee specified foreign corporation as of the E&P measurement date on December 31, 2017.

(2) *Definition of specified payment.* For purposes of paragraph (f)(1) of this section, the term *specified payment* means any amount paid or accrued by the payor specified foreign corporation, including a distribution by the payor specified foreign corporation with respect to its stock, if each of the following conditions are satisfied:

(i) Immediately before or immediately after the payment or accrual of the amount, the payor specified foreign corporation and the payee specified foreign corporation are related within the meaning of section 954(d)(3), substituting the term "specified foreign corporation" for "controlled foreign corporation" in each place that it appears;

(ii) The payor specified foreign corporation and the payee specified foreign corporation do not have the same tentative E&P measurement date;

(iii) The payment or accrual of the amount occurs after November 2, 2017, and on or before December 31, 2017; and

(iv) The payment or accrual of the amount would, without regard to the application of paragraph (f)(1) of this section, reduce the post-1986 earnings and profits of the payor specified foreign corporation as of the E&P measurement date on December 31, 2017.

(3) *Definition of tentative E&P measurement date.* For purposes of paragraph (f)(2) of this section, the term *tentative E&P measurement date* means—

(i) With respect to a specified foreign corporation that is not described in paragraph (f)(3)(ii) of this section, the E&P measurement date of the specified foreign corporation that, without regard to the application of paragraph (f)(1) of this section, would result in the "greater of" amount of accumulated post-1986 deferred foreign income described in section 965(a) and § 1.965-1(f)(36); and

(ii) With respect to a specified foreign corporation that, without regard to the application of paragraph (f)(1) of this section, would be an E&P deficit foreign corporation, the E&P measurement date as of November 2, 2017.



(4) *Examples.* The following examples illustrate the application of the rules in this paragraph (f).

*Example 1. Deductible payment between wholly owned specified foreign corporations is a specified payment.* (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 have calendar year taxable years. On November 2, 2017, each of CFC1 and CFC2 has post-1986 earnings and profits of 100u. Neither CFC1 nor CFC2 has post-1986 earnings and profits that are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1 or that, if distributed, would be excluded from the gross income of a United States shareholder under section 959 or from the gross income of another shareholder if such shareholder were a United States shareholder; therefore, no adjustment is made under section 965(d)(2) or § 1.965-1(f)(7) and each of CFC1's and CFC2's accumulated post-1986 deferred foreign income is equal to such corporation's post-1986 earnings and profits. On November 3, 2017, CFC2 makes a deductible payment of 10u to CFC1. The payment does not constitute subpart F income. CFC1 and CFC2 have no other items of income or deduction.

(ii) *Analysis.* (A) *Determination of tentative E&P measurement date.* Without regard to paragraph (f)(1) of this section, as of the E&P measurement date on December 31, 2017, CFC1 has post-1986 earnings and profits of 110u (100u plus 10u income from the payment from CFC2), and CFC2 has post-1986 earnings and profits of 90u (100u minus 10u deduction from the payment to CFC1). Therefore, the tentative E&P measurement date of CFC1 is December 31, 2017 (110u), and the tentative E&P measurement date of CFC2 is November 2, 2017 (100u).

(B) *Application of the requirements for a specified payment.* The payment from CFC2 to CFC1 is a specified payment because (A) CFC1 and CFC2 are related specified foreign corporations; (B) CFC1 and CFC2 do not have the same tentative measurement date; (C) the payment occurs after November 2, 2017, and on or before December 31, 2017; and (D) the payment would, without regard to the application of the rule in paragraph (f)(1) of this section, reduce the post-1986 earnings and profits of CFC2 as of the E&P measurement date on December 31, 2017. Under paragraph (f)(1) of this section, the payment is disregarded and CFC1 and CFC2 each have post-1986 earnings and profits of 100u as of December 31, 2017. Accordingly, the section 965(a) earnings amount of each of CFC1 and CFC2 is 100u.

*Example 2. Distribution is a specified payment.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (f)(4), except instead of a deductible payment to CFC1, CFC2 makes a 10u distribution on November 3, 2017, that, without regard to paragraph (f)(1) of this section would reduce the post-1986 earnings and profits of CFC2 as of the E&P

measurement date on December 31, 2017, and increase the post-1986 earnings and profits of CFC1 as of the E&P measurement date on December 31, 2017, by 10u.

(ii) *Analysis.* (A) *Determination of tentative E&P measurement date.* The analysis is the same as in paragraph (ii)(A) of *Example 1* of this paragraph (f)(4).

(B) *Application of the requirements for a specified payment.* The distribution is a specified payment because (A) CFC1 and CFC2 are related specified foreign corporations; (B) CFC1 and CFC2 do not have the same tentative measurement date; (C) the distribution occurs after November 2, 2017, and on or before December 31, 2017; and (D) the distribution would, without regard to the application of the rule in paragraph (f)(1) of this section, reduce the post-1986 earnings and profits of CFC2 as of the E&P measurement date on December 31, 2017. Under paragraph (f)(1) of this section, the distribution is disregarded with the result that CFC1 and CFC2 each have post-1986 earnings and profits of 100u as of the E&P measurement date on December 31, 2017 and a section 965(a) earnings amount of 100u.

*Example 3. Deductible payment between related (but not wholly owned) specified foreign corporations is a specified payment.*

(i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (f)(4), except that CFC1 owns only 51% of the only class of stock of CFC2, the remainder of which is owned by USI, a United States citizen unrelated to USP, CFC1, and CFC2.

(ii) *Analysis.* The analysis is the same as in paragraph (ii) of *Example 1* of this paragraph (f)(4); thus the payment is disregarded with the result that CFC1 and CFC2 each have post-1986 earnings and profits of 100u as of the E&P measurement date on December 31, 2017, and a section 965(a) earnings amount of 100u.

*Example 4. Deductible payment between unrelated specified foreign corporations is not a specified payment.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (f)(4), except that CFC1 owns only 50% of the only class of stock of CFC2, the remainder of which is owned by USI, a United States citizen unrelated to USP, CFC1, and CFC2.

(ii) *Analysis.* Paragraph (f)(1) of this section does not apply because CFC1 and CFC2 are not related. Thus, the payment is taken into account with the result that CFC1 has post-1986 earnings and profits of 110u as of the E&P measurement date on December 31, 2017, and a section 965(a) earnings amount of 110u.

*Example 5. Deductible payment and income accrued from unrelated persons are not specified payments.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (f)(4), except that CFC2 does not make a deductible payment to CFC1, and, between E&P measurement dates, CFC2 accrues gross income of 20u from a person that is not related to CFC2, and CFC1 incurs a deductible expense of 20u to a person that is not related to CFC1.

(ii) *Analysis.* Paragraph (f)(1) of this section does not apply because neither the deductible expense of CFC1 nor the income accrual by CFC2 are attributable to a specified payment.

*Example 6. Deductible payment and income accrued with respect to unrelated persons are not specified payments; deductible payment between wholly specified foreign corporations is a specified payment.*

(i) *Facts.* The facts are the same as in paragraph (i) of *Example 5* of this paragraph (f)(4), except that CFC2 also makes a deductible payment of 10u to CFC1 on November 3, 2017.

(ii) *Analysis.* (A) *Determination of tentative E&P measurement date.* Without regard to paragraph (f)(1) of this section, as of the E&P measurement date on December 31, 2017, CFC1 has post-1986 earnings and profits of 90u (100u minus 20u deductible expense plus 10u income from the payment from CFC2), and CFC2 has post-1986 earnings and profits of 110u (100u plus 20u gross income minus 10u deduction from the deductible payment to CFC1). Therefore, the tentative E&P measurement date of CFC1 is November 2, 2017 (100u) and the tentative E&P measurement date of CFC2 is December 31, 2017 (110u).

(B) *Application of the requirements for a specified payment.* The deductible payment is a specified payment because (A) CFC1 and CFC2 are related specified foreign corporations; (B) CFC1 and CFC2 do not have the same tentative measurement date; (C) the payment occurs after November 2, 2017, and on or before December 31, 2017; and (D) the deductible payment would, without regard to the application of the rule in paragraph (f)(1) of this section, reduce the post-1986 earnings and profits of CFC2 as of the E&P measurement date on December 31, 2017. Accordingly, under paragraph (f)(1) of this section, the deductible payment is disregarded with the result that CFC1 and CFC2 have 80u and 120u of post-1986 earnings and profits as of the E&P measurement date on December 31, 2017, respectively. Accordingly, CFC1 and CFC2 have section 965(a) earnings amounts of 100u and 120u, respectively.

■ **Par. 9.** Section 1.965-5 is added to read as follows:

**§ 1.965-5 Allowance of a credit or deduction for foreign income taxes.**

(a) *Scope.* This section provides rules for the allowance of a credit or deduction for foreign income taxes in connection with the application of section 965. Paragraph (b) of this section provides rules under section 965(g) for the allowance of a credit or deduction for foreign income taxes paid or accrued. Paragraph (c) of this section provides rules for the allowance of a credit or deduction for foreign income taxes treated as paid or accrued in connection with the application of section 965. Paragraph (d) of this section defines the term “applicable percentage.”

(b) *Rules for foreign income taxes paid or accrued.* Neither a deduction (including under section 164) nor a credit under section 901 is allowed for the applicable percentage of any foreign

income taxes paid or accrued with respect to any amount for which a section 965(c) deduction is allowed for a section 958(a) U.S. shareholder inclusion year. Neither a deduction (including under section 164) nor a credit under section 901 is allowed for the applicable percentage of any foreign income taxes attributable to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits. Accordingly, no deduction or credit is allowed for the applicable percentage of any withholding taxes imposed on a United States shareholder by the jurisdiction of residence of the distributing foreign corporation with respect to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits. Similarly, no deduction or credit is allowed for the applicable percentage of net basis taxes imposed on a United States citizen by the citizen's jurisdiction of residence upon receipt of a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits.

(c) *Rules for foreign income taxes treated as paid or accrued*—(1) *Disallowed credit*—(i) *In general*. A credit under section 901 is not allowed for the applicable percentage of any foreign income taxes treated as paid or accrued with respect to any amount for which a section 965(c) deduction is allowed for a section 958(a) U.S. shareholder inclusion year. For purposes of the preceding sentence, taxes treated as paid or accrued include foreign income taxes deemed paid under section 960(a)(1) with respect to a section 965(a) inclusion, foreign income taxes deemed paid under section 960(a)(3) with respect to distributions of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits, foreign income taxes allocated to an entity under § 1.901–2(f)(4), and a distributive share of foreign income taxes paid or accrued by a partnership.

(ii) *Foreign income taxes deemed paid under section 960(a)(3) (as in effect on December 21, 2017)*. Foreign income taxes deemed paid by a domestic corporation under section 960(a)(3) with respect to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously taxed earnings and profits include only the foreign income taxes paid or accrued by an upper-tier foreign corporation with respect to a distribution of section 965(a) previously taxed earnings and profits or section 965(b) previously

taxed earnings and profits from a lower-tier foreign corporation. No credit is allowed under section 960(a)(3) or any other section for foreign income taxes that would have been deemed paid under section 960(a)(1) with respect to the portion of a section 965(a) earnings amount that is reduced under § 1.965–1(b)(2) or § 1.965–8(b).

(iii) [Reserved]

(2) *Disallowed deduction*. No deduction (including under section 164) is allowed for the applicable percentage of any foreign income taxes treated as paid or accrued with respect to any amount for which a section 965(c) deduction is allowed. Such taxes include foreign income taxes allocated to an entity under § 1.901–2(f)(4) and a distributive share of foreign income taxes paid or accrued by a partnership.

(3) *Coordination with section 78*—(i) *In general*. With respect to foreign income taxes deemed paid by a domestic corporation with respect to its section 965(a) inclusion amount for a section 958(a) U.S. shareholder inclusion year, section 78 shall apply only to so much of such taxes as bears the same proportion to the amount of such taxes as—

(A) The excess of—

(1) The section 965(a) inclusion amount for a section 958(a) U.S. shareholder inclusion year, over

(2) The section 965(c) deduction amount allowable with respect to such section 965(a) inclusion amount, bears to

(B) Such section 965(a) inclusion amount.

(ii) *Domestic corporation that is a domestic pass-through owner*. With respect to foreign income taxes deemed paid by a domestic corporation attributable to such corporation's domestic pass-through owner share of a section 965(a) inclusion amount of a domestic pass-through entity, section 78 shall apply only to so much of such taxes as bears the same proportion to the amount of such taxes as the proportion determined under paragraph (c)(3)(i) of this section as applied to the domestic pass-through entity's section 965(a) inclusion amount for a section 958(a) U.S. shareholder inclusion year.

(d) *Applicable percentage*—(1) *In general*. For purposes of this section, the term *applicable percentage* means, with respect to a section 958(a) U.S. shareholder and a section 958(a) U.S. shareholder inclusion year, the amount (expressed as a percentage) equal to the sum of—

(i) 0.771 multiplied by the ratio of—

(A) The section 958(a) U.S. shareholder's 8 percent rate amount for

the section 958(a) U.S. shareholder inclusion year, divided by

(B) The sum of the section 958(a) U.S. shareholder's 8 percent rate amount for the section 958(a) U.S. shareholder inclusion year plus the section 958(a) U.S. shareholder's 15.5 percent rate amount for the section 958(a) U.S. shareholder inclusion year; plus

(ii) 0.557 multiplied by the ratio of—

(A) The section 958(a) U.S. shareholder's 15.5 percent rate amount for the section 958(a) U.S. shareholder inclusion year, divided by

(B) The amount described in paragraph (d)(1)(i)(B) of this section.

(2) *Applicable percentage for domestic pass-through owners*. In the case of a domestic pass-through owner that has a domestic pass-through owner share of a domestic pass-through entity's section 965(a) inclusion amount, the domestic pass-through owner's applicable percentage that is applied to foreign income taxes attributable to such section 965(a) inclusion amount is equal to the applicable percentage determined under paragraph (d)(1) of this section with respect to the domestic pass-through entity that is the section 958(a) U.S. shareholder.

■ **Par. 10.** Section 1.965–6 is added to read as follows:

**§ 1.965–6 Computation of foreign income taxes deemed paid and allocation and apportionment of deductions.**

(a) *Scope*. This section provides rules for the computation of foreign income taxes deemed paid and the allocation and apportionment of deductions. Paragraphs (b) and (c) of this section provide the general rules for the computation of foreign income taxes deemed paid under sections 902 and 960. Paragraph (d) of this section provides rules for allocation and apportionment of expenses.

(b) *Computation of foreign incomes taxes deemed paid*. For purposes of determining foreign income taxes deemed paid under section 960(a)(1) with respect to a section 965(a) inclusion attributable to a deferred foreign income corporation, section 902 applies as if the section 965(a) inclusion, translated (if necessary) into the functional currency of the deferred foreign income corporation using the spot rate on December 31, 2017, were a dividend paid by the deferred foreign income corporation.

(c) *Section 902 fraction*—(1) *In general*. The term *section 902 fraction* means, with respect to a foreign corporation that is either a deferred foreign income corporation or an E&P

deficit foreign corporation, the fraction that is—

(i) The dividend paid by, or the inclusion under section 951(a)(1) (including a section 965(a) inclusion) with respect to, the foreign corporation, as applicable (the *numerator*), divided by

(ii) The foreign corporation's post-1986 undistributed earnings (the *denominator*). See section 902(a).

(2) *Dividend or inclusion in excess of post-1986 undistributed earnings.* When the denominator of the section 902 fraction is positive but less than the numerator of such fraction, the section 902 fraction is one. When the denominator of the section 902 fraction is zero or less than zero, the section 902 fraction is zero and no foreign taxes are deemed paid.

(3) *Treatment of adjustment under section 965(b)(4)(B).* For purposes of section 902(c)(1), the post-1986 undistributed earnings of an E&P deficit foreign corporation are increased under section 965(b)(4)(B) and § 1.965-2(d)(2)(i)(A) as of the first day of the foreign corporation's first taxable year following the E&P deficit foreign corporation's last taxable year that begins before January 1, 2018.

(d) *Allocation and apportionment of deductions.* For purposes of allocating and apportioning expenses, a section 965(c) deduction does not result in any gross income, including a section 965(a) inclusion, being treated as exempt, excluded, or eliminated income within the meaning of section 864(e)(3) or § 1.861-8T(d). Similarly, a section 965(c) deduction does not result in the treatment of stock as an exempt asset within the meaning of section 864(e)(3) or § 1.861-8T(d). In addition, consistent with the general inapplicability of § 1.861-8T(d)(2) to earnings and profits described in section 959(c)(1) or 959(c)(2), neither section 965(a) previously taxed earnings and profits nor section 965(b) previously taxed earnings and profits are treated as giving rise to gross income that is exempt, excluded, or eliminated income. Similarly, the asset that gives rise to a section 965(a) inclusion, section 965(a) previously taxed earnings and profits, or section 965(b) previously taxed earnings and profits is not treated as a tax-exempt asset.

■ **Par. 11.** Section 1.965-7 is added to read as follows:

**§ 1.965-7 Elections, payment, and other special rules.**

(a) *Scope.* This section provides rules regarding certain elections and payments. Paragraph (b) of this section provides rules regarding the section

965(h) election. Paragraph (c) of this section provides rules regarding the section 965(i) election. Paragraph (d) of this section provides rules regarding the section 965(m) election and a special rule for real estate investment trusts. Paragraph (e) of this section provides rules regarding the section 965(n) election. Paragraph (f) of this section provides rules regarding the election to use the alternative method for calculating post-1986 earnings and profits. Paragraph (g) of this section provides definitions that apply for purposes of this section. For additional definitions that apply for purposes of the section 965 regulations, see § 1.965-1(f).

(b) *Section 965(h) election—(1) In general.* Any person with a section 965(h) net tax liability (that is, a section 958(a) U.S. shareholder or a domestic pass-through owner with respect to a domestic pass-through entity that is a section 958(a) U.S. shareholder, but not a domestic pass-through entity itself) may elect under section 965(h) and this paragraph (b) to pay its section 965(h) net tax liability in eight installments. This election may be revoked only by paying the full amount of the remaining unpaid section 965(h) net tax liability.

(i) *Amount of installments.* Except as provided in paragraph (b)(3) of this section, if a person makes a section 965(h) election, the amounts of the installments are—

(A) Eight percent of the section 965(h) net tax liability in the case of each of the first five installments;

(B) Fifteen percent of the section 965(h) net tax liability in the case of the sixth installment;

(C) Twenty percent of the section 965(h) net tax liability in the case of the seventh installment; and

(D) Twenty-five percent of the section 965(h) net tax liability in the case of the eighth installment.

(ii) *Increased installments due to a deficiency or a timely filed or amended return—(A) In general.* If a person makes a section 965(h) election, except as provided in paragraph (b)(1)(ii)(C) of this section, any deficiency or additional liability will be prorated to the installments described under paragraph (b)(1)(i) of this section if any of the following occur:

(1) A deficiency is assessed with respect to the person's section 965(h) net tax liability;

(2) The person files a return by the due date (taking into account extensions, if any) increasing the amount of its section 965(h) net tax liability beyond that taken into account in paying the first installment described

under paragraph (b)(1)(i) of this section; or

(3) The person files an amended return that reflects an increase in the amount of its section 965(h) net tax liability.

(B) *Timing.* If the due date for the payment of an installment to which the deficiency or additional liability is prorated has passed, the amount prorated to such installment must be paid on notice and demand by the Secretary. If the due date for the payment of an installment to which the deficiency or additional liability is prorated has not passed, then such amount will be due at the same time as, and as part of, the relevant installment.

(C) *Exception for negligence, intentional disregard, or fraud.* If a deficiency or additional liability is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax, the proration rule of this paragraph (b)(1)(ii) will not apply and the deficiency or additional liability (as well as any applicable interest and penalties) must be paid on notice and demand by the Secretary or, in the case of an additional liability reported on a return increasing the amount of the section 965(h) net tax liability after payment of the first installment or on an amended return, with the filing of the return.

(iii) *Due date of installments—(A) In general.* If a person makes a section 965(h) election, the first installment payment is due on the due date (without regard to extensions) for the return for the relevant taxable year. For purposes of this paragraph (b), the term *relevant taxable year* means, in the case in which the person is a section 958(a) U.S. shareholder, the section 958(a) U.S. shareholder inclusion year, or, in the case in which the person is a domestic pass-through owner, the taxable year in which the person has the section 965(a) inclusion to which the section 965(h) net tax liability is attributable. Each succeeding installment payment is due on the due date (without regard to extensions) for the return for the taxable year following the taxable year with respect to which the previous installment payment was made.

(B) *Extension for specified individuals.* If a person is a specified individual with respect to a taxable year within which an installment payment is due pursuant to paragraph (b)(1)(iii)(A) of this section, then, for purposes of determining the due date of an installment payment under paragraph (b)(1)(iii)(A) of this section, the due date of the return (without regard to extensions) due within the taxable year will be treated as the fifteenth day of the

sixth month following the close of the prior taxable year. This paragraph (b)(1)(iii)(B) is applicable regardless of whether the person is a specified individual with respect to the relevant taxable year.

(2) *Manner of making election—(i) Eligibility.* Any person with a section 965(h) net tax liability may make the section 965(h) election, provided that, with respect to the person, none of the acceleration events described in paragraph (b)(3)(ii) of this section have occurred before the election is made. Notwithstanding the preceding sentence, a person that would be eligible to make the section 965(h) election but for the occurrence of an event described in paragraph (b)(3)(ii) of this section may make the section 965(h) election if the exception described in paragraph (b)(3)(iii)(A) of this section applies.

(ii) *Timing.* A section 965(h) election must be made no later than the due date (taking into account extensions, if any, or any additional time that would have been granted if the person had made an extension request) for the return for the relevant taxable year. Relief is not available under § 301.9100–2 or 301.9100–3 to file a late election.

(iii) *Election statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, to make a section 965(h) election, a person must attach a statement, signed under penalties of perjury, to its return for the relevant taxable year. The statement must include the person's name, taxpayer identification number, total net tax liability under section 965, section 965(h) net tax liability, section 965(i) net tax liability with respect to which a section 965(i) election is effective (if applicable), and the anticipated amounts of each installment described under paragraph (b)(1)(i) of this section. The statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(3) *Acceleration of payment—(i) Acceleration.* Notwithstanding paragraph (b)(1)(i) of this section, if a person makes a section 965(h) election, and an acceleration event described in paragraph (b)(3)(ii) of this section subsequently occurs, then, except as provided in paragraph (b)(3)(iii) of this section, the unpaid portion of the remaining installments will be due on the date of the acceleration event (or in the case of a title 11 or similar case, the day before the petition is filed).

(ii) *Acceleration events.* The following events are acceleration events for purposes of paragraph (b)(3)(i) of this

section with respect to a person that has made a section 965(h) election:

(A) An addition to tax is assessed for the failure to timely pay an installment described in paragraph (b)(1)(i) of this section;

(B) A liquidation, sale, exchange, or other disposition of substantially all of the assets of the person (including in a title 11 or similar case, or, in the case of an individual, by reason of death);

(C) In the case of a person that is not an individual, a cessation of business by the person;

(D) Any event that results in the person no longer being a United States person, including a resident alien (as defined in section 7701(b)(1)(A)) becoming a nonresident alien (as defined in section 7701(b)(1)(B));

(E) In the case of a person that was not a member of any consolidated group, the person becoming a member of a consolidated group;

(F) In the case of a consolidated group, the group ceasing to exist (including by reason of the acquisition of a consolidated group within the meaning of § 1.1502–13(j)(5)) or the group otherwise discontinuing in the filing of a consolidated return; or

(G) A determination by the Commissioner described in the second sentence of paragraph (b)(3)(iii)(C)(2) of this section.

(iii) *Eligible section 965(h) transferee exception—(A) In general.* Paragraph (b)(3)(i) of this section does not apply (such that the unpaid portion of all remaining installments will not be due as of the date of the acceleration event) to a person with respect to which an acceleration event occurs if the requirements described in paragraphs (b)(3)(iii)(A)(1) and (2) of this section are satisfied. A person with respect to which an acceleration event described in this paragraph (b)(3)(iii)(A) occurs is referred to as an *eligible section 965(h) transferor*.

(1) *Requirement to have a covered acceleration event.* The acceleration event satisfies the requirements of this paragraph (b)(3)(iii)(A)(1) if it is described in—

(i) Paragraph (b)(3)(ii)(B) of this section and the acceleration event is a qualifying consolidated group member transaction within the meaning of paragraph (b)(3)(iii)(E) of this section;

(ii) Paragraph (b)(3)(ii)(B) of this section (other than, in the case of an individual, an acceleration event caused by reason of death) in a transaction that is not a qualifying consolidated group member transaction;

(iii) Paragraph (b)(3)(ii)(E) of this section; or

(iv) Paragraph (b)(3)(ii)(F) of this section, and the acceleration event results from the acquisition of a consolidated group within the meaning of § 1.1502–13(j)(5) and the acquired consolidated group members join a different consolidated group as of the day following the acquisition.

(2) *Requirement to enter into a transfer agreement.* An eligible section 965(h) transferor and an eligible section 965(h) transferee (as defined in paragraph (b)(3)(iii)(B) of this section) must enter into an agreement with the Commissioner that satisfies the requirements of paragraph (b)(3)(iii)(B) of this section.

(B) *Transfer agreement—(1) Eligibility.* A transfer agreement that satisfies the requirements of this paragraph (b)(3)(iii)(B) must be entered into by an eligible section 965(h) transferor and an eligible section 965(h) transferee. For this purpose, the term *eligible section 965(h) transferee* refers to a single United States person that is not a domestic pass-through entity and that—

(i) With respect to an acceleration event described in paragraph (b)(3)(iii)(A)(1)(i) of this section, is a departing member (as defined in paragraph (b)(3)(iii)(E)(1)(i) of this section) or its qualified successor (as defined in paragraph (b)(3)(iii)(E)(2) of this section);

(ii) With respect to an acceleration event described in paragraph (b)(3)(iii)(A)(1)(ii) of this section, acquires substantially all of the assets of an eligible section 965(h) transferor;

(iii) With respect to an acceleration event described in paragraph (b)(3)(iii)(A)(1)(iii) of this section, is the agent (within the meaning of § 1.1502–77) of the consolidated group that the eligible section 965(h) transferor joins; or

(iv) With respect to an acceleration event described in paragraph (b)(3)(iii)(A)(1)(iv) of this section, is the agent (within the meaning of § 1.1502–77) of the surviving consolidated group.

(2) *Filing requirements—(i) In general.* A transfer agreement must be timely filed. Except as provided in paragraph (b)(3)(iii)(B)(2)(ii) of this section, a transfer agreement is considered timely filed only if the transfer agreement is filed within 30 days of the date that the acceleration event occurs. The transfer agreement must be filed in accordance with the rules provided in forms, instructions, or other guidance. In addition, a duplicate copy of the transfer agreement must be attached to the returns of both the eligible section 965(h) transferee and the eligible section 965(h) transferor for the taxable year

during which the acceleration event occurs filed by the due date for such returns (taking into account extensions, if any). Relief is not available under § 301.9100–2 or 301.9100–3 to file a transfer agreement late.

(j) *Transition rule.* If an acceleration event occurs before September 10, 2018, the transfer agreement must be filed by October 9, 2018 in order to be considered timely filed.

(3) *Signature requirement.* The transfer agreement that is filed within 30 days of the acceleration event must be signed under penalties of perjury by a person who is authorized to sign a return on behalf of the eligible section 965(h) transferor and a person who is authorized to sign a return on behalf of the eligible section 965(h) transferee.

(4) *Terms of agreement.* A transfer agreement under this paragraph (b)(3)(iii)(B) must be entitled “Transfer Agreement Under Section 965(h)(3)” and must contain the following information and representations—

(i) A statement that the document constitutes an agreement by the eligible section 965(h) transferee to assume the liability of the eligible section 965(h) transferor for any unpaid installment payments of the eligible section 965(h) transferor under section 965(h);

(ii) A statement that the eligible section 965(h) transferee (and, if the eligible section 965(h) transferor continues in existence immediately after the acceleration event, the eligible section 965(h) transferor) agrees to comply with all of the conditions and requirements of section 965(h) and paragraph (b) of this section, as well as any other applicable requirements in the section 965 regulations;

(iii) The name, address, and taxpayer identification number of the eligible section 965(h) transferor and the eligible section 965(h) transferee;

(iv) The amount of the eligible section 965(h) transferor’s section 965(h) net tax liability remaining unpaid, as determined by the eligible section 965(h) transferor, which is subject to adjustment by the Commissioner;

(v) A copy of the eligible section 965(h) transferor’s most recent Form 965–A or Form 965–B, as applicable;

(vi) A detailed description of the acceleration event that led to the transfer agreement;

(vii) A representation that the eligible section 965(h) transferee is able to make the remaining payments required under section 965(h) and paragraph (b) of this section with respect to the section 965(h) net tax liability being assumed; and

(viii) If the eligible section 965(h) transferor continues to exist

immediately after the acceleration event, an acknowledgement that the eligible section 965(h) transferor and any successor to the eligible section 965(h) transferor will remain jointly and severally liable for any unpaid installment payments of the eligible section 965(h) transferor under section 965(h), including, if applicable, under § 1.1502–6.

(5) *Consolidated groups.* For purposes of this paragraph (b)(3)(iii)(B), in the case of a consolidated group, the terms “eligible section 965(h) transferor” and “eligible section 965(h) transferee” each refer to a consolidated group that is a party to a covered acceleration event described in paragraph (b)(3)(iii)(A)(1) of this section. In such a case, any transfer agreement under this paragraph (b)(3)(iii)(B) must be entered into by the agent (as defined in § 1.1502–77) of the relevant consolidated group.

(C) *Consent of Commissioner—(1) In general.* Except as otherwise provided in publications, instructions, forms, or other guidance, if an eligible section 965(h) transferor and an eligible section 965(h) transferee file a transfer agreement in accordance with the provisions of paragraph (b)(3)(iii)(B) of this section, the eligible section 965(h) transferor and the eligible section 965(h) transferee will be considered to have entered into an agreement described in paragraph (b)(3)(iii)(A)(2) of this section with the Commissioner for purposes of section 965(h)(3) and paragraph (b)(3)(iii) of this section. If the Commissioner determines that additional information is necessary (for example, additional information regarding the ability of the eligible section 965(h) transferee to fully pay the remaining section 965(h) net tax liability), the eligible section 965(h) transferee must provide such information upon request.

(2) *Material misrepresentations and omissions.* If the Commissioner determines that an agreement filed by an eligible section 965(h) transferor and an eligible section 965(h) transferee contains a material misrepresentation or material omission, then the Commissioner may reject the transfer agreement (effective as of the date of the related acceleration event). In the alternative, on the date that the Commissioner determines that the transfer agreement includes a material misrepresentation or material omission, the Commissioner may determine that an acceleration event has occurred with respect to the eligible section 965(h) transferee as of the date of the determination, such that any unpaid installment payments of the eligible section 965(h) transferor that were

assumed by the eligible section 965(h) transferee become due on the date of the determination.

(D) *Effect of assumption—(1) In general.* If the exception in this paragraph (b)(3)(iii) applies with respect to an eligible section 965(h) transferor and an eligible section 965(h) transferee, the eligible section 965(h) transferee assumes all of the outstanding obligations and responsibilities of the eligible section 965(h) transferor with respect to the section 965(h) net tax liability as though the eligible section 965(h) transferee had included the section 965(a) inclusion in income. Accordingly, the eligible section 965(h) transferee is responsible for making payments and reporting with respect to any unpaid installment payments. In addition, for example, if an acceleration event described in paragraph (b)(3)(ii) of this section occurs with respect to an eligible section 965(h) transferee, any unpaid installment payments of the eligible section 965(h) transferor that were assumed by the eligible section 965(h) transferee will become due on the date of such event, subject to any applicable exception in paragraph (b)(3)(iii) of this section.

(2) *Eligible section 965(h) transferor liability.* An eligible section 965(h) transferor (or a successor) remains jointly and severally liable for any unpaid installment payments of the eligible section 965(h) transferor that were assumed by the eligible section 965(h) transferee, as well as any penalties, additions to tax, or other additional amounts attributable to such net tax liability.

(E) *Qualifying consolidated group member transaction—(1) Definition of qualifying consolidated group member transaction.* For purposes of this paragraph (b)(3), the term *qualifying consolidated group member transaction* means a transaction in which—

(i) A member of a consolidated group (the *departing member*) ceases to be a member of the consolidated group (including by reason of the distribution, sale, or exchange of the departing member’s stock);

(ii) The transaction results in the consolidated group (which is treated as a single person for this purpose under § 1.965–8(e)(1)) being treated as transferring substantially all of its assets for purposes of paragraph (b)(3)(ii)(B) of this section; and

(iii) The departing member either continues to exist immediately after the transaction or has a qualified successor.

(2) *Definition of qualified successor.* For purposes of this paragraph (b)(3), the term *qualified successor* means, with respect to a departing member

described in this paragraph (b)(3)(iii)(E), another domestic corporation (or consolidated group) that acquires substantially all of the assets of the departing member (including in a transaction described in section 381(a)(2)).

(3) *Departure of multiple members of a consolidated group.* Multiple members that deconsolidate from the same consolidated group as a result of a single transaction are treated as a single departing member to the extent that, immediately after the transaction, they become members of the same (second) consolidated group, which would be treated as a single person under § 1.965-8(e)(1).

(c) *Section 965(i) election*—(1) *In general.* Each shareholder, other than a domestic pass-through entity, of an S corporation that is a United States shareholder of a deferred foreign income corporation may elect under section 965(i) and this paragraph (c) to defer the payment of the shareholder's section 965(i) net tax liability with respect to the S corporation until the shareholder's taxable year that includes a triggering event described in paragraph (c)(3) of this section. This election may be revoked only by paying the full amount of the unpaid section 965(i) net tax liability.

(2) *Manner of making election*—(i) *Eligibility.* Each shareholder with a section 965(i) net tax liability with respect to an S corporation may make the section 965(i) election with respect to such S corporation, provided that, with respect to the shareholder, none of the triggering events described in paragraph (c)(3)(ii) of this section have occurred before the election is made. Notwithstanding the preceding sentence, a shareholder that would be eligible to make the section 965(i) election but for the occurrence of an event described in paragraph (c)(3)(ii) of this section may make the section 965(i) election if an exception described in paragraph (c)(3)(ii) of this section applies.

(ii) *Timing.* A section 965(i) election must be made no later than the due date (taking into account extensions, if any) for the shareholder's return for each taxable year that includes the last day of the taxable year of the S corporation in which the S corporation has a section 965(a) inclusion to which the shareholder's section 965(i) net tax liability is attributable. Relief is not available under § 301.9100-2 or 301.9100-3 to make a late election.

(iii) *Election statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, to make a section 965(i) election, a

shareholder must attach a statement, signed under penalties of perjury, to its return for the taxable year that includes the last day of a taxable year of the S corporation in which the S corporation has a section 965(a) inclusion to which the shareholder's section 965(i) net tax liability is attributable. The statement must include the shareholder's name, taxpayer identification number, the name and taxpayer identification number of the S corporation with respect to which the election is made, the amount described in paragraph (g)(10)(i)(A) of this section as modified by paragraph (g)(6) of this section for purposes of determining the section 965(i) net tax liability with respect to the S corporation, the amount described in paragraph (g)(10)(i)(B) of this section, and the section 965(i) net tax liability with respect to the S corporation. The statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(3) *Triggering events*—(i) *In general.* If a shareholder makes a section 965(i) election with respect to an S corporation, the shareholder defers payment of its section 965(i) net tax liability with respect to the S corporation until the shareholder's taxable year that includes the occurrence of a triggering event described in paragraph (c)(3)(ii) of this section with respect to the section 965(i) net tax liability with respect to the S corporation. If a triggering event described in paragraph (c)(3)(ii) of this section with respect to an S corporation occurs, except as provided in paragraph (c)(3)(iv) of this section, the shareholder's section 965(i) net tax liability with respect to the S corporation will be assessed as an addition to tax for the shareholder's taxable year that includes the triggering event.

(ii) *Triggering events.* The following events are considered triggering events for purposes of paragraph (c)(3)(i) of this section with respect to a shareholder's section 965(i) net tax liability with respect to an S corporation—

(A) The corporation ceases to be an S corporation (determined as of the first day of the first taxable year that the corporation is not an S corporation);

(B) A liquidation, sale, exchange, or other disposition of substantially all of the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, or the S corporation ceasing to exist; or

(C) The transfer of any share of stock of the S corporation by the shareholder (including by reason of death or otherwise).

(iii) *Partial transfers.* If an S corporation shareholder transfers less than all of its shares of stock of the S corporation, the transfer will be a triggering event only with respect to the portion of a shareholder's section 965(i) net tax liability that is properly allocable to the transferred shares.

(iv) *Eligible section 965(i) transferee exception*—(A) *In general.* Paragraph (c)(3)(i) of this section will not apply (such that a shareholder's section 965(i) net tax liability with respect to an S corporation will not be assessed as an addition to tax for the shareholder's taxable year that includes the triggering event) if the requirements described in paragraphs (c)(3)(iv)(A)(1) and (2) of this section are satisfied. A shareholder with respect to which a triggering event described in this paragraph (c)(3)(iv)(A) occurs is referred to as an *eligible section 965(i) transferor*.

(1) *Requirement to have a covered triggering event.* The triggering event satisfies the requirements of this paragraph (c)(3)(iv)(A)(1) if it is described in paragraph (c)(3)(ii)(C) of this section.

(2) *Requirement to enter into a transfer agreement.* The shareholder with respect to which a triggering event occurs and an eligible section 965(i) transferee (as defined in paragraph (c)(3)(iv)(B)(1) of this section) must enter into an agreement with the Commissioner that satisfies the requirements of paragraph (c)(3)(iv)(B) of this section.

(B) *Transfer agreement*—(1) *Eligibility.* A transfer agreement that satisfies the requirements of this paragraph (c)(3)(iv)(B) may be entered into by an eligible section 965(i) transferor and an eligible section 965(i) transferee. For this purpose, the term *eligible section 965(i) transferee* refers to a single United States person that is not a domestic pass-through entity.

(2) *Filing requirements*—(i) *In general.* A transfer agreement must be timely filed. Except as provided in paragraph (c)(3)(iv)(B)(2)(ii) of this section, a transfer agreement is considered timely filed only if the transfer agreement is filed within 30 days of the date that the triggering event occurs. The transfer agreement must be filed in accordance with the rules provided in forms, instructions, or other guidance. In addition, a duplicate copy of the transfer agreement must be attached to the returns of both the eligible section 965(i) transferee and the eligible section 965(i) transferor for the taxable year during which the triggering event occurs filed by the due date (taking into account extensions, if any) for such returns. Relief is not available under

§ 301.9100–2 or 301.9100–3 to file a transfer agreement late.

(ii) *Transition rule.* If a triggering event occurs before September 10, 2018, the transfer agreement must be filed by October 9, 2018 in order to be considered timely filed.

(3) *Signature requirement.* The transfer agreement that is filed within 30 days of the triggering event must be signed under penalties of perjury by a person who is authorized to sign a return on behalf of the eligible section 965(i) transferor and a person who is authorized to sign a return on behalf of the eligible section 965(i) transferee.

(4) *Terms of agreement.* A transfer agreement under this paragraph (c)(3)(iv)(B) must be entitled “Transfer Agreement Under Section 965(i)(2)” and must contain the following information and representations:

(i) A statement that the document constitutes an agreement by the eligible section 965(i) transferee to assume the liability of the eligible section 965(i) transferor for the unpaid portion of the section 965(i) net tax liability, or, in the case of a partial transfer, for the unpaid portion of the section 965(i) net tax liability attributable to the transferred stock;

(ii) A statement that the eligible section 965(i) transferee agrees to comply with all of the conditions and requirements of section 965(i) and paragraph (c) of this section, including the annual reporting requirement, as well as any other applicable requirements in the section 965 regulations;

(iii) The name, address, and taxpayer identification number of the eligible section 965(i) transferor and the eligible section 965(i) transferee;

(iv) The amount of the eligible section 965(i) transferor’s unpaid section 965(i) net tax liability or, in the case of a partial transfer, the unpaid portion of the section 965(i) net tax liability attributable to the transferred stock, each as determined by the eligible section 965(i) transferor, which is subject to adjustment by the Commissioner;

(v) A copy of the eligible section 965(i) transferor’s most recent Form 965–A;

(vi) A detailed description of the triggering event that led to the transfer agreement, including the name and taxpayer identification number of the S corporation with respect to which the section 965(i) election was effective;

(vii) A representation that the eligible section 965(i) transferee is able to pay the section 965(i) net tax liability being assumed; and

(viii) An acknowledgement that the eligible section 965(i) transferor and any successor to the eligible section 965(i) transferor will remain jointly and severally liable for the section 965(i) net tax liability being assumed by the eligible section 965(i) transferee.

(C) *Consent of Commissioner—(1) In general.* Except as otherwise provided in publications, instructions, forms, or other guidance, if an eligible section 965(i) transferor and an eligible section 965(i) transferee file a transfer agreement in accordance with the provisions of paragraph (c)(3)(iv)(B) of this section, the eligible section 965(i) transferor and the eligible section 965(i) transferee will be considered to have entered into an agreement with the Commissioner for purposes of section 965(i)(2) and paragraph (c)(3)(iv) of this section. If the Commissioner determines that additional information is necessary (for example, additional information regarding the ability of the eligible section 965(i) transferee to pay the eligible section 965(i) transferor’s unpaid net section 965(i) tax liability), the eligible section 965(i) transferee must provide such information upon request.

(2) *Material misrepresentations and omissions.* If the Commissioner determines that an agreement filed by an eligible section 965(i) transferor and an eligible section 965(i) transferee contains a material misrepresentation or material omission, then the Commissioner may reject the transfer agreement (effective as of the date of the related triggering event). In the alternative, on the date that the Commissioner determines that the transfer agreement includes a material misrepresentation or material omission, the Commissioner may determine that a triggering event has occurred with respect to the eligible section 965(i) transferee as of the date of the determination, such that the unpaid section 965(i) net tax liability of the eligible section 965(i) transferor that was assumed by the eligible section 965(i) transferee becomes due on the date of the determination.

(D) *Effect of assumption—(1) In general.* When the exception in this paragraph (c)(3)(iv) applies with respect to an eligible section 965(i) transferor and an eligible section 965(i) transferee, the eligible section 965(i) transferee assumes all of the outstanding obligations and responsibilities of the eligible section 965(i) transferor with respect to the section 965(i) net tax liability with respect to the S corporation as though the eligible section 965(i) transferee had included the section 965(a) inclusion in income.

Accordingly, the eligible section 965(i) transferee is responsible for making payments and reporting with respect to any unpaid section 965(i) net tax liability with respect to the S corporation. In addition, for example, if a triggering event described in paragraph (c)(3)(ii) of this section occurs with respect to an eligible section 965(i) transferee, any unpaid portion of the section 965(i) net tax liability of the eligible section 965(i) transferor that was assumed by the eligible section 965(i) transferee becomes due on the date of such event, subject to any applicable exception in paragraph (c)(3)(iv) or (v) of this section.

(2) *Eligible section 965(i) transferor liability.* An eligible section 965(i) transferor remains jointly and severally liable for any unpaid installment payments of the eligible section 965(i) transferor that were assumed by the eligible section 965(i) transferee, as well as any penalties, additions to tax, or other additional amounts attributable to such net tax liability.

(v) *Coordination with section 965(h) election—(A) In general.* Subject to the limitation described in paragraph (c)(3)(v)(D) of this section, a shareholder that has made a section 965(i) election with respect to an S corporation, upon the occurrence of a triggering event with respect to such S corporation, may make a section 965(h) election with respect to the portion of the shareholder’s section 965(i) net tax liability with respect to such S corporation that is assessed as an addition to tax for the shareholder’s taxable year that includes the triggering event pursuant to paragraph (c)(3)(i) of this section as if such portion were a section 965(h) net tax liability.

(B) *Timing for election.* A section 965(h) election made pursuant to section 965(i)(4) and paragraph (c)(3)(v)(A) of this section must be made no later than the due date (taking into account extensions, if any) for the shareholder’s return for the taxable year in which the triggering event with respect to the S corporation occurs. Relief is not available under § 301.9100–2 or 301.9100–3 to make a late election.

(C) *Due date for installment.* If a shareholder has made a section 965(h) election pursuant to section 965(i)(4) and paragraph (c)(3)(v)(A) of this section, the payment of the first installment (as described in paragraph (b)(1)(i) of this section) must be made no later than the due date (without regard to extensions) for the shareholder’s return of tax for the taxable year in which the triggering event with respect to the S corporation occurs.

(D) *Limitation—(1) In general.* Notwithstanding paragraph (c)(3)(v)(A)

of this section, if the triggering event with respect to an S corporation is a triggering event described in paragraph (c)(3)(ii)(B) of this section, then the section 965(h) election may only be made with the consent of the Commissioner.

(2) *Manner of obtaining consent—(i) In general.* In order to obtain the consent of the Commissioner as required by paragraph (c)(3)(v)(D)(1) of this section, the shareholder intending to make the section 965(h) election must file the agreement described in paragraph (c)(3)(v)(D)(4) of this section within 30 days of the occurrence of the triggering event, except as described in paragraph (c)(3)(v)(D)(2)(ii) of this section. The agreement must be filed in accordance with the rules provided in forms, instructions, or other guidance. In addition, a duplicate copy of the agreement must be filed, with the shareholder's timely-filed return for the taxable year during which the triggering event occurs (taking into account extensions, if any), along with the election statement described in paragraph (b)(2)(iii) of this section. Relief is not available under § 301.9100–2 or 301.9100–3 to file an agreement late.

(ii) *Transition rule.* If a triggering event occurs before September 10, 2018, the agreement must be filed by October 9, 2018 in order to be considered timely filed.

(3) *Signature requirement.* The agreement that is filed within 30 days of the triggering event must be signed under penalties of perjury by the shareholder.

(4) *Terms of agreement.* The agreement under this paragraph (c)(3)(v)(D) must be entitled “Consent Agreement Under Section 965(i)(4)(D)” and must contain the following information and representations—

(i) A statement that the shareholder agrees to comply with all of the conditions and requirements of section 965(h) and paragraph (b) of this section, as well as any other applicable requirements in the section 965 regulations;

(ii) The name, address, and taxpayer identification number of the shareholder;

(iii) The amount of the section 965(i) net tax liability under section 965 remaining unpaid with respect to which the section 965(h) election is made pursuant to section 965(i)(4)(D) and paragraph (c)(3)(v)(A) of this section, as determined by the shareholder, which is subject to adjustment by the Commissioner; and

(iv) A representation that the shareholder is able to make the

payments required under section 965(h) and paragraph (b) of this section with respect to the portion of the total net tax liability under section 965 remaining unpaid described in paragraph (c)(3)(v)(D)(iii) of this section.

(5) *Consent of Commissioner—(i) In general.* If a shareholder files an agreement in accordance with the provisions of paragraph (c)(3)(v)(D) of this section, the shareholder will be considered to have obtained the consent of the Commissioner for purposes of section 965(i)(4)(D) and paragraph (c)(3)(v)(D)(1) of this section. However, if the Commissioner reviews the agreement and determines that additional information is necessary, the shareholder must provide such information upon request.

(ii) *Material misrepresentations and omissions.* If the Commissioner determines that an agreement filed by a shareholder in accordance with the provisions of this paragraph (c)(3)(v)(D) contains a material misrepresentation or material omission, then the Commissioner may reject the agreement (effective as of the date of the related triggering event).

(4) *Joint and several liability.* If any shareholder of an S corporation makes a section 965(i) election, the S corporation is jointly and severally liable for the payment of the shareholder's section 965(i) net tax liability with respect to the S corporation, as well as any penalties, additions to tax, or other additional amounts attributable to such net tax liability.

(5) *Extension of limitation on collection.* If an S corporation shareholder makes a section 965(i) election with respect to its section 965(i) net tax liability with respect to an S corporation, any limitation on the time period for the collection of the net tax liability shall not begin before the date of the triggering event with respect to the S corporation.

(6) *Annual reporting requirement—(i) In general.* A shareholder that makes a section 965(i) election with respect to its section 965(i) net tax liability with respect to an S corporation is required to report the amount of its deferred net tax liability on its return of tax for the taxable year in which the election is made and on the return of tax for each subsequent taxable year until such net tax liability has been fully assessed.

(ii) *Failure to report.* If a shareholder fails to report the amount of its deferred net tax liability as required with respect to any taxable year by the due date (taking into account extensions, if any) for the return of tax for that taxable year, five percent of such deferred net tax

liability will be assessed as an addition to tax for such taxable year.

(d) *Section 965(m) election and special rule for real estate investment trusts—(1) In general.* A real estate investment trust may elect under section 965(m) and this paragraph (d) to defer the inclusion in gross income (for purposes of the computation of real estate investment trust taxable income under section 857(b)) of its REIT section 965 amounts and include them in income according to the schedule described in paragraph (d)(2) of this section. This election is revocable only by including in gross income (for purposes of the computation of real estate investment trust taxable income under section 857(b)) the full amount of the REIT section 965 amounts.

(2) *Inclusion schedule for section 965(m) election.* If a real estate investment trust makes the section 965(m) election, the REIT section 965 amounts will be included in the real estate investment trust's gross income as follows—

(i) Eight percent of the REIT section 965 amounts in each taxable year in the five-taxable year period beginning with the taxable year the amount would otherwise be included;

(ii) Fifteen percent of the REIT section 965 amounts in the first year following the five year period described in paragraph (d)(2)(i) of this section;

(iii) Twenty percent of the REIT section 965 amounts in the second year following the five year period described in paragraph (d)(2)(i) of this section; and

(iv) Twenty-five percent of the REIT section 965 amounts in the third year following the five year period described in paragraph (d)(2)(i) of this section.

(3) *Manner of making election—(i) Eligibility.* A real estate investment trust with section 965(a) inclusions may make the section 965(m) election.

(ii) *Timing.* A section 965(m) election must be made no later than the due date (taking into account extensions, if any) for the return for the first year of the five year period described in paragraph (d)(2)(i) of this section. Relief is not available under § 301.9100–2 or 301.9100–3 to make a late election.

(iii) *Election statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, to make a section 965(m) election, a real estate investment trust must attach a statement, signed under penalties of perjury, to its return for the taxable year in which it would otherwise be required to include the REIT section 965 amounts in gross income. The statement must include the real estate investment trust's name, taxpayer identification number, REIT section 965 amounts, and the



anticipated amounts of each portion of the REIT section 965 amounts described under paragraph (d)(2) of this section, and the statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(4) *Coordination with section 965(h)*. A real estate investment trust that makes the section 965(m) election may not also make a section 965(h) election for any year with respect to which a section 965(m) election is in effect.

(5) *Acceleration of inclusion*. If a real estate investment trust makes a section 965(m) election and subsequently there is a liquidation, sale, exchange, or other disposition of substantially all of the assets of the real estate investment trust (including in a title 11 or similar case), or a cessation of business by the real estate investment trust, any amount not yet included in gross income (for purposes of the computation of real estate investment trust taxable income under section 857(b)) as a result of the section 965(m) election will be so included as of the day before the date of the event. The unpaid portion of any tax liability with respect to such inclusion will be due on the date of the event (or in the case of a title 11 or similar case, the day before the petition is filed).

(6) *Treatment of section 965(a) inclusions of a real estate investment trust*. Regardless of whether a real estate investment trust has made a section 965(m) election, and regardless of whether it is a United States shareholder of a deferred foreign income corporation, any section 965(a) inclusions of the real estate investment trust are not taken into account as gross income of the real estate investment trust for purposes of applying paragraphs (2) and (3) of section 856(c) for any taxable year for which the real estate investment trust takes into account a section 965(a) inclusion, including pursuant to paragraph (d)(2) of this section.

(e) *Section 965(n) election*—(1) *In general*—(i) *General rule*. A person may elect to not take into account the amount described in paragraph (e)(1)(ii) of this section in determining its net operating loss under section 172 for the taxable year or in determining the amount of taxable income for such taxable year (computed without regard to the deduction allowable under section 172) that may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172. The election for each taxable year is irrevocable.

(ii) *Applicable amount for section 965(n) election*. If a person makes a section 965(n) election, the amount

referred to in paragraph (e)(1)(i) of this section is the sum of—

(A) The person's section 965(a) inclusions for the taxable year reduced by the person's section 965(c) deductions for the taxable year, and

(B) In the case of a domestic corporation, the taxes deemed paid under section 960(a)(1) for the taxable year with respect to the person's section 965(a) inclusions that are treated as dividends under section 78.

(iii) *Scope of section 965(n) election*. If a person makes a section 965(n) election, the election applies to both net operating losses for the taxable year for which the election is made and the net operating loss carryovers or carrybacks to such taxable year, each in their entirety. Any section 965(n) election made by the agent (within the meaning of § 1.1502-77) of a consolidated group applies to all net operating losses available to the consolidated group, including all components of the consolidated net operating loss deduction (as defined in § 1.1502-21(a)).

(2) *Manner of making election*—(i) *Eligibility*. A person with a section 965(a) inclusion may make the section 965(n) election.

(ii) *Timing*. A section 965(n) election must be made no later than the due date (taking into account extensions, if any) for the person's return for the taxable year to which the election applies. Relief is not available under § 301.9100-2 or 301.9100-3 to make a late election.

(iii) *Election statement*. Except as otherwise provided in publications, forms, instructions, or other guidance, to make a section 965(n) election, a person must attach a statement, signed under penalties of perjury, to its return for the taxable year to which the election applies. The statement must include the person's name, taxpayer identification number, the amounts described in section 965(n)(2)(A) and paragraph (e)(1)(ii)(A) of this section and section 965(n)(2)(B) and paragraph (e)(1)(ii)(B) of this section, and the sum thereof, and the statement must be filed in the manner prescribed in instructions or other guidance.

(f) *Election to use alternative method for calculating post-1986 earnings and profits*—(1) *Effect of election for specified foreign corporations that do not have a 52-53-week taxable year*. If an election is made under this paragraph (f) with respect to a specified foreign corporation that does not have a 52-53-week taxable year, the amount of the post-1986 earnings and profits (including a deficit) as of the E&P measurement date on November 2, 2017, is determined under paragraph

(f)(3) of this section. The election described in this paragraph (f) is irrevocable. A specified foreign corporation that does not have a 52-53-week taxable year may not use the alternative method of determination in paragraph (f)(3) of this section for purposes of determining its post-1986 earnings and profits on the E&P measurement date on December 31, 2017.

(2) *Effect of election for specified foreign corporations that have a 52-53-week taxable year*. If an election is made under this paragraph (f) with respect to a specified foreign corporation that has a 52-53-week taxable year, the amount of the post-1986 earnings and profits (including a deficit) as of both E&P measurement dates is determined under paragraph (f)(3) of this section. The election described in this paragraph (f) is irrevocable.

(3) *Computation of post-1986 earnings and profits using alternative method*. With respect to an E&P measurement date, the post-1986 earnings and profits of a specified foreign corporation for which an election is properly made equals the sum of—

(i) The specified foreign corporation's post-1986 earnings and profits (including a deficit) determined as of the notional measurement date, as if it were an E&P measurement date, plus

(ii) The specified foreign corporation's annualized earnings and profits amount with respect to the notional measurement date.

(4) *Definitions*—(i) *52-53-week taxable year*. The term *52-53-week taxable year* means a taxable year described in § 1.441-2(a)(1).

(ii) *Annualized earnings and profits amount*. The term *annualized earnings and profits amount* means, with respect to a specified foreign corporation, an E&P measurement date, and a notional measurement date, the amount equal to the product of the number of days between the notional measurement date and the E&P measurement date (not including the former, but including the latter) multiplied by the daily earnings amount of the specified foreign corporation. The annualized earnings and profits amount is expressed as a negative number if the E&P measurement date precedes the notional measurement date.

(iii) *Daily earnings amount*. The term *daily earnings amount* means, with respect to a specified foreign corporation and a notional measurement date, the post-1986 earnings and profits (including a deficit) of the specified foreign corporation determined as of the close of the notional measurement date that were earned (or incurred) during

the specified foreign corporation's taxable year that includes the notional measurement date, divided by the number of days that have elapsed in such taxable year as of the close of the notional measurement date.

(iv) *Notional measurement date.* The term *notional measurement date* means—

(A) With respect to an E&P measurement date of a specified foreign corporation with a 52–53-week taxable year, the closest end of a fiscal month to such E&P measurement date, and

(B) With respect to the E&P measurement date on November 2, 2017, of all specified foreign corporations not described in paragraph (f)(4)(iv)(A) of this section, October 31, 2017.

(5) *Manner of making election—(i) Eligibility.* An election with respect to a specified foreign corporation to use the alternative method of calculating post-1986 earnings and profits as of an E&P measurement date pursuant to this paragraph (f) must be made on behalf of the specified foreign corporation by a controlling domestic shareholder (as defined in § 1.964–1(c)(5)) pursuant to the rules of § 1.964–1(c)(3).

(ii) *Timing.* An election under this paragraph (f) must be made no later than the due date (taking into account extensions, if any) for the person's return for the first taxable year in which the person has a section 965(a) inclusion amount with respect to the specified foreign corporation or in which the person takes into account a specified E&P deficit with respect to the specified corporation for purposes of computing a section 965(a) inclusion amount with respect to another specified foreign corporation. Relief is not available under § 301.9100–2 or 301.9100–3 to make a late election.

(iii) *Election statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, to make an election under this paragraph (f), a person must attach a statement, signed under penalties of perjury, to the person's return for the taxable year described in paragraph (f)(5)(ii) of this section. The statement must include the person's name, taxpayer identification number, and the name and taxpayer identification number, if any, of the specified foreign corporation with respect to which the election is made, and the statement must be filed in the manner prescribed in instructions or other guidance.

(6) *Examples.* The following examples illustrate the application of this paragraph (f).

*Example 1.* (i) *Facts.* FS, a foreign corporation, has a calendar year taxable year,

and as of October 31, 2017, FS has post-1986 earnings and profits of 10,000u, 3,040u of which were earned during the taxable year that includes October 31, 2017. An election is properly made under paragraph (f)(5) of this section with respect to FS, allowing FS to determine its post-1986 earnings and profits under the alternative method with respect to its E&P measurement date on November 2, 2017.

(ii) *Analysis.* As of the close of October 31, 2017, the notional measurement date with respect to the E&P measurement date on November 2, 2017, 304 days have elapsed in the taxable year of FS that includes October 31, 2017. Therefore, FS's daily earnings amount is 10u (3,040u divided by 304), and FS's annualized earnings and profits amount is 20u (10u multiplied by 2 (the number of days between the notional measurement date on October 31, 2017, and the E&P measurement date on November 2, 2017)). Accordingly, FS's post-1986 earnings and profits as of November 2, 2017, are 10,020u (its post-1986 earnings and profits as of October 31, 2017 (10,000u), plus its annualized earnings and profits amount (20u)).

*Example 2.* (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (f)(6), except that a deficit of 3,040u was incurred during the taxable year that includes October 31, 2017.

(ii) *Analysis.* The analysis is the same as in paragraph (ii) of *Example 1* of this paragraph (f)(6), except that FS's daily earnings amount is (10u) ((3,040u) divided by 304), and FS's annualized earnings and profits amount is (20u) ((10u) multiplied by 2 (the number of days between the notional measurement date on October 31, 2017, and the E&P measurement date on November 2, 2017)). Accordingly, FS's post-1986 earnings and profits as of November 2, 2017, are 9,980u (its post-1986 earnings and profits as of October 31, 2017 (10,000u), plus its annualized earnings and profits amount ((20u))).

(g) *Definitions.* This paragraph (g) provides definitions that apply for purposes of this section.

(1) *Deferred net tax liability.* The term *deferred net tax liability* means, with respect to any taxable year of a person, the amount of the section 965(i) net tax liability the payment of which has been deferred under section 965(i) and paragraph (c) of this section.

(2) *REIT section 965 amounts.* The term *REIT section 965 amounts* means, with respect to a real estate investment trust and a taxable year of the real estate investment trust, the aggregate amount of section 965(a) inclusions and section 965(c) deductions that would (but for section 965(m)(1)(B) and paragraph (d) of this section) be taken into account in determining the real estate investment trust's income for the taxable year.

(3) *Section 965(h) election.* The term *section 965(h) election* means the election described in section 965(h)(1) and paragraph (b)(1) of this section.

(4) *Section 965(h) net tax liability.* The term *section 965(h) net tax liability* means, with respect to a person that has made a section 965(h) election, the total net tax liability under section 965 reduced by the aggregate amount of the person's section 965(i) net tax liabilities, if any, with respect to which section 965(i) elections are effective.

(5) *Section 965(i) election.* The term *section 965(i) election* means the election described in section 965(i)(1) and paragraph (c)(1) of this section.

(6) *Section 965(i) net tax liability.* The term *section 965(i) net tax liability* means, with respect to an S corporation and a shareholder of the S corporation, in the case in which a section 965(i) election is made, the amount determined pursuant to paragraph (g)(10)(i) of this section by adding before the word “over” in (g)(10)(i)(A) of this section “determined as if the only section 965(a) inclusions included in income by the person are domestic pass-through entity shares of section 965(a) inclusions by the S corporation with respect to deferred foreign income corporations of which the S corporation is a United States shareholder.”

(7) *Section 965(m) election.* The term *section 965(m) election* means the election described in section 965(m)(1)(B) and paragraph (d)(1) of this section.

(8) *Section 965(n) election.* The term *section 965(n) election* means the election described in section 965(n)(1) and paragraph (e)(1)(i) of this section.

(9) *Specified individual.* The term *specified individual* means, with respect to a taxable year, a person described in § 1.6081–5(a)(5) or (6) who receives an extension of time to file and pay under § 1.6081–5(a) for the taxable year.

(10) *Total net tax liability under section 965—(i) General rule.* The term *total net tax liability under section 965* means, with respect to a person, the excess (if any) of—

(A) The person's net income tax for the taxable year in which the person includes a section 965(a) inclusion in income, over—

(B) The person's net income tax for the taxable year determined—

(1) Without regard to section 965, and

(2) Without regard to any income, deduction, or credit properly attributable to a dividend received (directly or through a chain of ownership described in section 958(a)) by the person (or, in the case of a domestic pass-through owner, by the person's domestic pass-through entity) from a deferred foreign income corporation.

(ii) *Net income tax.* For purposes of this paragraph (g)(10), the term *net*

*income tax* means the regular tax liability (as defined in section 26(b)) reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A of chapter 1 of subtitle A of the Internal Revenue Code.

(iii) *Foreign tax credits.* The foreign tax credit disregarded in determining net income tax determined under paragraph (g)(10)(i)(B) of this section includes the credit for foreign income taxes deemed paid with respect to section 965(a) inclusions or foreign income taxes deemed paid with respect to a dividend, including a distribution that would have been treated as a dividend in the absence of section 965. The foreign tax credit disregarded under paragraph (g)(10)(i)(B) of this section also includes the credit for foreign income taxes imposed on distributions of section 965(a) previously taxed earnings and profits or 965(b) previously taxed earnings and profits made in the taxable year in which the person includes a section 965(a) inclusion in income.

■ **Par. 12.** Section 1.965–8 is added to read as follows:

**§ 1.965–8 Affiliated groups (including consolidated groups).**

(a) *Scope.* This section provides rules for applying section 965 and the section 965 regulations to members of an affiliated group (as defined in section 1504(a)), including members of a consolidated group (as defined in § 1.1502–1(h)). Paragraph (b) of this section provides guidance regarding the application of section 965(b)(5) to determine the section 965(a) inclusion amounts of a member of an affiliated group. Paragraph (c) of this section provides guidance for designating the source of aggregate unused E&P deficits. Paragraph (d) provides rules regarding earning and profits and stock basis adjustments. Paragraph (e) of this section provides rules that treat members of a consolidated group as a single person for certain purposes. Paragraph (f) of this section provides definitions that apply for purposes of this section. Paragraph (g) of this section provides examples illustrating the application of this section. For additional definitions that apply for purposes of the section 965 regulations, see § 1.965–1(f).

(b) *Reduction of E&P net surplus shareholder's pro rata share of the section 965(a) earnings amount of a deferred foreign income corporation by the allocable share of the applicable share of the aggregate unused E&P deficit—(1) In general.* This paragraph (b) applies after the application of § 1.965–1(b)(2) for purposes of

determining the section 965(a) inclusion amount with respect to a deferred foreign income corporation of a section 958(a) U.S. shareholder that is both an E&P net surplus shareholder and a member of an affiliated group in which not all members are members of the same consolidated group. If this paragraph (b) applies, the U.S. dollar amount of the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation is further reduced (but not below zero) by the deferred foreign income corporation's allocable share of the section 958(a) U.S. shareholder's applicable share of the affiliated group's aggregate unused E&P deficit.

(2) *Consolidated group as part of an affiliated group.* If some, but not all, members of an affiliated group are members of a consolidated group, then the consolidated group is treated as a single member of the affiliated group for purposes of § 1.965–1(b)(2) and paragraph (b)(1) of this section.

(c) *Designation of portion of excess aggregate foreign E&P deficit taken into account—(1) In general.* This paragraph (c) provides rules for designating the source of an aggregate unused E&P deficit of an affiliated group that is not also a consolidated group taken into account under section 965(b)(5) and paragraph (b) of this section if the amount described in paragraph (f)(1)(i)(A) of this section with respect to the affiliated group exceeds the amount described in paragraph (f)(1)(i)(B) of this section with respect to the affiliated group. If this paragraph (c)(1) applies, each member of the affiliated group that is an E&P net deficit shareholder must designate by maintaining in its books and records a statement (identical to the statement maintained by all other such members) setting forth the portion of the excess aggregate foreign E&P deficit of the E&P net deficit shareholder taken into account under section 965(b)(5) and paragraph (b) of this section. See § 1.965–2(d)(2)(ii)(B) for a rule for designating the portion of a section 958(a) U.S. shareholder's pro rata share of a specified E&P deficit of an E&P deficit foreign corporation taken into account under section 965(b), § 1.965–1(b)(2), and paragraph (b) of this section, as applicable.

(2) *Consolidated group as part of an affiliated group.* If some, but not all, members of an affiliated group are properly treated as members of a consolidated group, then the consolidated group is treated as a single member of the affiliated group for purposes of applying paragraph (c)(1) of this section.

(d) [Reserved]

(2) *Consolidated groups.* See § 1.1502–33(d)(1) for adjustments to members' earnings and profits and § 1.1502–32(b)(3) for adjustments to members' basis.

(e) *Treatment of a consolidated group as a single section 958(a) U.S. shareholder or a single person—(1) In general.* All members of a consolidated group that are section 958(a) U.S. shareholders of a specified foreign corporation are treated as a single section 958(a) U.S. shareholder for purposes of section 965(b) and § 1.965–1(b)(2). Furthermore, all members of a consolidated group are treated as a single person for purposes of paragraphs (h), (k), and (n) of section 965 and § 1.965–7. Thus, for example, any election governed by section 965(h) and § 1.965–7(b) must be made by the agent (within the meaning of § 1.1502–77) of the group as a single election on behalf of all members of the consolidated group. Similarly, the determination of whether the transfer of assets by one member to a non-member of the consolidated group would constitute an acceleration event under section § 1.965–7(b)(3)(ii)(B) takes into account all of the assets of the consolidated group, which for purposes of this determination, includes all of the assets of each consolidated group member. In analyzing issues relating to the transfer of assets of a consolidated group, appropriate adjustments are made to prevent the duplication of assets or asset value.

(2) *Limitation.* Paragraph (e)(1) of this section does not apply to treat all members of a consolidated group as a single section 958(a) U.S. shareholder or a single person, as applicable, for purposes of determining the amount of any member's inclusion under section 951 (including a section 965(a) inclusion), the foreign income taxes deemed paid with respect to a section 965(a) inclusion (see sections 960 and 902), or any purpose other than those specifically listed in paragraph (e)(1) of this section or another provision of the section 965 regulations.

(3) *Determination of section 965(c) deduction amount.* Paragraph (e)(1) of this section does not apply to treat all members of a consolidated group as a single section 958(a) U.S. shareholder for purposes of determining the amount of any member's section 965(c) deduction amount. However, for purposes of determining the section 965(c) deduction amount of any section 958(a) U.S. shareholder that is a member of a consolidated group, the aggregate foreign cash position of the section 958(a) U.S. shareholder is equal to the

aggregate section 965(a) inclusion amount of the section 958(a) U.S. shareholder multiplied by the group cash ratio of the consolidated group.

(f) *Definitions.* This paragraph (f) provides definitions that apply for purposes of applying the section 965 regulations to members of an affiliated group, including members of a consolidated group.

(1) *Aggregate unused E&P deficit*—(i) *General rule.* The term *aggregate unused E&P deficit* means, with respect to an affiliated group, the lesser of—

(A) The sum of the excess aggregate foreign E&P deficit with respect to each E&P net deficit shareholder that is a member of the affiliated group, or

(B) The amount determined under paragraph (f)(3)(ii) of this section.

(ii) *Reduction with respect to E&P net deficit shareholders that are not wholly owned by the affiliated group.* If the group ownership percentage of an E&P net deficit shareholder is less than 100 percent, the amount of the excess aggregate foreign E&P deficit with respect to the E&P net deficit shareholder that is taken into account under paragraph (f)(1)(i) of this section is the product of the group ownership percentage multiplied by the excess aggregate foreign E&P deficit.

(2) *Allocable share.* The term *allocable share* means, with respect to a deferred foreign income corporation and an E&P net surplus shareholder's applicable share of an aggregate unused E&P deficit of an affiliated group, the product of the E&P net surplus shareholder's applicable share of the affiliated group's aggregate unused E&P deficit and the ratio described in § 1.965-1(f)(11) with respect to the deferred foreign income corporation.

(3) *Applicable share.* The term *applicable share* means, with respect to an E&P net surplus shareholder and an aggregate unused E&P deficit of an affiliated group, the amount that bears the same proportion to the affiliated group's aggregate unused E&P deficit as—

(i) The product of—

(A) The E&P net surplus shareholder's group ownership percentage, multiplied by

(B) The amount that would (but for section 965(b)(5) and paragraph (b) of this section) constitute the E&P net surplus shareholder's aggregate section 965(a) inclusion amount, bears to

(ii) The aggregate amount determined under paragraph (f)(3)(i) of this section with respect to all E&P net surplus shareholders that are members of the group.

(4) *Consolidated group aggregate foreign cash position.* The term

*consolidated group aggregate foreign cash position* means, with respect to a consolidated group, the sum of the amount that would be the aggregate foreign cash position (as defined in § 1.965-1(f)(8)(i)) of each member of the consolidated group that is a section 958(a) U.S. shareholder determined as if each such member were not a member of a consolidated group.

(5) *E&P net deficit shareholder.* The term *E&P net deficit shareholder* means a section 958(a) U.S. shareholder that has an excess aggregate foreign E&P deficit.

(6) *E&P net surplus shareholder.* The term *E&P net surplus shareholder* means a section 958(a) U.S. shareholder that would (but for section 965(b)(5) and paragraph (b) of this section) have an aggregate section 965(a) inclusion amount greater than zero.

(7) *Excess aggregate foreign E&P deficit.* The term *excess aggregate foreign E&P deficit* means, with respect to a section 958(a) U.S. shareholder, the amount, if any, by which the amount described in § 1.965-1(f)(9)(i) with respect to the section 958(a) U.S. shareholder exceeds the amount described in § 1.965-1(f)(9)(ii) with respect to the section 958(a) U.S. shareholder.

(8) *Group cash ratio.* The term *group cash ratio* means, with respect to a consolidated group, the ratio of—

(i) The consolidated group aggregate foreign cash position, to

(ii) The sum of the aggregate section 965(a) inclusion amounts of all members of the consolidated group.

(9) *Group ownership percentage.* The term *group ownership percentage* means, with respect to a section 958(a) U.S. shareholder that is a member of an affiliated group, the percentage of the value of the stock of the United States shareholder which is held by other includible corporations in the affiliated group. Notwithstanding the preceding sentence, the group ownership percentage of the common parent of the affiliated group is 100 percent. Any term used in this paragraph (f)(9) that is also used in section 1504 has the same meaning as when used in such section. Additionally, if the term is used in the context of a rule for which all members of a consolidated group are treated as a single section 958(a) U.S. shareholder under paragraph (e)(1) of this section, then the group ownership percentage is determined solely with respect to the value of the stock of the common parent of the consolidated group held by other includible corporations that are not members of the consolidated group.

(g) *Examples.* The following examples illustrate the application of this section.

*Example 1.* Application of affiliated group rule. (i) *Facts.* (A) *In general.* USP owns all of the stock of USS1, USS2, and USS3. Each of USP, USS1, USS2 and USS3 is a domestic corporation and is a member of an affiliated group of which USP is the common parent (the "USP Group"). The USP Group has not elected to file a consolidated federal income tax return. USS1 owns all of the stock of CFC1 and CFC2, USS2 owns all of the stock of CFC3, and USS3 owns all of the stock of CFC4. Each of CFC1, CFC2, CFC3, and CFC4 is a controlled foreign corporation within the meaning of section 957(a) and, therefore, each is a specified foreign corporation under section 965(e) and § 1.965-1(f)(45). Each of USP, USS1, USS2, USS3, CFC1, CFC2, CFC3, and CFC4 has the calendar year as its taxable year.

(B) *Facts relating to section 965.* CFC1 and CFC3 are deferred foreign income corporations with section 965(a) earnings amounts of \$600x and \$300x, respectively. CFC1 and CFC3 have cash positions of \$0x and \$50x, respectively, on each of their cash measurement dates. CFC2 and CFC4 are E&P deficit foreign corporations with specified E&P deficits of \$400x and \$100x, respectively. CFC2 and CFC4 have cash positions of \$100x and \$50x, respectively, on each of their cash measurement dates. CFC1, CFC2, CFC3, and CFC4 all use the U.S. dollar as their functional currency.

(ii) *Analysis.* (A) *Section 965(a) inclusion amounts before application of section 965(b)(5).* USS1 is a section 958(a) U.S. shareholder with respect to CFC1 and CFC2; USS2 is a section 958(a) U.S. shareholder with respect to CFC3; and USS3 is a section 958(a) U.S. shareholder with respect to CFC4. USS1's pro rata share of CFC1's section 965(a) earnings amount is \$600x. Under section 965(b)(3)(A) and § 1.965-1(f)(9), USS1's aggregate foreign E&P deficit is \$400x, the lesser of the aggregate of USS1's pro rata share of the specified E&P deficit of each E&P deficit foreign corporation (\$400x) and the amount described in § 1.965-1(f)(9)(ii) with respect to USS1 (\$600x). Under section 965(b) and § 1.965-1(b)(2), in determining its section 965(a) inclusion amount with respect to CFC1, USS1 reduces its pro rata share of the U.S. dollar amount of section 965(a) earnings amount of CFC1 by CFC1's allocable share of USS1's aggregate foreign E&P deficit. CFC1's allocable share of USS1's aggregate foreign E&P deficit is \$400x, which is the product of USS1's aggregate foreign E&P deficit (\$400x) and 1, which is the ratio determined by dividing USS1's pro rata share of the section 965(a) earnings amount of CFC1 (\$600x), by the amount described in § 1.965-1(f)(9)(ii) with respect to USS1 (\$600x). Accordingly, under section 965(b) and § 1.965-1(b)(2) (before applying section 965(b)(5) and paragraph (b) of this section), USS1's section 965(a) inclusion amount with respect to CFC1 would be \$200x (USS1's pro rata share of the section 965(a) earnings amount of CFC1 of \$600x reduced by CFC1's allocable share of USS1's aggregate foreign E&P deficit of \$400x). Under section 965(b) and § 1.965-1(b)(2) (before applying section 965(b)(5) and paragraph (b) of this section), USS2's section 965(a) inclusion amount with respect to

CFC3 would be \$300x (USS2's pro rata share of the section 965(a) earnings amount of CFC3).

(B) *Application of section 965(b)(5)—(1) Determination of E&P net surplus shareholders and E&P net deficit shareholders.* USS1 is an E&P net surplus shareholder because it would have an aggregate section 965(a) inclusion amount of \$200x but for the application of section 965(b)(5) and paragraph (b) of this section. USS2 is also an E&P net surplus shareholder because it would have an aggregate section 965(a) inclusion amount of \$300x but for the application of section 965(b)(5) and paragraph (b) of this section. USS3 is an E&P net deficit shareholder because it has an excess aggregate foreign E&P deficit of \$100x.

(2) *Determining section 965(a) inclusion amounts under section 965(b)(5).* Under section 965(b) and paragraph (b) of this section, for purposes of determining the section 965(a) inclusion amount of a section 958(a) U.S. shareholder with respect to a deferred foreign income corporation, if, after applying § 1.965-1(b)(2), the section 958(a) U.S. shareholder is an E&P net surplus shareholder, then the U.S. dollar amount of the section 958(a) U.S. shareholder's pro rata share of the section 965(a) earnings amount of the deferred foreign income corporation is further reduced (but not below zero) by the deferred foreign income corporation's allocable share of the section 958(a) U.S. shareholder's applicable share of the affiliated group's aggregate unused E&P deficit. USS3 is the only E&P net deficit shareholder in the USP Group, and therefore the aggregate unused E&P deficit of the USP Group is equal to USS3's excess aggregate foreign E&P deficit (\$100x). The applicable share of the USP Group's aggregate unused E&P deficit of each of USS1 and USS2, respectively, is an amount that bears the same proportion to the USP Group's aggregate unused E&P deficit as the product of the group ownership percentage of USS1 and USS2, respectively, multiplied by the amount that would (but for section 965(b)(5) and paragraph (b) of this section) constitute the aggregate section 965(a) inclusion amount of USS1 and USS2, respectively, bears to the aggregate of such amounts with respect to both USS1 and USS2. Therefore, USS1's applicable share of the USP Group's aggregate unused E&P deficit is \$40 ( $\$100x \times (\$200x / (\$200x + \$300x))$ ) and USS2's applicable share of the USP Group's aggregate unused E&P deficit is \$60x ( $\$100x \times (\$300x / (\$200x + \$300x))$ ). Because USS1 is a section 958(a) U.S. shareholder with respect to only one deferred foreign income corporation, the entire \$60x of USS1's applicable share of the USP Group's aggregate unused E&P deficit is treated as CFC1's allocable share of USS1's applicable share of the USP Group's aggregate unused E&P deficit, and thus USS1's section 965(a) inclusion amount with respect to CFC1 is reduced to \$160x ( $\$200x - \$40x$ ). Because USS2 is a section 958(a) U.S. shareholder with respect to only one deferred foreign income corporation, the entire \$60x of USS2's applicable share of the USP Group's aggregate unused E&P deficit is treated as CFC3's allocable share of USS2's applicable

share of the USP Group's aggregate unused E&P deficit, and thus USS2's section 965(a) inclusion amount with respect to CFC3 is reduced to \$240x ( $\$300x - \$60x$ ).

(C) *Aggregate foreign cash position.* Under section 965(c) and § 1.965-1(c), a section 958(a) U.S. shareholder that includes a section 965(a) inclusion amount in income is allowed a deduction equal to the section 965(c) deduction amount. The section 965(c) deduction amount is computed by taking into account the aggregate foreign cash position of the section 958(a) U.S. shareholder. Under § 1.965-1(f)(8)(i), the aggregate foreign cash position of USS1 is \$100x, and the aggregate foreign cash position of USS2 is \$50x.

(D) *Section 965(c) deduction amount.* The section 965(c) deduction amount of USS1 is \$102x, which is equal to (i) USS1's 8 percent rate equivalent percentage (77.1428571%) of its 8 percent rate amount for USS1's 2017 year (\$60x ( $\$160x - \$100x$ )), plus USS1's 15.5 percent rate equivalent percentage (55.7142857%) of its 15.5 percent rate amount for USS1's 2017 year (\$100x). The section 965(c) deduction amount of USS2 is \$174.43x, which is equal to (i) USS2's 8 percent rate equivalent percentage (77.1428571%) of its 8 percent rate amount for USS2's 2017 year ( $\$190x (\$240x - \$50x)$ ), plus USS2's 15.5 percent rate equivalent percentage (55.7142857%) of its 15.5 percent rate amount for USS2's 2017 year (\$50x). Because USS3 has no section 965(a) inclusion amount, it has no section 965(c) deduction amount and therefore is not allowed a section 965(c) deduction.

*Example 2.* Application to members of a consolidated group. (i) *Facts.* The facts are the same as in paragraph (i) of *Example 1* of this paragraph (g), except that the USP Group has elected to file a consolidated return.

(ii) *Analysis—(A) Section 965(a) inclusion amount—(1) Single section 958(a) U.S. shareholder treatment.* Because each of USS1, USS2, and USS3 is a section 958(a) U.S. shareholder of a specified foreign corporation and is a member of a consolidated group, paragraph (e)(1) of this section applies to treat USS1, USS2, and USS3 as a single section 958(a) U.S. shareholder for purposes of section 965(b) and § 1.965-1(b)(2).

(2) *Determination of inclusion amount.* The single section 958(a) U.S. shareholder composed of USS1, USS2, and USS3 is a section 958(a) U.S. shareholder with respect to CFC1, CFC2, CFC3, and CFC4. Under § 1.965-1(b)(2), in determining USS1's section 965(a) inclusion amount, the single section 958(a) U.S. shareholder decreases its pro rata share of the U.S. dollar amount of the section 965(a) earnings amount of CFC1 by CFC1's allocable share of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder. CFC1's allocable share of the aggregate foreign E&P deficit is \$333.33x, which is the product of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder (\$500x ( $\$400x + \$100x$ )) and .67, which is the ratio determined by dividing its pro rata share of the section 965(a) earnings amount of CFC1 (\$600x) by the amount described in § 1.965-1(f)(9)(ii) with respect to the single section 958(a) U.S. shareholder (\$900x ( $\$600x +$

\$300x)). Therefore, USS1's section 965(a) inclusion amount with respect to CFC1 is \$266.67 (its pro rata share of the section 965(a) earnings amount of CFC1 (\$600) less CFC1's allocable share of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder (\$333.33x)). Similarly, under § 1.965-1(b)(2), in determining the section 965(a) inclusion amount of USS2, the single section 958(a) U.S. shareholder decreases its pro rata share of the U.S. dollar amount of the section 965(a) earnings amount of CFC3 by CFC3's allocable share of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder. CFC3's allocable share of the aggregate foreign E&P deficit is \$166.67x, which is the product of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder (\$500x) and .33, which is the ratio determined by dividing its pro rata share of the section 965(a) earnings amount of CFC3 (\$300x) by the amount described in § 1.965-1(f)(9)(ii) with respect to the single section 958(a) U.S. shareholder (\$900x ( $\$600x + \$300x$ )). Therefore, USS2's section 965(a) inclusion amount with respect to CFC3 is \$133.33x (its pro rata share of the section 965(a) earnings amount of CFC3 (\$300x) less CFC3's allocable share of the aggregate foreign E&P deficit of the single section 958(a) U.S. shareholder (\$166.67x)).

(B) *Consolidated group aggregate foreign cash position.* Because USS1 and USS2 are members of a consolidated group, the aggregate foreign cash position of each of USS1 and USS2 is determined under paragraph (e)(3) of this section. Under paragraph (e)(3) of this section, the aggregate foreign cash position of each of USS1 and USS2 is equal to the aggregate section 965(a) inclusion amount of USS1 and USS2, respectively, multiplied by the group cash ratio of the USP Group, as determined pursuant to paragraph (f)(8) of this section. The group cash ratio of the USP Group is .50, which is the ratio of the USP Group's consolidated group aggregate foreign cash position ( $\$200x (\$50x + \$100x + \$50x)$ ) and the sum of the aggregate section 965(a) inclusion amounts of all members of the USP Group ( $\$400x (\$266.67x + \$133.33x)$ ). Therefore, under paragraph (e)(3) of this section, the aggregate foreign cash positions of USS1 and USS2 are, respectively, \$133.34x ( $\$266.67x \times (\$200x / \$400x)$ ) and \$66.67 ( $\$133.33x \times (\$200x / 400x)$ ).

(C) *Section 965(c) deduction amount.* The section 965(c) deduction amount of USS1 is \$177.14x, which is equal to (i) USS1's 8 percent rate equivalent percentage (77.1428571%) of its 8 percent rate amount for USS1's 2017 year ( $\$133.33x (\$266.67x - \$133.34x)$ ), plus USS1's 15.5 percent rate equivalent percentage (55.7142857%) of its 15.5 percent rate amount for USS1's 2017 year (\$133.34x). The section 965(c) deduction amount of USS2 is \$88.56x, which is equal to (i) USS2's 8 percent rate equivalent percentage (77.1428571%) of its 8 percent rate amount for USS2's 2017 year ( $\$66.66x (\$133.33x - \$66.67x)$ ), plus USS2's 15.5 percent rate equivalent percentage (55.7142857%) of its 15.5 percent rate amount for USS2's 2017 year (\$66.67x). Because USS3 has no section 965(a)

inclusion amount, it has no section 965(c) deduction amount and therefore is not allowed a section 965(c) deduction.

■ **Par. 13.** Section 1.965-9 is added to read as follows:

**§ 1.965-9 Applicability dates.**

(a) *In general.* Sections 1.965-1 through 1.965-8 apply beginning the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a United States person, beginning the taxable year in which or with which such taxable year of the foreign corporation ends.

(b) *Applicability dates for rules disregarding certain transactions.* Section 1.965-4 applies regardless of whether, with respect to a foreign corporation, the transaction, effective date of a change in method of accounting, effective date of an entity classification election, or specified payment described in § 1.965-4 occurred before the first day of the foreign corporation's last taxable year that begins before January 1, 2018, or, with respect to a United States person,

the transaction, effective date of a change in method of accounting, effective date of an entity classification election, or specified payment described in § 1.965-4 occurred before the first day of the taxable year of the United States person in which or with which the taxable year of the foreign corporation ends.

■ **Par. 14.** Section 1.986(c)-1 is added to read as follows:

**§ 1.986(c)-1 Coordination with section 965.**

(a) *Amount of foreign currency gain or loss.* Foreign currency gain or loss with respect to distributions of section 965(a) previously taxed earnings and profits (as defined in § 1.965-1(f)(39)) is determined based on movements in the exchange rate between December 31, 2017, and the time such distributions are made.

(b) *Section 965(a) previously taxed earnings and profits.* Any gain or loss recognized under section 986(c) with respect to distributions of section 965(a) previously taxed earnings and profits is

reduced in the same proportion as the reduction by a section 965(c) deduction amount (as defined in § 1.965-1(f)(42)) of the section 965(a) inclusion amount (as defined in § 1.965-1(f)(38)) that gave rise to such section 965(a) previously taxed earnings and profits.

(c) *Section 965(b) previously taxed earnings and profits.* Section 986(c) does not apply with respect to distributions of section 965(b) previously taxed earnings and profits (as defined in § 1.965-1(f)(40)).

(d) *Applicability dates.* The section applies beginning the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to a United States person, for the taxable year in which or with which such taxable year of the foreign corporation ends.

**Kirsten Wielobob,**

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