DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–104464–18]

RIN 1545–BO55

Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance to determine the amount of the deduction for foreign-derived intangible income and global intangible low-taxed income. This document also contains proposed regulations coordinating the deduction for foreign-derived intangible income and global intangible low-taxed income with other provisions in the Internal Revenue Code.

DATES: Written or electronic comments and requests for a public hearing must be received by May 6, 2019.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–104464–18), 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–104464–18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (REG–104464–18).

FOR FURTHER INFORMATION CONTACT: Concerning proposed §§ 1.250(a)–1 through 1.250(b)–6, 1.962–1, 1.6038–2, 1.6038–3, and 1.6038A–2, Kenneth Jeruchim at (202) 317–6939; concerning proposed §§ 1.1502–12, 1.1502–13 and 1.1502–50, Michelle A. Monroy at (202) 317–5363 or Austin Diamond-Jones at (202) 317–6847; concerning submissions of comments and requests for a public hearing, Regina L. Johnson, (202) 317–6901 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under sections 250, 962, 1502, 6038, and 6038A (''proposed regulations''). Section 14202(a) of the Tax Cuts and Jobs Act, Public Law 115–97 (2017) (the ''Act''), added section 250 to the Internal Revenue Code (the ''Code'').[1] The new section provides a domestic corporation with a deduction (''section 250 deduction'') for its foreign-derived intangible income (''FDII'') and its global intangible low-taxed income (''GILTI'') and the amount treated as a dividend under section 78 which is attributable to its GILTI. Section 14202(c) of the Act provides that section 250 and the conforming amendments in section 14202(b) apply to taxable years beginning after December 31, 2017.

Section 14201(a) of the Act (codified in section 951A) requires a United States shareholder (''U.S. shareholder'') of any controlled foreign corporation (''CFC'') for any taxable year to include in gross income the shareholder's GILTI for the year. The Department of the Treasury (''Treasury Department'') and the IRS published a separate notice of proposed rulemaking that provides guidance to U.S. shareholders on how to determine the amount of GILTI to include in gross income. See 83 FR 51072 (Oct. 10, 2018).

Section 14302(a) of the Act also added a new foreign tax credit category for foreign branch income (defined in section 904(d)(2)(J)), which is cross-referenced in section 250(b)(3)(A)(i)(VI). The Treasury Department and the IRS published a separate notice of proposed rulemaking that provides rules for determining a corporation's foreign branch income for purposes of section 904. See 83 FR 63200 (Dec. 7, 2018).

Explanation of Provisions

I. Overview of Proposed Regulations

In general, income earned directly by a U.S. person on foreign business income is subject to U.S. tax on a current basis. Before the Act, foreign business income earned indirectly by a U.S. person through a foreign corporation was not generally subject to U.S. tax until such income was distributed as a dividend to the U.S. person. Certain anti-deferral regimes could cause the U.S. owner to be taxed on a current basis in the United States regardless of whether the income had been distributed as a dividend to the U.S. owner. Sections 951 through 965 of the Code (generally referred to as the ''subpart F'' provisions), applicable to certain passive and mobile categories of income earned by CFCs, is the main anti-deferral regime of relevance to U.S.-based corporate groups. However, because subpart F does not generally apply to active foreign business income of a CFC (as defined in section 957(a)), U.S. shareholders before the Act could indefinitely defer U.S. taxation with respect to their foreign business income—in particular, mobile income arising from the exploitation of intangible property—by allocating such income to its CFCs operating in low- or zero-tax jurisdictions. This system of deferral, in turn, resulted in a ''lock-out effect,'' whereby U.S. shareholders that had allocated income to CFCs formed in low- or zero-tax jurisdictions could not repatriate such income to the United States without incurring significant U.S. tax.

In order to facilitate the efficient redeployment of foreign earnings in the United States, the Act established a participation exemption system under which certain earnings of a foreign corporation can be repatriated to a corporate U.S. shareholder without U.S. tax. See section 14101(a) of the Act and section 245A. However, Congress recognized that, without any base protection measures, the participation exemption system could further incentivize taxpayers to allocate intangible income to CFCs formed in low- or zero-tax jurisdictions because the earnings related to such intangible income could now be repatriated to the United States without incurring any U.S. tax. See Senate Committee on the Budget, 115th Cong., ''Reconciliation Recommendations Pursuant to H. Con. Res. 71,'' at 370 (Comm. Print 2017) (''Senate Explanation''). Therefore, Congress enacted section 951A, which subjects a U.S. shareholder's ''global intangible low-taxed income'' or ''GILTI'' (a new term created by the Act) derived through its CFCs to U.S. tax on a current basis, similar to the taxation of such CFCs' subpart F income under section 951(a)(1)(A).

Most member countries of the Organisation for Economic Co-operation and Development (''OECD'') provide a full or partial (*e.g.,* 95 percent) participation exemption with respect to income of foreign subsidiaries distributed to domestic shareholders. See OECD (2018), *Tax Policy Reforms 2018: OECD and Selected Partner Economies,* at 73, OECD Publishing, Paris (Sept. 2018). While some countries also have CFC inclusion regimes similar to subpart F that subject certain narrow classes of income of foreign subsidiaries to current tax in the home country, many countries do not subject active foreign business income of foreign subsidiaries to current tax. Congress recognized that taxing such income at the full U.S. corporate tax rate could hurt the competitive position of U.S. corporations relative to their foreign peers, and therefore determined that GILTI earned by such corporations

[1] Except as otherwise stated, all section references in this preamble are to the Internal Revenue Code.

should be subject to a reduced effective U.S. tax rate. See Senate Explanation, at 370. Accordingly, Congress enacted section 250, which provides corporate U.S. shareholders a deduction of 50 percent for taxable years beginning after December 31, 2017, and before January 1, 2026, with respect to their GILTI, and the amount treated as a dividend under section 78 which is attributable to their GILTI (''section 78 gross-up''). In contrast, a domestic corporation's inclusion of its CFCs' subpart F income is not eligible for the section 250 deduction, and is therefore generally subject to U.S. tax at the full corporate rate.

After the Act, income earned directly by a domestic corporation is subject to a 21 percent rate. Absent a deduction with respect to intangible income attributable to foreign market activity earned directly by a domestic corporation, the lower effective tax rate applicable to GILTI by reason of the section 250 deduction would perpetuate the pre-Act incentive for domestic corporations to allocate intangible income to CFCs formed in low- or zero-tax jurisdictions. Therefore, to neutralize the effect of providing a lower U.S. effective tax rate with respect to the active earnings of a CFC of a domestic corporation through a deduction for GILTI, section 250 provides a lower effective U.S. tax rate with respect to ''foreign-derived intangible income'' or ''FDII'' (a new term created by the Act) earned directly by the domestic corporation through a deduction of 37.5 percent for taxable years beginning after December 31, 2017, and before January 1, 2026. The result of the section 250 deduction for both GILTI and FDII is to help neutralize the role that tax considerations play when a domestic corporation chooses the location of intangible income attributable to foreign-market activity, that is, whether to earn such income through its U.S.-based operations or through its CFCs.

The proposed regulations provide guidance for determining the amount of the section 250 deduction allowed to a domestic corporation for its FDII and GILTI. Proposed § 1.250(a)–1 provides rules for determining the amount of the deduction, including rules for applying the taxable income limitation of section 250(a)(2). Proposed § 1.250(b)–1 provides general rules for computing a domestic corporation's FDII. Proposed § 1.250(b)–2 provides rules for determining a domestic corporation's qualified business asset investment (''QBAI''), which is a component of the computation of FDII. Proposed § 1.250(b)–3 provides general rules for determining gross income included in gross foreign-derived deduction eligible income (''gross FDDEI''), which is a component of the computation of FDII. Proposed § 1.250(b)–4 provides rules for determining gross FDDEI from sales of property. Proposed § 1.250(b)–5 provides rules for determining gross FDDEI from the provision of a service. Proposed § 1.250(b)–6 provides rules relating to the sale of property or the provision of a service to a related party.

II. Amount of Deduction Allowed Under Section 250(a)

Proposed § 1.250(a)–1 provides general rules to determine the amount of a domestic corporation's section 250 deduction and associated definitions that apply for purposes of the proposed regulations. The section 250 deduction is available only to domestic corporations. See section 250(a)(1) and proposed § 1.250(a)–1(b)(1). For this purpose, the term ''domestic corporation'' has the meaning set forth in section 7701(a)—an association, joint-stock company, or insurance company created or organized in the United States or under the law of the United States or of any State—but does not include a regulated investment company (as defined in section 851), a real estate investment trust (as defined in section 856), or an S corporation (as defined in section 1361). See proposed § 1.250(a)–1(c)(1). The section 250 deduction is not available to individuals except in certain cases where an individual makes an election under section 962. See part IV of this Explanation of Provisions section for more information about that provision.

As discussed in part I of this Explanation of Provisions section, the deduction under section 250 is generally intended to reduce the effective rate of U.S. income tax on FDII and GILTI in order to help neutralize the role that tax considerations play when a domestic corporation chooses the location of intangible income attributable to foreign-market activity. There is no indication that Congress intended the section 250 deduction to reduce the effective rate of tax imposed by non-income tax provisions outside of chapter 1 of the Internal Revenue Code. Accordingly, for purposes of the excise tax imposed by section 4940(a), the proposed regulations provide that a section 250 deduction is not treated as an ordinary and necessary expense paid or incurred for the production or collection of gross investment income within the meaning of section 4940(c)(3)(A). See proposed § 1.250(a)–1(b)(4).

The section 250 deduction is subject to a taxable income limitation. If, for any taxable year, the sum of a domestic corporation's FDII and GILTI exceeds its taxable income, the excess is allocated pro rata to reduce the corporation's FDII and GILTI solely for purposes of computing the amount of the section 250 deduction. See section 250(a)(2) and proposed § 1.250(a)–1(b)(2). For this purpose, a domestic corporation's taxable income is determined without regard to the section 250 deduction. See section 250(a)(2)(A)(ii) and proposed § 1.250(a)–1(c)(4). The Code does not otherwise define ''taxable income'' for purposes of applying the taxable income limitation of section 250(a)(2).

In general, a taxpayer's taxable income is based, in part, upon the availability, and proper calculation, of deductions. However, multiple Code provisions simultaneously limit the availability of a deduction based, directly or indirectly, upon a taxpayer's taxable income, including sections 163(j)(1) (limiting a deduction for business interest) and 172(a)(2) (limiting a net operating loss deduction). Sections 163(j)(2) and 172(b) also provide that any deduction not allowed to a taxpayer for a taxable year by reason of the limitation in section 163(j)(1) or 172(a)(2), respectively, may be allowed to the taxpayer, subject to the same limitation, in its succeeding taxable year. A taxpayer's net operating loss for a taxable year is determined without regard to the section 250 deduction (see section 172(d)(9)), and a taxpayer's adjusted taxable income is determined without regard to section 172. See section 163(j)(8)(A)(iii). However, neither section 163(j) nor section 250 prescribes an ordering rule with respect to the other provision.

The Treasury Department and the IRS considered proposing computations requiring the use of simultaneous equations in lieu of an ordering rule but determined that an approach that requires such computations would result in undue administrative and compliance burdens. Therefore, the proposed regulations provide an ordering rule for applying sections 163(j) and 172 in conjunction with section 250 that the Treasury Department and the IRS have determined is consistent with the statutory language for each provision. Specifically, the proposed regulations provide that a domestic corporation's taxable income for purposes of applying the taxable income limitation of section 250(a)(2) is determined after all of the corporation's other deductions are taken into account. See proposed § 1.250(a)–1(c)(4). Accordingly, a domestic corporation's taxable income for purposes of section 250(a)(2) is its taxable income determined without regard to section 250, but taking into account the application of sections 163(j) and 172(a), including amounts permitted to be carried forward to such taxable year by reason of sections 163(j)(2) and 172(b).

Proposed regulations issued under section 163(j) provide guidance on the interaction of sections 163(j) and 250 that the Treasury Department and the IRS consider to be consistent with these proposed regulations under section 250. See 83 FR 67490 (Dec. 28, 2018). Specifically, the proposed regulations under section 163(j) provide that, for purposes of determining the limitation under section 163(j), a deduction under section 250(a)(1) that is properly allocable to a non-excepted trade or business is taken into account in determining a taxpayer's taxable income and thus its adjusted taxable income. See proposed § 1.163(j)–1(b)(37)(ii). However, for this purpose, the taxpayer's deduction under section 250(a)(1) is determined without regard to the limitations under sections 250(a)(2) and 163(j). See id.

As a result of these proposed regulations under section 250 and the proposed regulations under section 163(j), a domestic corporation's allowable business interest under section 163(j), its net operating loss deduction under section 172(a), and its section 250 deduction are determined in the following manner: First, a domestic corporation computes the tentative amount of its FDII and the tentative amount of its section 250 deduction (''tentative section 250 deduction'') taking into account all deductions, but without regard to any carryforwards or disallowances under section 163(j), the amount of any net operating loss deduction under section 172(a), or the taxable income limitation of section 250(a)(2) and proposed § 1.250(a)–1(b)(2). Second, the corporation computes the amount of its business interest allowed after the application of section 163(j), for this purpose taking into account the amount of its tentative section 250 deduction but without regard to the amount of any net operating loss deduction under section 172(a). See section 163(j)(8)(A)(iii) and proposed § 1.163(j)–1(b)(1)(i)(B) and (b)(37)(ii). Third, the corporation computes the amount of its net operating loss deduction under section 172(a), for this purpose taking into account the amount of its business interest allowed after application of section 163(j) and the taxable income limitation of section 172(a)(2), but without regard to the amount of its section 250 deduction (including its tentative section 250 deduction). See section 172(d)(9). Fourth, the corporation computes the amount of its FDII, for this purpose taking into account the amount of its business interest allowed after application of section 163(j) and the amount of its net operating loss deduction under section 172(a) (determined in steps two and three, respectively). See part III(A)(2) of this Explanation of Provisions section for a discussion on the allocation of deductions to gross DEI and gross FDDEI. Fifth, the corporation computes the amount of its section 250 deduction after the application of the taxable income limitation of section 250(a)(2) and proposed § 1.250(a)–1(b)(2), for this purpose taking into account the amount of its business interest allowed after application of section 163(j) and the amount of its net operating loss deduction under section 172(a). See proposed § 1.250(a)–1(f)(2) (*Example 2*), which illustrates the interaction of sections 163(j), 172, and 250.

The Treasury Department and the IRS request comments on the proposed ordering rule, as well as how the section 250 deduction should be accounted for in determining adjusted taxable income at the partnership level under section 163(j)(4)(A).

III. Determination of FDII

A. General Computational Rules

1. In General

A domestic corporation's FDII is the corporation's deemed intangible income (''DII'') multiplied by the corporation's foreign-derived ratio. Proposed § 1.250(b)–1(b). A domestic corporation's DII is the excess (if any) of the corporation's deduction eligible income (''DEI'') over its deemed tangible income return (''DTIR''). Proposed § 1.250(b)–1(c)(3). A domestic corporation's DTIR is 10 percent of the corporation's QBAI. Proposed § 1.250(b)–1(c)(4). The foreign-derived ratio is the domestic corporation's ratio of foreign-derived deduction eligible income (''FDDEI'') to DEI. Proposed § 1.250(b)–1(c)(13).

2. Determination of DEI and FDDEI

A domestic corporation's DEI is the excess of its gross income without regard to certain excluded items (''gross DEI'') over the deductions properly allocable to gross DEI. See proposed § 1.250(b)–1(c)(2). Gross DEI excludes six categories of gross income: any amount included in gross income under section 951(a), GILTI, financial services income, dividends from CFCs, domestic oil and gas extraction income, and foreign branch income. See proposed § 1.250(b)–1(c)(14). The proposed regulations clarify that, for this purpose, a dividend includes any amount treated as a dividend under any other provision of subtitle A of the Internal Revenue Code, including the section 78 gross-up attributable to inclusions under sections 951(a) and 951A(a). See proposed § 1.250(b)–1(c)(5). In addition, the proposed regulations define foreign branch income by reference to proposed § 1.904–4(f), except that it also includes the sale, directly or indirectly, of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or partnership interest. See proposed § 1.250(b)–1(c)(11). The result is that income from the sale of any such asset is not included in gross DEI.

For purposes of calculating the foreign-derived ratio, FDDEI is the excess of gross FDDEI over deductions properly allocable to gross FDDEI. See proposed § 1.250(b)–1(c)(12). The proposed regulations define gross FDDEI as the portion of a corporation's gross DEI that is derived from all of its ''FDDEI sales'' and ''FDDEI services'' (collectively, ''FDDEI transactions''). See proposed § 1.250(b)–1(c)(8), (9), (10), and (15). The determination of whether a sale of property or a provision of a service is a FDDEI sale or a FDDEI service, respectively, is made under the provisions of proposed §§ 1.250(b)–3 through 1.250(b)–6. See part III(B) through (F) of this Explanation of Provisions section. The portion of a corporation's gross DEI that is not gross FDDEI is referred to as gross non-FDDEI. See proposed § 1.250(b)–1(c)(16). Therefore, all income included in gross DEI is included in either gross FDDEI or gross non-FDDEI, and all income included in either gross FDDEI or gross non-FDDEI is included in gross DEI.

In the case of property produced or acquired for resale, gross income is generally determined by subtracting cost of goods sold from gross sales receipts. In determining the amount of gross income included in gross DEI or gross FDDEI, cost of goods sold is attributed to gross receipts with respect to gross DEI and gross FDDEI using any reasonable method. See proposed § 1.250(b)–1(d)(1). The proposed regulations clarify that cost of goods sold that is associated with activities undertaken in an earlier taxable year cannot be segregated into component costs and attributed disproportionately to amounts excluded from gross FDDEI or to amounts excluded from gross DEI. See id. This is similar to the clarification in proposed § 1.199–4(b)(2)(iii)(A) and is intended to preclude a method that attributes cost of goods sold of an inventory item to gross receipts other than gross receipts included in the computation of gross DEI or gross FDDEI if the gross receipts from the sale of that item are included in the computation of amounts included in the computation of gross DEI or gross FDDEI, respectively. See 80 FR 51978, 51990 (Aug. 27, 2015). The Treasury Department and the IRS request comments on whether there are alternative approaches for dealing with timing issues, and whether additional rules should be provided for attributing cost of goods sold in determining gross DEI and gross FDDEI. Cf. § 1.199–4(b)(2) through (6).

Section 250(b)(3)(A) defines DEI as the excess of a domestic corporation's gross income (excluding certain items) over ''the deductions (including taxes) properly allocable to such gross income.'' FDDEI is defined as ''any deduction eligible income'' of the taxpayer generated through foreign-market sales and services. See section 250(b)(4). Therefore, a taxpayer's deductions that are ''properly allocable'' to gross DEI and gross FDDEI must be determined for purposes of calculating its DEI and FDDEI. The statute does not specify how deductions should be allocated for purposes of determining DEI and FDDEI. However, the rules set forth in §§ 1.861–8 through 1.861–14T and 1.861–17 apply for purposes of several other provisions in the Code which require the determination of taxable income from specific sources or activities, for example, for purposes of determining the foreign tax credit limitation under section 904 or qualified production activities income under former section 199. See generally §§ 1.199–4 and 1.861–8(f)(1). Accordingly, the proposed regulations provide that the rules set forth in §§ 1.861–8 through 1.861–14T and 1.861–17 apply for purposes of determining DEI and FDDEI. See proposed § 1.250(b)–1(d)(2)(i). In order to avoid circularity, in applying those rules for purposes of determining DEI and FDDEI, the section 250 deduction is not treated as giving rise to exempt income or assets. See proposed § 1.861–8(d)(2)(ii)(C)(*4*). Comments are requested on whether alternative approaches should be considered or additional rules are needed for purposes of allocating and apportioning a net operating loss deduction to gross DEI and gross FDDEI.

In certain circumstances, as a result of expense apportionment or attribution of cost of goods sold, a domestic corporation's FDDEI could exceed its DEI. For example, a domestic corporation could have $80x of DEI and $100x of FDDEI, with losses attributable to domestic market sales accounting for the $20x difference between DEI and FDDEI. However, it would be inconsistent with the statutory language to treat a domestic corporation as having a foreign-derived ratio in excess of one, and therefore FDII in excess of DII. In particular, section 250(b)(4) defines FDDEI as a subset of DEI, that is, ''any deduction eligible income of such taxpayer which is derived in connection with'' certain transactions. Therefore, the proposed regulations clarify that the foreign-derived ratio cannot exceed one. See proposed § 1.250(b)–1(c)(13).

3. Treatment of Partnerships

Section 250(a)(1) allows a deduction to a domestic corporation, but does not provide any rules for domestic corporations that are partners in a partnership. However, the conference report accompanying the Act (''Conference Report'') suggests that Congress intended that a domestic corporate partner of a partnership receive the benefit of a section 250 deduction for its FDII and GILTI. See H. Rept. 115–466, at 623, fn. 1517 (2017) (Conf. Rep.) (''The Committee intends that the deduction allowed by new Code section 250 be treated as exempting the deducted income from tax. Thus, for example, the deduction for global intangible low-taxed income could give rise to an increase in a domestic corporate partner's basis in a domestic partnership under section 705(a)(1)(B).'').

The proposed regulations give effect to this legislative intent by adopting an aggregate approach to partnerships for determining a domestic corporate partner's FDII attributable to the income and assets of a partnership. Specifically, the proposed regulations provide that a domestic corporate partner of a partnership takes into account its distributive share of a partnership's gross DEI, gross FDDEI, and deductions in order to calculate the partner's FDII. See proposed § 1.250(b)–1(e)(1). In addition, for purposes of determining a domestic corporate partner's DTIR, a domestic corporation's QBAI is increased by its share of the partnership's adjusted basis in partnership specified tangible property. See proposed § 1.250(b)–2(g).

Under the proposed regulations, the section 250 deduction is computed and allowed solely at the level of a domestic corporate partner. The Conference Report in footnote 1517 suggests that the section 250 deduction could give rise to an increase in a domestic corporate partner's basis in a domestic partnership under section 705(a)(1)(B) because some of the partnership's income may be treated as exempt income by reason of section 250. However, regardless of whether the deduction gives rise to exempt income in other contexts, because the section 250 deduction is computed and allowed solely at the level of a domestic corporate partner, the section 250 deduction does not exempt the deducted income from tax for purposes of applying section 705(a)(1)(B). As a result, a basis adjustment to a domestic corporate partner's interest in a domestic partnership is not appropriate to account for a section 250 deduction.

4. Treatment of Tax-Exempt Corporations

A domestic corporation that is subject to the unrelated business income tax under section 511 may claim a section 250 deduction. However, the proposed regulations clarify that such corporation's FDII for this purpose is determined only with respect to the corporation's items of income, gain, deduction, or loss, and adjusted bases in property, that are taken into account in computing its unrelated business taxable income. See proposed § 1.250(b)–1(g). The proposed regulations also clarify how a tax-exempt corporation subject to the unrelated business income tax under section 511 computes the dual use ratio with respect to property used in the production of gross DEI and income that is not gross DEI for purposes of determining its QBAI. See id.

5. Determination of QBAI

Section 250(b)(2)(B) provides that QBAI for purposes of section 250 is defined under section 951A(d), and is determined by substituting ''deduction eligible income'' for ''tested income'' and without regard to whether the corporation is a CFC. Accordingly, the determination of QBAI for purposes of FDII is similar to the determination of QBAI for purposes of GILTI. Compare proposed § 1.951A–3 with proposed § 1.250(b)–2. A domestic corporation's QBAI for FDII is equal to its aggregate average adjusted bases in specified tangible property, which is defined as tangible property used in the production of gross DEI. See proposed § 1.250(b)–2(b) and (c). The proposed regulations also provide rules for dual use property, calculating QBAI in a short taxable year, and calculating a domestic corporate partner's share of partnership QBAI. See proposed § 1.250(b)–2(d), (f), and (g).

In order to prevent the avoidance of the purposes of QBAI, the proposed regulations disregard certain transfers of specified tangible property by a domestic corporation to a related party where the corporation continues to use the property in production of gross DEI. See sections 250(c) and 951A(d)(4). Specifically, for purposes of calculating a domestic corporation's QBAI, the proposed regulations disregard a transfer of specified tangible property by the domestic corporation to a related party (whose QBAI would not be taken into account in calculating the corporation's DTIR) if, within a two-year period beginning one year before the transfer, the domestic corporation (or a related party whose QBAI would be taken into account in calculating the corporation's DTIR) leases the same or substantially similar property from a related party and such transfer and lease occur pursuant to a principal purpose of reducing the domestic corporation's DTIR. See proposed § 1.250(b)–2(h)(1) and (h)(4)(i) through (iv). A transfer and lease described in the preceding sentence is treated per se as occurring pursuant to a principal purpose of reducing a domestic corporation's DTIR if both the transfer and the lease occur within the same six-month period. See proposed § 1.250(b)–2(h)(3). If the anti-avoidance rule applies, the domestic corporation that transferred the property is treated as owning such property from the later of the beginning of the term of the lease or date of the transfer until the earlier of the end of the term of the lease or the end of the recovery period of the transferred property. See proposed § 1.250(b)–2(h)(1).

The anti-avoidance rule does not apply to a transfer to and lease from an unrelated party, unless the transfer to and lease from the unrelated party is pursuant to a structured arrangement. See proposed § 1.250(b)–2(h)(2). A structured arrangement exists only if either a reduction in the domestic corporation's DTIR is a material factor in the pricing of the arrangement with the transferee or, based on all the facts and circumstances, the reduction in the domestic corporation's DTIR is a principal purpose of the arrangement. See id. The proposed regulations provide a non-inclusive list of facts and circumstances indicating that a principal purpose of an arrangement is the reduction of DTIR. See proposed § 1.250(b)–2(h)(2)(ii)(A) through (D). The Treasury Department and the IRS welcome comments on alternative approaches to identifying a structured arrangement involving unrelated parties.

No inference is intended regarding the application of any other Code section or judicial doctrine that may apply to affect the determination of FDII and its components.

B. General Rules for FDDEI Transactions

1. Definitions of Sale, Foreign Person, and United States

Proposed § 1.250(b)–3 provides rules relevant to determining whether a sale of property is a FDDEI sale and whether a provision of a service is a FDDEI service.

Section 250(b)(5)(E) provides that for purposes of section 250(b), the term ''sale'' includes any lease, license, exchange, or other disposition. Accordingly, for purposes of determining whether a sale of property is a FDDEI sale, the proposed regulations define ''sale'' to include a lease, license, exchange, or other disposition of property, including a transfer of property resulting in gain or an income inclusion under section 367. See proposed § 1.250(b)–3(b)(7).

The proposed regulations define a foreign person as a person that is not a United States person, which includes a foreign government or international organization for purposes of the proposed regulations. See proposed § 1.250(b)–3(b)(2). A United States person (''U.S. person'') has the same meaning as under section 7701(a)(30), except that an individual that is a bona fide resident of a U.S. territory within the meaning of section 937(a) is excluded. See proposed § 1.250(b)–3(b)(10). While corporations formed in U.S. territories are generally treated as foreign corporations, under section 7701(a)(30), U.S. persons include all U.S. citizens or residents, regardless of whether they reside in a U.S. territory. However, a bona fide resident of a U.S. territory is generally exempt from U.S. tax on income sourced in that territory. See sections 931(a), 932(c)(4), 933(1), and 935. Therefore, to prevent the disparate treatment of sales to entities in a U.S. territory (potentially qualifying as a FDDEI sale) and sales to individuals in a U.S. territory (not qualifying as a FDDEI sale), the proposed regulations exclude bona fide residents of a U.S. territory from the definition of U.S. person.

A partnership is generally a ''person'' for purposes of the Code. See section 7701(a)(1). Accordingly, in determining whether a sale of property to or by a partnership qualifies as a FDDEI sale, or the provision of a service to or by a partnership qualifies as a FDDEI service, the proposed regulations treat a partnership as a person. See proposed § 1.250(b)–3(g). Therefore, for example, a sale of property to a foreign partnership for a foreign use may constitute a FDDEI sale because such sale is to a foreign person, whereas a sale of property to a domestic partnership, even if for a foreign use, will not constitute a FDDEI sale because such sale is to a domestic person. The Treasury Department and the IRS request comments on whether there are circumstances where it would be appropriate to treat a partnership as an aggregate of its partners for purposes of determining whether a sale of property or a provision of a service to a partnership is a sale or service to a foreign person.

The proposed regulations provide that the term ''United States'' generally has the meaning described in section 7701(a)(9). See proposed § 1.250(b)–3(b)(9). However, with respect to mines, oil and gas wells, and other natural deposits, the term United States includes certain seabed and subsoil of submarine areas adjacent to the territorial waters of the United States, as described in section 638(1). See id.

2. Foreign Military Sales

The Treasury Department and the IRS recognize that the statute is unclear as to whether a sale of property or the provision of a service to the U.S. government for resale or on-service to a foreign government under the Arms Export Control Act of 1976, as amended (22 U.S.C. 2751 *et seq.*), may qualify for the section 250 deduction. In general, the Arms Export Control Act governs the export of certain sales and services to foreign governments. Under the Arms Export Control Act, a seller or service provider provides sales or services to the U.S. government that are for the ultimate benefit of a foreign government. The concern is that such sale or service to the U.S. government governed by the Arms Export Control Act is not a sale to a ''person who is not a United States person'' within the meaning of section 250(b)(4)(A) or a service to a ''person not located within the United States'' within the meaning of section 250(b)(4)(B), notwithstanding that such a sale or service is ultimately provided to the foreign government.

The proposed regulations provide that, for purposes of section 250, a sale of property or the provision of a service to the U.S. government under the Arms Export Control Act of 1976 is treated as a sale of property or provision of a service to a foreign government. See proposed § 1.250(b)–3(c). See part I(D)(3) of the Special Analyses section for additional discussion regarding the analysis for the adoption of this rule. As discussed in part III(B)(1) of this Explanation of Provisions section, a foreign government or international organization is a foreign person for purposes of section 250 and the proposed regulations. See proposed § 1.250(b)–3(b)(2). Therefore, a sale of property or provision of a service to the U.S. government under the Arms Export Control Act may qualify as a FDDEI transaction if the other requirements under proposed §§ 1.250(b)–3 through 1.250(b)–6 are satisfied. To the extent other requirements under proposed §§ 1.250(b)–3 through 1.250(b)–6 are not satisfied, a sale or service will not qualify as a FDDEI transaction regardless of whether such sale or service is pursuant to the Arms Export Control Act.

The Treasury Department and the IRS have not currently identified readily available documentation sufficient to demonstrate that a particular sale or service was made pursuant to the Arms Export Control Act. Comments are requested on whether final regulations should provide guidance on how taxpayers can demonstrate that a sale or service has been made pursuant to the Arms Export Control Act.

3. Knowledge and Reason To Know

As discussed in part III(C) of this Explanation of Provisions section, the proposed regulations provide that a sale of property qualifies as a FDDEI sale only if the seller or renderer does not know or have reason to know that the recipient is not a foreign person or that the property will not be for a foreign use. See proposed § 1.250(b)–4(c), (d), and (e). In addition, as discussed in part III(D) of this Explanation of Provisions section, the proposed regulations provide that the provision of a general service (as defined in proposed § 1.250(b)–5(c)(4)) qualifies as a FDDEI service only if the renderer of the service does not know or have reason to know that the recipient is located within the United States. See proposed § 1.250(b)–5(d)(1) and (e)(1). The terms ''know'' and ''reason to know'' are used throughout the Code and Treasury regulations. The Treasury Department and the IRS request comments regarding whether definitions of ''know'' and ''reason to know'' are necessary for purposes of the section 250 regulations.

4. Reliability of Documentation

In order for a transaction to constitute a FDDEI transaction, the proposed regulations prescribe different types of documentation that are required to be obtained for each type of transaction. For example, in the case of a sale of property, the seller must obtain documentation that establishes the recipient's status as a foreign person. See proposed § 1.250(b)–4(c)(2). See parts III(C) and III(D) of this Explanation of Provisions section for an explanation of the documentation requirements in these proposed regulations; see also part II of the Special Analyses section for a discussion of the Paperwork Reduction Act.

The proposed regulations provide that, for any documentation described in the proposed regulations to be relied upon, the seller or renderer must obtain the documentation by the FDII filing date, the documentation must be obtained no earlier than one year before the sale or service, and the seller or renderer must not know or have reason to know that the documentation is incorrect or unreliable. See proposed § 1.250(b)–3(d); see also proposed § 1.250(b)–3(b)(1) (defining the term ''FDII filing date''). For this purpose, a seller or renderer has reason to know that documentation is unreliable or incorrect if its knowledge of all the relevant facts or statements contained in the documentation is such that a reasonably prudent person in the position of the seller or renderer would question the accuracy of the documentation. See proposed § 1.250(b)–3(d)(1).

The Treasury Department and the IRS welcome comments on the documentation requirements in the proposed regulations.

5. Transactions Consisting of Both Sales and Services

Under section 250(b)(4) and (5) and these proposed regulations, the criteria for establishing that a transaction is foreign-derived is different for sales and services. For example, a transaction with a U.S. person that is located outside of the United States may qualify as a FDDEI service, but cannot qualify as a FDDEI sale. Because a transaction might include elements of both a sale and a service, the proposed regulations clarify that a transaction is classified according to the overall predominant character of the transaction. See proposed § 1.250(b)–3(e). For example, a sale of equipment that includes incidental support services from the seller at no additional cost would be classified as a sale, and therefore the provisions of proposed § 1.250(b)–4 would apply to determine whether gross income from the transaction is included in gross FDDEI.

6. Special Rule for Certain Loss Transactions

A domestic corporation's FDDEI includes all gross income included in gross DEI that is derived from FDDEI sales and FDDEI services in a taxable year, reduced by the amount of deductions properly allocable to such income. See proposed § 1.250(b)–1(c)(12) and part III(A)(2) of this Explanation of Provisions section. In most cases, a FDDEI sale or FDDEI service will increase a domestic corporation's section 250 deduction, because the income from such sale or service will increase the corporation's FDDEI and thus its foreign-derived ratio. However, in some cases, a FDDEI sale or a FDDEI service could have the effect of reducing FDDEI and thus a domestic corporation's section 250 deduction for the year. This could happen where, for instance, the domestic corporation's cost of goods sold attributed to property sold in a FDDEI sale exceeds its gross receipts from the sale, or the expenses allocated to the gross income from a FDDEI sale or FDDEI service exceed the gross income arising from the sale or service. In such a case, absent a rule to the contrary, a domestic corporation could intentionally fail to satisfy the documentation requirements with respect to a transaction that would otherwise qualify as a FDDEI sale or FDDEI service in order to prevent the transaction from reducing its FDDEI and thereby its section 250 deduction.

Section 250(b) does not contemplate a transaction-by-transaction determination of FDII, but rather an aggregate calculation based on all gross income ''which is derived in connection with'' sales and services described in section 250(b)(4). Therefore, it would be inappropriate to permit taxpayers to elect to exclude losses related to sales to foreign persons for a foreign use and services to persons located outside the United States by merely failing the documentation requirements. Accordingly, the proposed regulations provide that if a seller or renderer knows or has reason to know that property is sold to a foreign person for a foreign use or a general service is provided to a person located outside the United States, but the seller or renderer does not satisfy the documentation requirements applicable to such sale or service, the sale of property or provision of a service is nonetheless deemed a FDDEI transaction if treating the sale or service as a FDDEI transaction would reduce a domestic corporation's FDDEI. See proposed § 1.250(b)–3(f).

The special loss transaction rule in proposed § 1.250(b)–3(f) does not apply to proximate services, property services, and transportation services, each of which is defined and discussed in part III(D)(3) through (5) of this Explanation of Provisions section, because the proposed regulations do not require documentation with respect to such services. Therefore, a proximate service, property service, or transportation service is a FDDEI service if it meets the applicable substantive requirements for a FDDEI service described in § 1.250(b)–5(f), (g), and (h), respectively.

C. FDDEI Sales

1. In General

Section 250(b)(4)(A) provides that FDDEI includes income from property the taxpayer sells to any person who is not a U.S. person, and which the taxpayer establishes to the satisfaction of the Secretary is for a foreign use. Accordingly, the proposed regulations define a FDDEI sale as a sale of property to a foreign person for a foreign use. See proposed § 1.250(b)–4(b).

2. Foreign Person

The proposed regulations provide that a recipient is treated as a foreign person only if the seller obtains documentation of the recipient's foreign status and does not know or have reason to know that the recipient is not a foreign person. See proposed § 1.250(b)–4(c)(1). The proposed regulations provide several types of permissible documentation for this purpose, such as a written statement by the recipient indicating that the recipient is a foreign person. See proposed § 1.250(b)–4(c)(2)(i). To alleviate the burden of documentation on small businesses and small transactions, the proposed regulations allow a seller that has less than $10,000,000 of gross receipts in the prior taxable year, or less than $5,000 in gross receipts from a single recipient during the current taxable year, to treat a recipient as a foreign person if the seller has a shipping address for the recipient that is outside the United States. See proposed § 1.250(b)–4(c)(2)(ii). The $10,000,000 and $5,000 thresholds were chosen based on the experience of the Treasury Department and the IRS and not based on any specific quantitative analysis. The Treasury Department and the IRS request comments regarding whether the $10,000,000 and $5,000 thresholds are appropriate and especially solicit comments that provide data, other evidence, and models that can enhance the rigor of the process by which such thresholds are determined.

3. Foreign Use

Under the proposed regulations, the rules applicable to the determination of whether a sale of property is for a foreign use depends on whether the property sold is ''general property'' or ''intangible property.'' See proposed § 1.250(b)–4(d) and (e). The proposed regulations define general property as property other than intangible property, a security (as defined in section 475(c)(2)), or a commodity (as defined in section 475(e)(2)(B) through (D)). See proposed § 1.250(b)–3(b)(3). The proposed regulations define intangible property by cross-reference to section 367(d)(4). See proposed § 1.250(b)–3(b)(4).

The proposed regulations provide that a sale of a security (as defined in section 475(c)(2)) or a commodity (as defined in section 475(e)(2)(B) through (D)) is not a FDDEI sale because such financial instruments are not subject to ''any use, consumption, or disposition'' outside the United States within the meaning of section 250(b)(5)(A). See proposed § 1.250(b)–4(f).

The proposed regulations provide that a sale of property (whether general property or intangible property) is treated as for a foreign use only if the seller obtains documentation that the property is for a foreign use and does not know or have reason to know, as of the FDII filing date, that the property is not for a foreign use (or, in the case of intangible property, that the portion of the sale of the intangible property for which the seller establishes foreign use is not for a foreign use). See proposed § 1.250(b)–4(d)(1) and (e)(1). Accordingly, if, as of the FDII filing date, the seller does not know or have reason to know that either the documentation obtained with respect to the sale is not reliable or that the property is not for a foreign use within the meaning of § 1.250(b)–4(d)(2) or (e)(2), then the sale of the property is treated as for a foreign use under § 1.250(b)–4(d)(1) or (e)(1) even if, in fact, the sale of such property is not for a foreign use within the meaning of § 1.250(b)–4(d)(2) or (e)(2).

a. Foreign Use for General Property

The sale of general property is for a foreign use if either the property is not subject to domestic use within three years of delivery of the property or the property is subject to manufacture, assembly, or other processing outside the United States before any domestic use of the property. See proposed § 1.250(b)–4(d)(2)(i) and Conf. Rep. at 625, fn. 1522 (''If property is sold by a taxpayer to a person who is not a U.S. person, and after such sale the property is subject to manufacture, assembly, or other processing (including the incorporation of such property, as a component, into a second product by means of production, manufacture, or assembly) outside the United States by such person, then the property is for a foreign use.''). Domestic use is defined as the use, consumption, or disposition of property within the United States, including manufacture, assembly, or other processing within the United States. See proposed § 1.250(b)–4(d)(2)(ii). Comments are requested on the supply chain implications of these rules.

General property is subject to manufacturing, assembly, or other processing only if it meets either of the following two tests: (1) There is a physical and material change to the property, or (2) the property is incorporated as a component into a second product. See proposed § 1.250(b)–4(d)(2)(iii)(A). The proposed regulations clarify that a physical and material change does not include ''minor assembly, packaging, or labeling.'' See proposed § 1.250(b)–4(d)(2)(iii)(B). However, whether property has undergone a physical and material change (as opposed to minor assembly, packaging, or labeling) is determined based on all the relevant facts and circumstances. The Treasury Department and the IRS request comments regarding whether additional guidance should be provided for determining whether property has undergone a physical and material change.

General property is incorporated as a component into a second product only if the fair market value of the property when it is delivered to the recipient constitutes no more than 20 percent of the fair market value of the second product, determined when the second product is completed. See proposed § 1.250(b)–4(d)(2)(iii)(C). If the seller sells multiple items of property that are incorporated into the second product, an aggregation rule treats all of the property sold by the seller that is incorporated into the second product as a single item of property for purposes of determining whether the property constitutes more than 20 percent of the fair market value of the second product. See id.

In order to establish that general property is for a foreign use, the seller must generally obtain documentation with respect to the sale. See proposed § 1.250(b)–4(d)(3). Such documentation could include, for example, proof of shipment of the property to a foreign address. See proposed § 1.250(b)–4(d)(3)(i). However, in the case of certain small businesses and small transactions, the seller may rely on a foreign shipping address for the recipient instead of obtaining documentation. See proposed § 1.250(b)–4(d)(3)(ii).

In lieu of the general documentation requirements for determining foreign use for sales of general property, in the case of a sale of multiple items of general property, which because of their fungible nature cannot reasonably be specifically traced to the location of use (''fungible mass''), a seller may establish that some, but not all, of the property is for a foreign use through market research, including statistical sampling, economic modeling, and other similar methods. See proposed § 1.250(b)–4(d)(3)(iii). A de minimis rule applies to treat the entire fungible mass as for a foreign use if a seller obtains documentation establishing that 90 percent or more of the fungible mass is for a foreign use. See id. Conversely, no portion of the fungible mass is treated as for a foreign use if the seller does not obtain documentation establishing that 10 percent or more of the fungible mass is for a foreign use. Id.

A special rule applies for purposes of determining whether the sale of certain transportation property is for a foreign use, which takes into account the special nature of property used for international transportation. Specifically, the sale of aircraft, railroad rolling stock, vessel, motor vehicle, or similar property that provides a mode of transportation and is capable of traveling internationally is for a foreign use only if, during the three-year period from the date of delivery of the property, the property is located outside the United States more than 50 percent of the time and more than 50 percent of the miles traversed in the use of such property will be traversed outside the United States. See proposed § 1.250(b)–4(d)(2)(iv). The seller can establish that a sale of general property used for international transportation is for a foreign use through, for example, a written statement from the recipient that the property is anticipated to satisfy the test described in the preceding sentence. See proposed § 1.250(b)–4(d)(3)(i)(A).

b. Foreign Use for Intangible Property

As discussed in part III(B) of this Explanation of Provisions section, a sale includes a license and any transfer of property in which gain or income is recognized under section 367, including a transfer of intangible property subject to section 367(d). See proposed § 1.250(b)–3(b)(7). The proposed regulations provide that a sale of intangible property is for a foreign use to the extent revenue is earned from exploiting the intangible property outside the United States, the documentation requirements are satisfied, and the seller does not know or have reason to know that the portion of the sale of the intangible property for which the seller establishes foreign use is not for a foreign use. See proposed § 1.250(b)–4(e)(1). Unlike a sale of general property (other than a sale of a fungible mass), a seller may establish foreign use for a portion of the income from the sale of intangible property. For purposes of determining whether a sale of intangible property is for a foreign use, the location where revenue is earned is generally determined based on the location of end-user customers licensing the intangible property or purchasing products for which the intangible property was used in development, manufacture, sale, or distribution. See proposed § 1.250(b)–4(e)(2). This determination is generally made on an annual basis based on the actual revenue earned by the recipient. Id.

Special rules apply to lump sum sales because, in these cases, it may be difficult or impossible to know the location where revenue will be generated when the sale occurs. The determination of foreign use in these cases is made based on the net present value of revenue the seller would have reasonably expected to earn from the exploitation of the intangible property. See proposed § 1.250(b)–4(e)(2)(iii). For sales of rights to intangible property for use both within and outside the United States, the seller must establish the proportionate amount of revenue earned within and outside the United States from use of the intangible property to establish foreign use. The proposed regulations describe documentation that can be used to establish where revenue is earned from use of the intangible property. See proposed § 1.250(b)–4(e)(3)(i). For example, if a domestic corporation licenses to a foreign person the worldwide rights to market and sell an item protected by a copyright, the domestic corporation would need to obtain documentation, as provided in the proposed regulations, establishing where revenue is earned from sales of the copyright-protected item.

A seller may establish the extent to which a sale of intangible property for a lump sum is for a foreign use through documentation containing reasonable projections of the amount and location of revenue that the seller would have reasonably expected to earn from the use of intangible property. See proposed § 1.250(b)–4(e)(3)(iii). To be considered reasonable, the net present value must be consistent with the financial data and projections used by the seller to determine the sales price to the foreign person. See id. The same rule for documentation applies to a sale to a foreign person (other than a related party of the seller) for annual payments that are not contingent on revenue or profit unless the seller has access to reliable information to determine the actual revenue earned by the foreign unrelated party from the exploitation of the intangible property. See proposed § 1.250(b)–4(e)(3)(ii).

As discussed in part III(C)(3)(a) of this Explanation of Provisions section, a sale of general property is treated as for a foreign use if the property is subject to manufacturing, assembly, or other processing outside the United States. See proposed § 1.250(b)–4(d)(2)(i)(B). This rule is based on footnote 1522 of the Conference Report, which provides that ''[i]f property is sold by a taxpayer to a person who is not a U.S. person, and after such sale the property is subject to manufacture, assembly, or other processing (including the incorporation of such property, as a component, into a second product by means of production, manufacture, or assembly) outside the United States by such person, then the property is for a foreign use.'' Intangible property is not ''subject to'' manufacture, assembly, or processing, and there is no other discussion in the Conference Report that indicates an intent to provide an analogous rule for intangible property otherwise used in the manufacturing process. However, comments are requested on whether a rule for intangible property similar to proposed § 1.250(b)–4(d)(2)(i)(B) is appropriate. Comments are also requested on what additional rules may be needed for determining the location of revenue generation from end-users and what types of documentation should be accepted to document the location of revenue generation with respect to intangible property.

D. FDDEI Services

1. In General

Section 250(b)(4)(B) provides that FDDEI includes income from services provided by a domestic corporation to any person, or with respect to property, not located within the United States. Section 250 does not prescribe rules for determining whether a person or property is ''not located within the United States.'' Proposed § 1.250(b)–5 provides rules for determining whether a service is provided to a person, or with respect to property, located outside the United States.

Under the proposed regulations, whether a service is provided to a person, or with respect to property, located outside the United States, depends on the type of service provided and, in the case of a general service (defined below), the type of recipient of the service. The proposed regulations distinguish between services where the service provider (the ''renderer'') and the recipient are in physical proximity when the service is performed (''proximate services''), services with respect to tangible property (''property services''), services to transport people or property (''transportation services''), and all other services (''general services''). See proposed § 1.250(b)–5(b) and (c)(4) through (7). For purposes of determining whether a service constitutes a FDDEI service, the proposed regulations look to the location of the performance of the service for proximate services, the location of the property for property services, the origin and destination of transportation services, and the location of the recipient for general services. See proposed § 1.250(b)–5(d) through (h).

Each category of service described in § 1.250(b)–5 is mutually exclusive of each other category, and every possible service is described in a single category. Therefore, whether a service is a FDDEI service is determined under the rules relevant to one, and only one, category of service described in § 1.250(b)–5. For example, a general service that is provided to a recipient located within the United States is not a FDDEI service, even if the service is performed outside the United States, whereas a property service that is performed outside the United States is a FDDEI service, even if the recipient of the service is located within the United States. See parts III(D)(2) and (4) of this Explanation of Provisions section.

2. General Services to Persons Located Outside the United States

A general service is a service other than a proximate service, a property service, or a transportation service. See proposed § 1.250(b)–5(c)(4). General services is the residual category of services. Accordingly, a service that is not a property service, a transportation service, or a proximate service is analyzed as a general service.

For general services, the proposed regulations distinguish between services provided to ''consumers'' and services provided to ''business recipients.'' A consumer is defined as an individual that purchases a service for personal consumption. See proposed § 1.250(b)–5(c)(3). A business recipient is defined as any recipient other than a consumer. See proposed § 1.250(b)–5(c)(2). In both cases, general services are treated as provided to a person located outside the United States if the renderer does not know or have reason to know that the consumer or business recipient is located within the United States and obtains appropriate documentation. See proposed § 1.250(b)–5(d)(1) and (e)(1).

a. General Services to Consumers

The provision of a general service to a consumer located outside the United States is a FDDEI service. See proposed § 1.250(b)–5(b)(1). The proposed regulations provide that the consumer is located where a consumer resides when the service is provided. See proposed § 1.250(b)–5(d)(2).

The proposed regulations require a domestic corporation to document the location of the consumer. See proposed § 1.250(b)–5(d)(1) and (3). The proposed regulations provide several types of permissible documentation for this purpose, including a written statement by the consumer indicating the residence of the consumer when the service is provided. See proposed § 1.250(b)–5(d)(3)(i). However, in the case of certain small businesses and small transactions, the renderer may rely on a foreign billing address for the consumer instead of obtaining documentation. See proposed § 1.250(b)–5(d)(3)(ii).

b. General Services to Business Recipients

The provision of a general service to a business recipient located outside the United States is a FDDEI service. See proposed § 1.250(b)–5(b)(2). Under the proposed regulations, all general services that are not provided to consumers are treated as services provided to business recipients, regardless of whether the recipient is engaged in a trade or business. See proposed § 1.250(b)–5(c)(2).

The proposed regulations determine the location of a business recipient based on the location of the business recipient's operations, and the operations of any related party of the recipient, that receive a benefit (as defined in § 1.482–9(l)(3)) from such service. See proposed § 1.250(b)–5(e)(2) and (4). For purposes of this determination, the location of residence, incorporation, or formation of a business recipient is not relevant. For example, a general service that confers a benefit only on the U.S. operations of a foreign person will generally not qualify as a FDDEI service, whereas a service that confers a benefit only on the foreign operations of a U.S. person will generally qualify as a FDDEI service. For purposes of this rule, a business recipient is treated as having operations in any location where it maintains an office or other fixed place of business. See proposed § 1.250(b)–5(e)(2)(ii).

The proposed regulations provide that a service is generally provided to a business recipient located outside the United States to the extent that the renderer's gross income from providing the service is allocated to the business recipient's operations outside the United States. See proposed § 1.250(b)–5(e)(2)(i). To make this allocation, the renderer must first determine which of the business recipient's operations receive a benefit from the service. See proposed § 1.250(b)–5(e)(2)(i)(A). Where the service confers a benefit on the operations of the business recipient in specific locations, gross income of the renderer is allocated based on the location of the operations in specific locations that receive the benefit. See id. Where a service confers a benefit on the recipient's business as a whole, or where reliable information about the particular portion of the operations that specifically receive a benefit from the service is unavailable, the proposed regulations provide that the service is deemed to confer a benefit on all of the business recipient's operations. See id. The renderer then must allocate its gross income from providing the service between the operations that receive a benefit from the service that are located within and outside the United States. See proposed § 1.250(b)–5(e)(2)(i)(B). For this purpose, any reasonable method may be used, and the principles of § 1.482–9(k) apply to determine whether a method is reasonable. See id. A reasonable method may include, for example, an allocation based on the renderer's time spent working with different offices of the business recipient or publicly available information about the business recipient's revenue from different markets. See id. The Treasury Department and the IRS request comments on this approach for determining the location of a business recipient that operates both within and outside of the United States.

The proposed regulations also require a domestic corporation to obtain documentation sufficient to establish the location of a business recipient's operations that benefit from the service. See proposed § 1.250(b)–5(e)(1) and (3). A domestic corporation may obtain a statement from the recipient specifying the location of the operations that will benefit from the service or include a similar statement in a binding contract. See proposed § 1.250(b)–5(e)(3)(i)(A) and (B). A domestic corporation may also establish the location of the business recipient using information provided in the ordinary course of the provision of a service or publicly available information. See proposed § 1.250(b)–5(e)(3)(i)(C) and (D). However, in the case of certain small businesses and small transactions, the renderer may rely on a foreign billing address for the business recipient instead of obtaining documentation. See proposed § 1.250(b)–5(e)(3)(ii).

3. Proximate Services

The provision of a proximate service to a recipient located outside the United States is a FDDEI service. See proposed § 1.250(b)–5(b)(3). A proximate service is defined as a service, other than a property service or a transportation service, substantially all of which is performed in the physical presence of the recipient or, in the case of a business recipient, its employees. See proposed § 1.250(b)–5(c)(6). For example, a training, consulting, or auditing service that is performed on-site would generally constitute a proximate service. Substantially all of a service is performed in the physical presence of the recipient or its employees if the renderer spends more than 80 percent of the time providing the service in the physical presence of the recipient or its employees. See proposed § 1.250(b)–5(c)(6). The recipient of a proximate service is treated as located where the service is performed. See proposed § 1.250(b)–5(f). If a proximate service is performed partly within and partly outside the United States, a proportionate amount of the service is treated as rendered to a person located outside the United States corresponding to the portion of time spent providing the proximate service outside the United States. See id.

4. Property Services

The provision of a property service with respect to tangible property located outside the United States is a FDDEI service. See proposed § 1.250(b)–5(b)(4). A property service is defined as a service, other than a transportation service, provided with respect to tangible property, but only if substantially all of the service is performed at the location of the property and results in physical manipulation of the property such as through assembly, maintenance, or repair. See proposed § 1.250(b)–5(c)(5). The proposed regulations provide that substantially all of a service is performed at the location of property if the renderer spends more than 80 percent of the time providing the service at or near the location of the property. See id. A property service is a FDDEI service only if the tangible property with respect to which the service is performed is located outside the United States for the duration of the period of performance. See proposed § 1.250(b)–5(g). The Treasury Department and the IRS request comments on whether to consider an exception for property that is located in the United States temporarily solely for purposes of the performance of certain services, such as maintenance or repairs. As discussed in part III(E) of this Explanation of Provisions section, a property service may qualify as a FDDEI service even if it is performed for a person located within the United States.

Other services that relate to property but may not necessarily be provided in close proximity to tangible property or do not result in the physical manipulation of such property such as through assembly, maintenance, or repair may be subject to the rules for proximate services, transportation services, or general services. For example, an architectural or engineering service that is not performed in physical proximity to the property or the recipient will be evaluated as a general service even if the service relates to property located outside the United States, and thus whether such a service is a FDDEI service will be determined based on the location of the recipient rather than the location of the property.

5. Transportation Services

The provision of a transportation service to a recipient, or with respect to property, located outside the United States is a FDDEI service. See proposed § 1.250(b)–5(b)(5). A transportation service is defined as a service to transport a person or property using any mode of transportation (such as an airplane). See proposed § 1.250(b)–5(c)(7).

Basing the location of a transportation service on the residence of the recipient of the transportation service could provide inconsistent results with respect to similar services. Similarly, providing different rules for the transportation of a person or property could provide inconsistent results with respect to similar services. Therefore, the proposed regulations provide that whether a ''transportation service'' is provided to a recipient, or with respect to property, located outside the United States is determined based on the origin and destination of the service. See proposed § 1.250(b)–5(h). If both the origin and destination of a transportation service are outside of the United States, then the service is a FDDEI service. See id. If either the origin or the destination of the transportation service is outside of the United States, but not both, then 50 percent of the service is a FDDEI service and thus 50 percent of the gross income from the provision of the service is included in the renderer's gross FDDEI. See id.

E. Domestic Intermediary Rules

Section 250(b)(5)(B) describes special rules for ''domestic intermediaries'' (the ''domestic intermediary rules''). Section 250(b)(5)(B)(i) provides that if a seller sells property to another person (other than a related party) for further manufacture or other modification within the United States, the property is not treated as sold for a foreign use even if such other person subsequently uses such property for a foreign use. Section 250(b)(5)(B)(ii) provides that services provided to a person (other than a related party) located within the United States are not treated as services described in section 250(b)(4)(B) even if such other person uses such services in providing services that are described in section 250(b)(4)(B).

The proposed regulations do not contain specific rules corresponding to the domestic intermediary rules because those rules are encompassed within the general rules relating to FDDEI sales and FDDEI services in the proposed regulations. With respect to sales of property, the proposed regulations provide that general property is not for a foreign use if, before being subject to manufacture, assembly, or other processing outside the United States, the property is subject to a domestic use. See proposed § 1.250(b)–4(d)(2)(i). For this purpose, domestic use includes manufacture, assembly, or other processing within the United States. See proposed § 1.250(b)–4(d)(2)(ii)(B). In addition, a sale of property to a U.S. person cannot qualify as a FDDEI sale under any circumstance. See section 250(b)(4)(A) and proposed § 1.250(b)–4(b). Therefore, a sale of property to a foreign person for further manufacture in the United States or to a U.S. person does not qualify for a FDDEI sale, regardless of the ultimate use of the property by the recipient.

With respect to the provision of services, the proposed regulations provide that a service is a FDDEI service only if the recipient of the service, or the property to which the service relates, is located outside the United States. See proposed § 1.250(b)–5(b)(1) through (5). Therefore, a service provided to a person, or with respect to property, located within the United States is not a FDDEI service, regardless of the ultimate use of the service by the recipient.

Section 250(b)(5)(B)(ii) could be read literally to provide that a FDDEI service includes only services provided to a person not located within the United States, in which case a service provided ''with respect to property located outside the United States'' would not qualify as a FDDEI service if the recipient of such service was located within the United States. As discussed in part III(D) of this Explanation of Provisions section, consistent with the general rule of section 250(b)(4)(B), the proposed regulations clarify that a service qualifies as a FDDEI service if it is provided either to a person located outside the United States or with respect to property located outside the United States. The Treasury Department and the IRS have determined that an interpretation of section 250(b)(5)(B)(ii) that effectively eliminates the disjunctive test of section 250(b)(4)(B) would not be reasonable. Therefore, under the proposed regulations, whether a service that is treated as with respect to property—a property service or a transportation service—is a FDDEI service is determined solely by reference to the location of the property, and not the location of the recipient. See proposed § 1.250(b)–5(g) and (h).

Finally, the parenthetical references to related parties in the domestic intermediary rules could be read to imply the existence of an exception for further manufacture or modification in the United States by a related party or a service provided to a related party located within the United States. However, the general rules of section 250(b)(4)(A) and (B) do not authorize such exceptions, and the domestic intermediary rules do not purport to expand these general rules, but rather to limit the transactions that qualify under them. Therefore, with respect to related party domestic intermediaries, the proposed regulations do not provide an exception to the general rule that property must be sold to a foreign person to qualify as a FDDEI sale or that a service must be provided to a person located outside the United States to qualify as a FDDEI service. Cf. part V of this Explanation of Provisions section regarding the applicability of the attribute redetermination rule of § 1.1502–13(c)(1)(i) to the determination of FDDEI of a member of a consolidated group.

F. Related Party Transactions

A sale of property or a provision of a service may qualify as a FDDEI transaction, regardless of whether the recipient of such service is a related party of the seller or renderer. However, in the case of a sale of general property or a provision of a general service to a related party, section 250(b)(5)(C) and proposed § 1.250(b)–6 provide additional requirements that must be satisfied for the transaction to qualify as a FDDEI sale or FDDEI service. These requirements must be satisfied in addition to the general requirements that apply to such sales and services as provided in proposed §§ 1.250(b)–3 through 1.250(b)–5.

The proposed regulations define a related party with respect to any person as any member of a modified affiliated group that includes such person. Proposed § 1.250(b)–1(c)(19). A modified affiliated group is defined as an affiliated group as provided in section 1504(a) by substituting ''more than 50 percent'' for ''at least 80 percent'' each place it appears, and without regard to section 1504(b)(2) and (3). Proposed § 1.250(b)–1(c)(17)(i). A modified affiliated group also includes any person other than a corporation that is controlled by one or more members of a modified affiliated group or that controls such a member. Proposed § 1.250(b)–1(c)(17)(ii). For this purpose, ''control'' is defined as provided in section 954(d)(3), meaning direct, indirect, or constructive ownership under section 958 of more than 50 percent of the value of the beneficial interests in such person. Proposed § 1.250(b)–1(c)(17)(iii).

1. Related Party Sales

Section 250(b)(5)(C)(i) provides that property sold to a related party that is not a U.S. person ''shall not be treated as for a foreign use unless (I) such property is ultimately sold by a related party, or used by a related party in connection with property which is sold or the provision of services, to another person who is an unrelated party who is not a United States person, and (II) the taxpayer establishes to the satisfaction of the Secretary that such property is for a foreign use.'' Accordingly, the proposed regulations provide that a sale of general property to a foreign related party (a ''related party sale'') qualifies as a FDDEI sale only if certain additional requirements described in § 1.250(b)–6(c)(1)(i) or (ii) are satisfied. See proposed § 1.250(b)–6(c)(1).

If a foreign related party resells the purchased property (such as where the foreign related party is a distributor or a manufacturer of a product that incorporates the purchased property as a component), the sale to the foreign related party qualifies as a FDDEI sale only if an unrelated party transaction with respect to such sale occurs and the unrelated party transaction is a FDDEI sale. An unrelated party transaction is generally a transaction between the foreign related party and an unrelated foreign person in which the property purchased by the foreign related party is sold or used. See proposed § 1.250(b)–6(b)(5). For purposes of this rule, whether property is a component of another property that is subsequently sold in an unrelated party transaction is determined without regard to the rule defining a ''component'' for purposes of determining whether general property is subject to manufacturing, assembly, or other processing, as described in part III(C)(3)(a) of this Explanation of Provisions section. The unrelated party sale generally must occur on or before the FDII filing date; otherwise the gross income from the related party sale is included in the domestic corporation's gross DEI for the taxable year of the related party sale, but is not included in its gross FDDEI. See proposed § 1.250(b)–6(c)(1)(i). However, if an unrelated party transaction occurs after the FDII filing date but within the period of limitations provided by section 6511, the proposed regulations provide that the domestic corporation may file an amended return for the taxable year in which the related party sale occurred claiming the related party sale as a FDDEI sale for purposes of determining the taxpayer's foreign-derived intangible income for that taxable year, provided that the sale otherwise meets the requirements in proposed § 1.250(b)–6(c)(1)(i). See id. The Treasury Department and the IRS welcome comments on whether alternatives should be considered in lieu of requiring the filing of an amended return.

For transactions other than the resale of purchased property, such as where the foreign related party uses the purchased property to produce other property that is sold in unrelated party transactions, or where the foreign related party uses the property in the provision of a service in an unrelated party transaction, the sale of property does not qualify as a FDDEI sale unless, as of the FDII filing date, the seller reasonably expects that more than 80 percent of the revenue earned by the foreign related party from the use of the property in all transactions will be earned from unrelated party transactions that are FDDEI transactions (determined without regard to the documentation requirements in § 1.250(b)–4 or § 1.250(b)–5). See proposed § 1.250(b)–6(c)(1)(ii).

The rules applicable to related party sales apply only to determine whether sales of general property qualify as a FDDEI sale. See proposed § 1.250(b)–6(c)(1). Sales of intangible property, whether to a related or an unrelated party, are for a foreign use only to the extent that the intangible property generated revenue from exploitation outside the United States. See proposed § 1.250(b)–4(e)(2) and part III(C)(3)(b) of this Explanation of Provisions section. Thus, additional rules with respect to related party sales of intangible property are unnecessary to ensure that such sales are ultimately for a foreign use.

2. Related Party Services

Section 250(b)(5)(C)(ii) provides that a service provided to a related party not located in the United States ''shall not be treated [as a FDDEI service] unless the taxpayer establishe[s] to the satisfaction of the Secretary that such service is not substantially similar to services provided by such related party to persons located within the United States.'' Accordingly, the proposed regulations generally provide that a provision of a general service to a business recipient that is a related party qualifies as a FDDEI service only if the service is not substantially similar to a service provided by the related party to persons located within the United States. See proposed § 1.250(b)–6(d)(1).

Absent section 250(b)(5)(C)(ii) and proposed § 1.250(b)–6(d)(1) (the ''related party services rule''), a domestic corporation could generate gross FDDEI from the provision of services that primarily benefit persons within the United States by using a related party located outside the United States as a conduit. The related party services rule prevents taxpayers from claiming gross FDDEI derived from such ''round tripping'' arrangements. In contrast, proximate services, property services, and transportation services by their nature present minimal risk for ''round tripping,'' because the location of the recipient or property, as applicable, for purposes of such services is generally determined based on the place of performance. See proposed § 1.250(b)–5(f), (g), and (h), and parts III(D)(3), (4), and (5) of this Explanation of Provisions section. Further, a general service provided to a consumer that is a related party cannot be substantially similar to a service provided by a consumer to a person located within the United States, because a consumer, by definition, is an individual that purchases the service for personal use. See proposed § 1.250(b)–5(c)(3). Accordingly, the proposed regulations provide that the related party services rule applies only to determine whether a general service provided to a business recipient that is a related party is a FDDEI service. See proposed § 1.250(b)–6(d)(1).

A service provided by a renderer to a related party is ''substantially similar'' to a service provided by the related party to a person located within the United States if the renderer's service (or ''related party service'') is used by the related party to provide a service to a person located within the United States and either the ''benefit test'' of proposed § 1.250(b)–6(d)(2)(i) or the ''price test'' of proposed § 1.250(b)–6(d)(2)(ii) is satisfied. The rules to determine the location of a recipient of a service provided by a related party are generally the same as the rules for determining the location of a recipient of a service provided by the renderer.

The benefit test is satisfied if 60 percent or more of the benefits conferred by the related party service are to persons located within the United States. See proposed § 1.250(b)–6(d)(2)(i). For this purpose, the term ''benefit'' has the meaning provided in § 1.482–9(l)(3). See proposed § 1.250(b)–5(c)(1). Therefore, a related party service provides a benefit to a customer of the related party if it provides ''a reasonably identifiable increment of economic or commercial value'' to the customer, rather than an indirect or remote benefit. See § 1.482–9(l)(3)(i) and (ii). Because the benefit test compares the benefits from the service provided to persons located in the United States to the total benefits from the service provided by the renderer (rather than to the total benefits of the service provided by the related party), a service provided to a related party is ''substantially similar'' to a service provided by the related party to persons located within the United States if 60 percent or more of the benefits of the service are conferred on persons located within the United States, even if the related party adds significant value to the service through, for instance, bundling the related party service with other high value services.

Under the price test, a service provided by a renderer to a related party is ''substantially similar'' to a service provided by the related party to a person located within the United States if the renderer's service is used by the related party to provide a service to a person located within the United States and 60 percent or more of the price that persons located within the United States pay for the service provided by the related party is attributable to the renderer's service. See proposed § 1.250(b)–6(d)(2)(ii). Therefore, the price test compares the value of the service that is provided by the renderer to the related party to the value of the service that is provided by the related party to its customers. Consequently, a related party service that is not treated as substantially similar to a service provided by the related party to persons located in the United States under the benefit test, because more than 40 percent of the benefits from the service are conferred to persons located outside the United States, is nonetheless treated as ''substantially similar'' under the price test if the related party service accounts for 60 percent or more of the total price that is charged to customers located within the United States.

If a related party service is treated as substantially similar to a service provided by the related party to a person located within the United States solely by reason of the price test, the general rule that wholly disqualifies the related party service as a FDDEI service does not apply. Rather, in such case, a portion of the gross income from the related party service will be treated as a FDDEI service corresponding to the ratio of benefits conferred by the related party service to persons not located within the United States to the sum of all benefits conferred by the related party service. See proposed § 1.250(b)–6(d)(1).

IV. Section 250 Deduction for Individuals Making a Section 962 Election

As discussed in part II of this Explanation of Provisions section, the section 250 deduction for FDII and GILTI is available only to domestic corporations. However, section 962(a)(1) provides that an individual that is a U.S. shareholder may generally elect to be taxed on amounts included in the individual's gross income under section 951(a) in ''an amount equal to the tax that would be imposed under section 11 if such amounts were received by a domestic corporation.'' GILTI is treated as an amount included under section 951(a) for purposes of section 962. See section 951A(f)(1)(A) and proposed § 1.951A–6(b)(1). A section 962 election can be made by an individual U.S. shareholder who is considered, by reason of section 958(b), to own stock of a foreign corporation owned (within the meaning of section 958(a)) by a domestic pass-through entity, including a partnership or an S corporation. See § 1.962–2(a).

Congress enacted section 962 to ensure that individuals' tax burdens with respect to undistributed foreign earnings of their CFCs ''will be no heavier than they would have been had they invested in an American corporation doing business abroad.'' S. Rept. 1881, 1962–3 C.B. 784, at 798. Existing § 1.962–1(b)(1)(i) provides that a deduction of a U.S. 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. However, allowing a section 250 deduction with respect to GILTI of an individual (including an individual that is a shareholder of an S corporation or a partner in a partnership) that makes an election under section 962 is consistent with the purpose of that provision of ensuring that such individual's tax burden with respect to its CFC's undistributed foreign earnings is no greater than if the individual owned such CFC through a domestic corporation. Accordingly, the proposed regulations provide that, for purposes of section 962, ''taxable income'' as used in section 11 of an electing individual is reduced by the portion of the section 250 deduction that would be allowed to a domestic corporation with respect to the individual's GILTI and the section 78 gross-up attributable to the shareholder's GILTI. See proposed § 1.962–1(b)(1)(i)(B)(*3*).

V. Application of Section 250 to Consolidated Groups

As discussed in the Background section of this preamble, section 250 provides a domestic corporation a deduction for its FDII, GILTI, and the section 78 gross-up attributable to its GILTI. The section 250 deduction is available to a member of a consolidated group (''member'') in the same manner as the deduction is available to any domestic corporation. However, a computation of a member's section 250 deduction based solely on its items of income and QBAI may not result in a clear reflection of the consolidated group's income tax liability. For example, a consolidated group could segregate all of its QBAI in one member, thereby decreasing the DTIR of other members relative to the consolidated group's DTIR if determined at a group level. Alternatively, a strict, separate-entity application of section 250 could inappropriately decrease a consolidated group's aggregate amount of deduction for its FDII, for instance, because one member's DII (which is the excess of DEI over DTIR) would not be taken into account in calculating the FDII of another member that has FDDEI in excess of its DEI.

Based on the foregoing, the proposed regulations provide that a member's section 250 deduction is determined by reference to the relevant items of all members of the same consolidated group. Consistent with the authority provided by section 1502, the proposed regulations ensure that the aggregate amount of section 250 deductions allowed to members appropriately reflects the income, expenses, gains, losses, and property of all members. Definitions in proposed § 1.1502–50(f) result in the aggregation of the DEI, FDDEI, DTIR, and GILTI of all members. These aggregate numbers and the consolidated group's consolidated taxable income are then used to calculate an overall deduction amount for the group. Proposed § 1.1502–50(b) then allocates this overall deduction amount among the members on the basis of their respective contributions to the consolidated group's aggregate amount of FDDEI and the consolidated group's aggregate amount of GILTI.

The proposed regulations also address two issues relating to intercompany transactions. First, the proposed regulations add an example to § 1.1502–13 demonstrating the applicability of the attribute redetermination rule of § 1.1502–13(c)(1)(i) to the determination of FDDEI. This example applies the intercompany transaction rules to clearly reflect consolidated taxable income. It does not indicate a change in the law. In this example, the attribute redetermination rule applies to gross DEI and gross FDDEI, which are attributes of an intercompany or corresponding item. The Treasury Department and the IRS were concerned that applying § 1.1502–13(c) to DEI and FDDEI directly could result in circular computations due to the apportionment of certain expenses on a gross income basis. In addition, the example illustrates the applicability of the attribute redetermination rule in the context of an intercompany loss. In such circumstances, the application of the allocation and apportionment rules of §§ 1.861–8 through 1.861–14T and 1.861–17 may be modified in order to achieve the same overall result within the consolidated group that would occur if the members were divisions of a single corporation.

Second, the proposed regulations provide that, for purposes of determining a member's QBAI, the basis of specified tangible property will not be affected by an intercompany transaction. See proposed § 1.1502–50(c)(1). Accordingly, an intercompany transaction cannot result in the increase or decrease of a consolidated group's aggregate amount of DTIR or, in turn, aggregate amount of deduction.

VI. Reporting Requirements

To claim a deduction under section 250 by reason of having FDII, a taxpayer must calculate its deemed intangible income, deduction eligible income, and foreign-derived deduction eligible income. None of these terms are used in other provisions of the Code, and thus pre-existing forms do not collect data relevant to determining these amounts. In addition, when calculating its deduction under section 250, a taxpayer must determine the application of the taxable income limitation of section 250(a)(2). In order to effectively administer and enforce section 250, the proposed regulations require the collection of relevant information on new or existing forms.

A domestic corporation or an individual making an election under section 962 that claims a deduction under section 250 for a taxable year must make an annual return on Form 8993, ''Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)'' (or any successor form) for such year, providing the information required by the form. See proposed § 1.250(a)–1(d).

Certain related party transactions are reported on various information returns under sections 6038 and 6038A. Under section 6038(a)(1), U.S. persons that control foreign business entities (''controlling U.S. persons'') must report certain information with respect to those entities, which includes information listed in section 6038(a)(1)(A) through (E), as well as information that ''the Secretary determines to be appropriate to carry out the provisions of this title.'' This information is reported on Form 5471, ''Information Return of U.S. Persons With Respect To Certain Foreign Corporations,'' or Form 8865, ''Return of U.S. Persons With Respect to Certain Foreign Partnerships,'' as applicable. Section 6038A requires 25-percent foreign-owned domestic corporations (''reporting corporations'') to file certain information returns with respect to those corporations, including information related to transactions between the reporting corporation and each foreign person which is a related party to the reporting corporation. This information is reported on Form 5472, ''Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.'' In order to effectively administer and enforce section 250, the proposed regulations provide that controlling U.S. persons or reporting corporations, as described above, that claim a deduction under section 250 determined by reference to FDII with respect to amounts reported on Form 5471, 5472, or 8865 must report certain information relating to transactions with foreign business entities or related parties in accordance with sections 6038 and 6038A. See proposed §§ 1.6038–2(f)(15), 1.6038–3(g)(4), and 1.6038A–2(b)(5)(iv).

Certain partnerships and their partners also have reporting requirements under sections 6031 and 6038 with respect to partnership income. A domestic partnership is generally required to file an annual information return (Form 1065, ''U.S. Return of Partnership Income'') and provide information to its partners on Schedule K–1 (Form 1065), ''Partner's Share of Income, Deductions, Credits, etc.,'' with respect to each partner's distributive share of partnership items and other information. See section 6031 and § 1.6031(b)–1T. The proposed regulations provide that a partnership that has one or more direct or indirect partners that are domestic corporations and that is required to file a return under section 6031 must furnish on Schedule K–1 (Form 1065) the partner's share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI for each taxable year in which the partnership has gross DEI, gross FDDEI, or partnership specified tangible property. See proposed § 1.250(b)–1(e)(2). Although a foreign partnership that does not have income effectively connected with a trade or business within the United States or U.S. source income is not required to file Form 1065, a U.S. person who owns a ten-percent interest or a fifty-percent interest of a foreign partnership controlled by U.S. persons is required to report certain information under section 6038. Similar to the requirements for partnership reporting on Form 1065, the proposed regulations require controlling ten-percent partners and controlling fifty-percent partners (as defined in § 1.6038–3(a)(1) and (2)) of certain foreign partnerships controlled by U.S. persons to report on Schedule K–1 (Form 8865), ''Partner's Share of Income, Deductions, Credits, etc.,'' the partner's share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI. See proposed § 1.6038–3(g)(4).

VII. Applicability Dates

Proposed §§ 1.250(a)–1 through 1.250(b)–6 are proposed to apply to taxable years ending on or after March 4, 2019. See section 7805(b)(1)(B). However, the Treasury Department and the IRS recognize that these rules may apply to transactions that have occurred before the filing of these proposed regulations and that taxpayers may not be able to obtain the documentation required for transactions that have already been completed. Accordingly, for taxable years beginning on or before March 4, 2019, taxpayers may use any reasonable documentation maintained in the ordinary course of the taxpayer's business that establishes that a recipient is a foreign person, property is for a foreign use (within the meaning of proposed § 1.250(b)–4(d) and (e)), or a recipient of a general service is located outside the United States (within the meaning of proposed § 1.250(b)–5(d)(2) and (e)(2)), as applicable, in lieu of the documentation required in proposed §§ 1.250(b)–4(c)(2), (d)(3), and (e)(3) and 1.250(b)–5(d)(3) and (e)(3), provided that such documentation meets the reliability requirements described in proposed § 1.250(b)–3(d). Reasonable documentation includes, but is not limited to, documents described in or similar to the documents described in proposed §§ 1.250(b)–4(c)(2), (d)(3), and (e)(3) and 1.250(b)–5(d)(3) and (e)(3). For this purpose, reasonable documentation also includes the documentation described in the special rules for small businesses and small transactions in proposed §§ 1.250(b)–4(c)(2)(ii) and (d)(3)(ii) and 1.250(b)–5(d)(3)(ii) and (e)(3)(ii), even if the taxpayer would not otherwise qualify for the special rules. The Treasury Department and the IRS welcome comments on this special applicability date rule.

Proposed § 1.962–1(b)(1)(i)(B)(*3*), which allows individuals making an election under section 962 to take into account the section 250 deduction, is proposed to apply to taxable years of a foreign corporation ending on or after *March 4, 2019,* and with respect to a U.S. person, for the taxable year in which or with which such taxable year of the foreign corporations ends. See id. Taxpayers may rely on proposed §§ 1.250(a)–1 through 1.250(b)–6 and § 1.962–1(b)(1)(i)(B)(*3*) for taxable years ending before May 4, 2019.

Proposed § 1.1502–50 is proposed to apply to consolidated return years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. See sections 1503(a) and 7805(b)(1)(A). Taxpayers may rely on proposed § 1.1502–50 for taxable years ending before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Proposed §§ 1.6038–2(f)(15) and 1.6038A–2(b)(5)(iv) are proposed to apply with respect to information for annual accounting periods beginning on or after May 4, 2019. See sections 6038(a)(3) and 7805(b)(1)(B). Proposed § 1.6038–3(g)(4) is proposed to apply to taxable years of a foreign partnership beginning on or after May 4, 2019. See section 7805(b)(1)(B).

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

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, of reducing costs, of harmonizing rules, and of promoting flexibility.

These proposed regulations have been designated as economically significant by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) and subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

A. Background

As described in part I of the Explanation of Provisions section, the section 250 deduction is an important component of the changes to the U.S. international tax system included in the Act. The purpose of the section 250 deduction is to minimize the role that U.S. tax considerations play in a domestic corporation's decision whether to service foreign markets directly or through a controlled foreign corporation (''CFC''). See Senate Explanation, at 370 (''[O]ffering similar, preferential rates for intangible income derived from serving foreign markets, whether through U.S.-based operations or through CFCs, reduces or eliminates the tax incentive to locate or move intangible income abroad, thereby limiting one margin where the Code distorts business investment decisions.''). Further, the section 250 deduction protects the U.S. tax base against base erosion incentives created by the new participation exemption system established under section 245A, discussed in part I of the Explanation of Provisions section. At the most basic level, the section 250 deduction is allowed to a domestic corporation with respect to its intangible income derived from foreign markets, resulting in a lower effective rate of U.S. tax on its global intangible low-taxed income

(''GILTI'') and foreign-derived intangible income (''FDII'').

The Act defines a corporation's FDII as the portion of its return in excess of a return on tangible assets that is derived from serving foreign markets, while it defines a corporation's GILTI as the portion of its return in excess of a return on tangible assets that is derived through its foreign affiliates. FDII and GILTI are calculated through formulas set out in sections 250 and 951A, respectively. For taxable years between 2018 and 2026, section 250 generally allows a deduction equal to the sum of 37.5 percent of the corporation's FDII plus 50 percent of its GILTI (thereafter, these deductions are reduced to 21.875 percent and 37.5 percent, respectively). These deduction rates produce comparable tax rates on income earned from serving foreign markets, regardless of where such income is earned. Different percentages are required by the Act to achieve approximate parity, given that the 80 percent limitation on foreign tax credits in section 960(d) results in additional U.S. tax.[2] More specifically, the Act defines a domestic corporation's FDII as its deemed intangible income (''DII'') multiplied by the percentage of its deduction eligible income (''DEI'') that is foreign-derived deduction eligible income (''FDDEI''). The Act defines DEI as the excess of the corporation's gross income (with certain exclusions[3]) over deductions (including taxes) properly allocable to the income. The Act defines DII as the excess (if any) of its DEI over 10 percent of its qualified business asset investment (''QBAI''), or tangible asset base. The Act defines FDDEI as DEI derived from sales of property to foreign persons for foreign use and from the provision of services to persons, or with respect to property, located outside the United States. Finally, if the sum of a corporation's FDII and GILTI exceeds its taxable income (determined without regard to section 250), then the Act requires that the amount of FDII and GILTI for which a deduction is allowed is reduced pro rata by the excess. While the Act provides the framework for determining a domestic corporation's FDII, it grants discretion to the Secretary to establish how certain requirements, such as whether sales are for a foreign use, are satisfied. See sections 250(b)(4)(A) and (B), (b)(5)(C)(i)(II), and (b)(5)(C)(ii). In addition, the Act does not address all of the details necessary to calculate FDII, such as the allocation of expenses. Further, the Act is unclear regarding whether the section 250 deduction for FDII is available for certain foreign military sales or services and whether a section 250 deduction for GILTI is available for an individual taxpayer making a section 962 election. The following analysis describes the need for the proposed regulations and discusses the costs and benefits relative to the baseline, as well as the important alternative regulatory choices that were considered.

B. The Need for Proposed Regulations

The purpose of the proposed regulations is to provide guidance to taxpayers in determining the amount of their deduction under section 250. Section 250(c) states that ''[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of [section 250].'' Therefore, the proposed regulations seek to provide the detail, structure, and language required to implement section 250.

The proposed regulations seek to assist taxpayers in calculating the allowable section 250 deduction, for example, by providing details on how to compute FDII, and the components of FDII such as QBAI, DEI, and FDDEI. In particular, with respect to FDDEI, the proposed regulations provide guidance on which sales of property and which provisions of services generate gross income included in FDDEI, and on how to allocate expenses to such gross income to determine FDDEI.

In addition, the proposed regulations provide an ordering rule to coordinate the computation of the section 250 taxable income limitation with the taxable income limitations across other provisions of the Code.

The proposed regulations also seek to clarify that the section 250 deduction for FDII is available for certain foreign military sales and services. In addition, the proposed regulations allow a section 250 deduction to individual taxpayers with respect to GILTI if they make an election under section 962.

Finally and importantly, the proposed regulations also seek to provide clarity and guidance regarding the types of documentation required to substantiate that, in fact, sales of property are to foreign persons for a foreign use and provisions of services are to persons, or with respect to property, located outside the United States. In developing the proposed regulations, the Treasury Department and the IRS sought to balance the need for rigorous documentation to ensure compliance with the desire to minimize administrative burden and costs to taxpayers.

C. Baseline

The economic analysis that follows compares the proposed regulations to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of the proposed regulations. A no-action baseline reflects the current environment including the existing international tax regulations, prior to any amendment by the proposed regulations.

D. Cost and Benefits of the Proposed Regulations and Potential Alternatives

The proposed regulations provide certainty, clarity, and consistency in the application of the section 250 deduction by unambiguously defining terms, calculations, and acceptable forms of documentation, and also by making clear the conditions under which military sales are eligible to claim the deduction. In the absence of such guidance, the chance that different taxpayers would interpret the statute differently would be exacerbated. Similarly situated taxpayers might interpret the statutory rules pertaining to particular sales or services differently, with one taxpayer pursuing a sale that another taxpayer might decline to make, because of different interpretations of how the income would be treated under section 250. If this second taxpayer's activity were more profitable, an economic loss arises. Such situations are more likely to arise in the absence of guidance. While no guidance can curtail all differential or inaccurate interpretations of the statute, the proposed regulations will significantly mitigate the chance for such interpretations and thereby increase economic efficiency.

In general, the Treasury Department and the IRS expect that in the absence of this guidance, taxpayers would undertake fewer eligible sales and services. Thus, the proposed regulation will generally enhance U.S. sales and

[2] At the most basic level, abstracting from various complexities of the GILTI regime, the 21 percent U.S. statutory rate with a 50 percent deduction for GILTI implies that at foreign effective rates in excess of 10.5 percent (assuming no U.S. expenses), foreign tax credits are sufficient to fully offset U.S. tax on GILTI income. However, the GILTI regime limits foreign tax credits to 80 percent of their total value, so a ''baseline'' GILTI scenario, with zero expense allocations, implies that foreign tax credits can fully offset U.S. tax on GILTI at foreign effective tax rates in excess of 13.125 percent (*i.e.,* 10.5/0.8). The section 250 deduction for FDII is also intended to have a ''baseline rate'' of 13.125 percent (*i.e.,* $0.21 \times (1 - 0.375)$); typically foreign tax credits are not relevant for FDII, and there is no 80 percent limitation applied to foreign tax credits with respect to FDII.

[3] The exclusions are: (1) Subpart F inclusions (section 951); (2) GILTI; (3) financial services income (as defined in section 904(d)(2)(D)); (4) dividends received from the corporation's CFCs; (5) domestic oil and gas extraction income; and (6) foreign branch income (as defined in section 904(d)(2)(J)).

services across all eligible activities. The Treasury Department and the IRS have not made quantitative estimates of these effects.

The benefits and costs of major, specific provisions of these proposed regulations relative to the no-action baseline and alternatives to these proposed rules considered by the Treasury Department and the IRS are discussed in further detail below.

1. Documentation Requirements

The proposed regulations set forth what forms of documentation can be used to substantiate that receipts qualify as ''foreign-derived'' for purposes of FDII and the section 250 deduction. In general, the Treasury Department and the IRS weighed the compliance burden imposed on taxpayers from documentation requirements against the need for documentation to be sufficiently rigorous in establishing foreign use or the location of a person that receives a service. Because the statute provides different requirements for sales or services to qualify for a section 250 deduction and the proposed regulations provide different requirements depending on the type of sale or the type of service, and because documentation needs to be tailored to the applicable requirement, the proposed regulations specify different types of acceptable documentation for different types of transactions. In particular, documentation requirements vary with respect to the determination of whether a sale of property is to a foreign person, whether a sale of general property is for a foreign use, whether a sale of intangible property is for a foreign use, whether an individual consumer of a general service is located outside the United States, and whether a business recipient of a general service is located outside the United States.

In each case, the proposed regulations provide that the list of acceptable documentation constitutes reasonable proof that a transaction is a FDDEI transaction. In general, the types of documentation listed are readily accessible to most taxpayers. For example, with respect to demonstrating foreign use for general property, taxpayers can show evidence of shipment to a location outside the United States (presuming that the seller has no knowledge or reason to know that that information is unreliable or incorrect).

To further reduce compliance burdens, the proposed regulations allow additional flexibility for particular types of taxpayers or transactions. For example, throughout the proposed regulations, small businesses (defined in the proposed regulations as taxpayers with less than $10 million of gross receipts annually) are subject to less stringent documentation requirements because their smaller scale makes compliance more burdensome for them and makes the sophisticated tax minimization planning that can sometimes characterize abuse unlikely. Small transactions (defined in the proposed regulations as less than $5,000 of gross receipts from a single recipient) are also subject to less stringent documentation requirements, because the fixed costs of compliance likely account for a larger fraction of the profit on small transactions, and large scale abuse is less likely. The Treasury Department and the IRS request comments on whether the thresholds in the proposed regulations for small businesses and small transactions are appropriate and especially solicit comments that provide data, other evidence, and models that can enhance the rigor of the process by which such thresholds are determined. Further, the proposed regulations allow a more flexible approach for the documentation of sales of fungible general property because it is burdensome and unnecessary to track each sale of a fungible item as long as the taxpayer can establish by documentation that a certain percentage of the fungible property is for a foreign use.

In determining appropriate documentation requirements, the Treasury Department and the IRS balanced the rigor and reliability of the proof that transactions are foreign-derived with the cost to taxpayers of obtaining such documentation. The Treasury Department and the IRS considered a spectrum of trade-offs between the rigor of proof of foreign use and the burden such proof would impose on taxpayers. One option considered was allowing only the most stringent form of documentation in each case (for example, a written statement of foreign use made under penalties of perjury, plus evidence of such use) without any flexibility, but this was deemed overly burdensome for taxpayers and foreign buyers. Overly burdensome documentation requirements might shift transactions to sellers that do not need or cannot use the FDII deduction, or it may discourage foreign persons from transacting with a U.S. seller or renderer. The Treasury Department and the IRS aimed to propose rules that would not alter economic decisions because of these concerns. In addition, highly burdensome rules may lead to abuse. For example, a foreign buyer that falsifies documentation provided to a domestic corporation to allow the corporation to obtain a deduction would not be subject to penalties by the IRS. Because the incentives for compliance by foreign buyers are limited (for example, contractual liability between the parties), the burden should also be limited. In comparison, chapters 3 and 4 of subtitle A of the Code require U.S. financial institutions to withhold on certain payments to foreign persons if they do not provide documentation. Because of the enforcement mechanism built into the statutes in chapters 3 and 4 (*i.e.,* withholding), the IRS can require stricter documentation (for example, most foreign persons have to provide to the financial institution a specific IRS form, completed and signed under penalties of perjury, and in some cases must attach additional documentation on underlying payees).

The Treasury Department and the IRS also considered a system in which taxpayers submitted documentation in advance of a potential FDDEI transaction for the IRS to review and determine whether the documentation is sufficient. This option was rejected because the time involved would delay normal business transactions.

A third option that the Treasury Department and the IRS considered was to allow a taxpayer to use its discretion to determine what type of documentation is appropriate, but this would not provide sufficient clarity and assurance to taxpayers and is potentially open to abuse. For each type of transaction, the Treasury Department and the IRS chose to allow a menu of acceptable documentation options that vary according to the type of transaction, and selected documentation options that would be readily available to the taxpayer whenever possible. By allowing taxpayers to, in some cases, rely on documents already obtained in the normal course of business, the proposed regulations impose essentially zero documentation cost in such cases. The Treasury Department and the IRS request comments on the approaches and decisions relating to documentation requirements discussed in this part I(D)(1) of this Special Analyses section. See part II of this Special Analyses section regarding the Paperwork Reduction Act for additional discussion on the expected paperwork burden of these documentation requirements.

2. Computation of the Ratio of FDDEI to DEI

The proposed regulations provide guidance on the computation of the foreign-derived ratio. As noted in part I(A) of this Special Analyses section, the

Act defines a corporation's FDII as its DII multiplied by the corporation's foreign-derived ratio, which is the ratio of its DEI to its FDDEI. The proposed regulations specify that, for purposes of determining the numerator of the foreign-derived ratio, the domestic corporation must allocate expenses to its gross FDDEI. The Treasury Department and the IRS deemed this approach the most consistent with the statute by providing what the Treasury Department and the IRS have determined to be the most accurate measure of the corporation's income that is ''foreign-derived,'' through matching of expenses to gross income.

The Treasury Department and the IRS considered two other approaches; one, in which the foreign-derived ratio would be computed as the ratio of foreign versus U.S. gross receipts and another in which the ratio would be computed as foreign versus U.S. gross income. The Treasury Department and the IRS have determined that both of these approaches would result in a less accurate measure of foreign-derived net income. The Treasury Department and the IRS have determined that these alternative approaches could also reward low margin (or even loss-leading) sales or services to foreign markets by allowing a section 250 deduction due to positive gross receipts or income from foreign sources, even if the net income from foreign sources after allocated expenses is zero or negative. The Treasury Department and the IRS have determined that the chosen alternative generally provides the most accurate computation of FDII but solicit comments on whether an alternative method would be more appropriate.

3. Military Sales

Section 250 requires sales to be made to a foreign person and services to be provided to a person located outside the United States but does not include specific rules applicable to foreign military sales or services. For example, many sales of military equipment and services by a U.S. defense contractor to a foreign government are structured, pursuant to the Arms Export Control Act, as sales and services provided to the U.S. government for resale or on-service to the foreign government. See part III(B)(2) of the Explanation of Provisions section for additional discussion of the Arms Export Control Act. In effect, the contractor is selling goods and services to a foreign person, but the sale is technically made to the U.S. government. The Treasury Department and the IRS recognize that the statute is unclear as to whether certain foreign military sales and services can qualify for the section 250 deduction, due to the concern that a foreign military sale or service pursuant to the Arms Export Control Act would not qualify as a sale or service to a foreign person since the sale is actually made to the U.S. government and not to a foreign person or a person located outside the United States.

The Treasury Department and the IRS considered several options for addressing this issue. One option was not addressing this issue in the proposed regulations. This option was rejected because the Treasury Department and the IRS determined that it would perpetuate uncertainty about the application of section 250 to foreign military sales and services and could result in economic inequities if some taxpayers took the position that foreign military sales and services qualify for a section 250 deduction but other similarly-situated taxpayers took the position that such sales and services do not qualify. A second option the Treasury Department and the IRS considered was to clarify that a foreign military sale or service through the U.S. government can never qualify for a section 250 deduction. However, this option was rejected because the Treasury Department and the IRS determined that it would treat taxpayers in the defense industry inequitably relative to other industries by denying them a section 250 deduction with respect to a significant amount of their foreign market sales or services. A third option the Treasury Department and the IRS considered was to allow any sale or service to a U.S. person that acts as an intermediary and does not take on the benefits and burdens of ownership to potentially qualify for a section 250 deduction if there is an ultimate foreign recipient. This option was rejected because the Treasury Department and the IRS determined that such a broad exception would allow multiple deductions in instances where both the seller and the intermediary buyer are U.S. taxpayers, because both the seller and the intermediary could potentially qualify for a section 250 deduction. In contrast, the U.S. government is not a taxpayer eligible for a section 250 deduction so only the seller would benefit from a special rule for military exports. Furthermore, determining whether a party is an ''intermediary'' for this purpose would require a complex facts and circumstances analysis of whether the party had the benefits and burdens of ownership, which could create uncertainty in the application of section 250 with respect to any transaction in which property or services are sold for resale or on-service.

The proposed regulations provide uniform tax treatment across the economy by generally allowing all sectors to claim the section 250 deduction, subject to other applicable rules. Otherwise, certain sales and services by the defense industry that are clearly intended for a foreign use, and that satisfy all other requirements under section 250, would be denied the benefit solely as a result of such sales or services being first made to the U.S. government under the Arms Export Control Act, whereas other industries that are not subject to the Arms Export Control Act would not have this concern. Therefore, the proposed regulations provide that foreign military sales or services to the U.S. government under the Arms Export Control Act would be treated as a sale of property or provision of a service to a foreign person. This rule seeks to provide uniform tax treatment between the defense sector and other sectors of the U.S. economy with respect to sales and services that are clearly meant for a foreign use.

4. Section 962

The section 250 deduction for FDII and GILTI is available only to domestic corporations. However, Congress enacted section 962 in Public Law 89–834 (1962) to ensure that individuals' tax burdens with respect to undistributed foreign earnings of their CFCs are comparable with their tax burdens if they had held their CFCs through a domestic corporation. See S. Rept. 1881, 87th Cong., 2d Sess. 92 (1962). Allowing a section 250 deduction with respect to GILTI of an individual (including an individual that is a shareholder of an S corporation or a partner in a partnership) that makes an election under section 962 provides comparable treatment for this income.

The Treasury Department and the IRS considered two options with respect to extending the section 250 deduction to individuals (which include, for this purpose, individual partners in partnerships and individual shareholders in S corporations) that make an election under section 962. The first option considered was to not allow the deduction for individuals. Not allowing the section 250 deduction would require that individuals that own their CFCs directly (or indirectly through a partnership or S corporation) transfer the stock of their CFCs to new U.S. corporations in order to obtain the benefit of the section 250 deduction. The Treasury Department and the IRS determined that such reorganization would be economically costly, both in terms of legal fees and substantive economic costs related to organizing and operating new corporate entities. The second option considered was to give individuals the section 250 deduction with respect to their GILTI if they make the section 962 election. The Treasury Department and the IRS determined that allowing individuals the section 250 deduction would improve economic efficiency by preventing the need for costly restructuring solely for the purpose of tax savings. This is the option adopted by the Treasury Department and the IRS in the proposed regulations. The Treasury Department and the IRS welcome comments on whether an alternative approach would be more appropriate.

II. Paperwork Reduction Act

The proposed regulations provide the authority for the IRS to require taxpayers to file certain forms (identified and discussed in further detail below) with the IRS to obtain the benefit of the section 250 deduction. In order to provide advance notice and solicit public comment, the IRS released drafts of the relevant forms in 2018 based on the statutory language and requested comments. The IRS received no comments on the forms during the comment period. The 2018 versions of the forms that were released in 2018 are available at *https://www.irs.gov/forms-instructions.* The Treasury Department and the IRS are not proposing to make any changes to those forms through these regulations. The Treasury Department and the IRS are also soliciting public comment on the forms and paperwork requirements in general discussed in the proposed regulations. The Treasury Department and the IRS specifically request comments on whether there are (1) ways to reduce the burdens associated with the forms, (2) opportunities to clarify the forms or associated instructions, or (3) ways to improve the quality of the collections in general.

The proposed regulations require all taxpayers with a section 250 deduction to file one new form (Form 8993). The proposed regulations also authorize the IRS to request additional information on several existing forms (Forms 1065 (Schedule K–1), 5471, 5472, and 8865) if the filer of the form has a deduction under section 250. With respect to Forms 5471, 5472, and 8993, the proposed regulations do not specify the information that will be required from taxpayers that have a section 250 deduction, but instead provide that this information will be prescribed by the forms and instructions. With respect to Forms 1065 (Schedule K–1) and 8865, the proposed regulations specify the additional information that must be provided. For additional explanation of the reporting requirements contained in these proposed regulations, see part VI of the Explanation of Provisions section. The rest of this part II of the Special Analyses section provides additional details on forms and information about the paperwork burden.

The information collection burdens under the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.* (''PRA'') from the proposed regulations are in proposed §§ 1.250(a)–1(d), 1.250(b)–1(e)(2), 1.6038–2(f)(15), 1.6038–3(g)(4), and 1.6038A–2(b)(5)(iv).

The collection of information in proposed § 1.250(a)–1(d) would be mandatory for each domestic corporation claiming a deduction under section 250 as well as for any individual making an election under section 962 that claims a deduction under section 250 attributable to the individual's GILTI. The collection of information in proposed § 1.250(a)–1(d) is pursuant to sections 6001 and 6011 and would be satisfied by submitting a new reporting form, Form 8993, ''Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI),'' with an income tax return. For purposes of the PRA, the reporting burden associated with proposed § 1.250(a)–1(d) will be reflected in the PRA submission for new Form 8993 (OMB control numbers 1545–0123 in the case of business taxpayers, and 1545–0074 in the case of individual taxpayers).

The collection of information in proposed § 1.250(b)–1(e)(2) would require each partnership to provide to each of its partners the partner's distributive share of gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI. For purposes of the PRA, the reporting burden associated with proposed § 1.250(b)–1(e)(2) would be reflected in the PRA submission for Form 1065 (OMB control number 1545–0123).

The collection of information in proposed § 1.6038–2(f)(15) would require every U.S. person that controls a foreign corporation during an annual accounting period and files Form 5471, ''Information Return of U.S. Persons With Respect to Certain Foreign Corporations,'' for that period. The collection of information in proposed § 1.6038–2(f)(15) would be satisfied by providing information about the section 250 deduction for the corporation's accounting period as Form 5471 and its instructions may prescribe. For purposes of the PRA, the reporting burden on the applicable business taxpayers associated with proposed § 1.6038–2(f)(15) will be reflected in the PRA submission for Form 5471 (OMB control number 1545–0123).

The collection of information in proposed § 1.6038–3(g)(4) would be mandatory for every U.S. person that controls a foreign partnership during the partnership tax year and files Form 8865, ''Return of U.S. Persons With Respect to Certain Foreign Partnerships,'' for that period. The collection of information in proposed § 1.6038–3(g)(4) would require a controlling ten-percent partner or controlling fifty-percent partner to provide to the IRS on Form 8865 its share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI. For purposes of the PRA, the reporting burden associated with proposed § 1.6038–3(g)(4) will be reflected in the PRA submission for Form 8865 (OMB control number 1545–1668).

The collection of information in proposed § 1.6038A–2(b)(5)(iv) would be mandatory for every reporting corporation that files Form 5472, ''Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business,'' for the tax year. The collection of information in proposed § 1.6038A–2(b)(5)(iv) would be satisfied by providing information about the section 250 deduction for the tax year as Form 5472 and its instructions may prescribe. For purposes of the PRA, the reporting burden associated with proposed § 1.6038A–2(b)(5)(iv) will be reflected in the PRA submission for Form 5472 (OMB control number 1545–0123).

The tax forms that will be created or revised as a result of the information collections in the proposed regulations, as well as the estimated number of respondents, are as follows:

RELATED NEW OR REVISED TAX FORMS

	New	Revision of existing form	Number of respondents (estimated)
Form 8993	✓		75,000–350,000
Form 1065, Schedule K–1 (for corporate partners only, revision starting TY2020)		✓	15,000–45,000
Form 5471		✓	10,000–20,000
Form 8865		✓	<10,000
Form 5472		✓	50,000–80,000

Source: RAAS:CDW and ITA

The numbers of respondents in the Related New or Revised Tax Forms table were estimated by the Research, Applied Analytics and Statistics Division (''RAAS'') of the IRS from the Compliance Data Warehouse (''CDW''), using tax years 2014 through 2016; as well as based on export data from the International Trade Administration (''ITA'') for 2015 and 2016. Tax data for 2017 are not yet available due to extended filing dates. Data for Form 8993 represent preliminary estimates of the total number of taxpayers that may be required to file the new Form 8993. The upper bound estimate reflects the total number of exporting companies reported in the ITA data, as well as the CDW-based counts of individuals reporting related party transactions. The lower bound estimate reflects the CDW-based counts of individual and corporate taxpayers reporting related party transactions. Data for each of the Forms 1065, 5471, 5472, and 8865 represent preliminary estimates of the total number of taxpayers that are expected to file these revised forms regardless of whether that taxpayer must also file Form 8993.

The current status of the Paperwork Reduction Act submissions related to the tax forms that will be revised as a result of the information collections in the proposed regulations is provided in the accompanying table. As described above, the reporting burdens associated with the information collections in the proposed regulations are included in the aggregated burden estimates for OMB control numbers 1545–0123 (which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017)), 1545–0074 (which represents a total estimated burden time, including all other related forms and schedules for individuals, of 1.784 billion hours and total estimated monetized costs of $31.764 billion ($2017)), and 1545–1668 (which represents a total estimated burden time for all related forms and schedules for other filers, in particular trusts and estates, of 281,974 hours and total estimated monetized costs of $25.107 million ($2017)). The overall burden estimates provided for the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be created or revised as a result of the information collections in the proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed regulations. These burdens have been reported for other regulations related to the taxation of cross-border income and the Treasury Department and the IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions imposed prior to the Act. No burden estimates specific to the forms affected by the proposed regulations are currently available. The Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden.

Form	Type of filer	OMB Number(s)	Status
Form 8993 (NEW)	Business (NEW Model)	1545–0123	Published in the **Federal Register** Notice (FRN) on 10/11/18. Public Comment period closed on 12/10/18.
	Link: *https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd.*		
	Individual (NEW Model)	1545–0074	Limited Scope submission (1040 only). Full ICR submission for 2019 for all forms in 3/2019. 60 Day FRN not published yet for full collection for 2019.
	Link: *https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201808-1545-031.*		
Form 1065, Schedule K–1	Business (NEW Model)	1545–0123	Published in the FRN on 10/11/18. Public Comment period closed on 12/10/18.
	Link: *https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd.*		
Form 5471	Business (NEW Model)	1545–0123	Published in the FRN on 10/11/18. Public Comment period closed on 12/10/18.

Form	Type of filer	OMB Number(s)	Status
	Link: *https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd.*		
Form 8865	All other filers (mainly trusts and estates) (Legacy system).	1545–1668	Published in the FRN on 10/01/18. Public Comment period closed on 11/30/18.
	Link: *https://www.federalregister.gov/documents/2018/10/01/2018-21288/proposed-collection-comment-request-for-regulation-project.*		
Form 5472	Business (NEW Model)	1545–0123	Published in the FRN on 10/11/18. Public Comment period closed on 12/10/18.
	Link: *https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd.*		

III. Regulatory Flexibility Act

It is hereby certified that this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Although the Treasury Department and the IRS project that the proposed regulations may affect a substantial number of small entities, the economic impact on small entities as a result of this notice of proposed rulemaking is not expected to be significant.

The small business entities that are subject to section 250 and this notice of proposed rulemaking are small domestic corporations claiming a deduction under section 250 based on their FDII and GILTI. Pursuant to proposed § 1.250(a)–1(d), taxpayers are required to file new Form 8993 to compute the amount of the eligible deduction for FDII and GILTI under section 250. The Treasury Department and the IRS estimate that there are between 75,000 and 350,000 respondents of all sizes that are likely to file Form 8993. The lower end estimate comes from IRS-collected data on related party transactions that are indicative of exports to related parties. These data provide a lower bound for the number of taxpayers that export since related party exports are only a part of total exports. The IRS does not collect information on exports to third parties; therefore, International Trade Administration (''ITA'') statistics of the number of companies engaged in export activities are used.[4] The ITA data provide the upper bound of the estimate of affected taxpayers. The Treasury Department and the IRS welcome comments on the analysis of number of entities affected, particularly on how such analysis should take into account different industries. Additionally, under proposed § 1.250(b)–1(e), a partnership that has one or more direct or indirect partners that are domestic corporations and that is required to file a return under section 6031 must furnish on Schedule K–1 (Form 1065) certain information that would allow the partner to accurately calculate its FDII. The Treasury Department and the IRS estimate the number of domestic corporations that are direct or indirect partners in a partnership affected by proposed § 1.250(a)–1(e) is between 15,000 and 45,000.

In order to substantiate the amount of the section 250 deduction on Form 8993 related to the calculation of FDII for the sale of property or the provision of a service, the proposed regulations in §§ 1.250(b)–3 through 1.250(b)–5 prescribe different types of documentation that should be obtained for each transaction. As discussed in the Explanation of Provisions section of the preamble, the proposed regulations provide several types of permissible documentation for the purpose of determining the amount of a domestic corporation's income that is considered foreign-derived. For example, in the case of a sale of general property, the seller must (1) obtain documentation that establishes the recipient's status as a foreign person, such as a written statement by the recipient indicating that the recipient is a foreign person; and (2) obtain documentation that the property is for foreign use, such as proof of shipment of the property to a foreign address.

To alleviate the burden of documentation on many small businesses and small transactions, the proposed regulations allow a seller that has less than $10,000,000 of gross receipts in the prior taxable year, or less than $5,000 in gross receipts from a single recipient during the current taxable year, to treat a recipient as a foreign person if the seller has a shipping address for the recipient that is outside the United States. The small business and small transaction exceptions to establish foreign person status are applicable to sales of both general property and intangible property. Furthermore, to establish that general property is for a foreign use, certain small businesses and businesses with small transactions may rely on the existence of a foreign shipping address for the recipient instead of obtaining documentation. The proposed regulations also contain small business and small transaction exceptions related to general services provided to consumers and business recipients. The Treasury Department and the IRS anticipate that a substantial share of small entities claiming a section 250 deduction will qualify for the small business and small transactions exceptions described above, thereby significantly reducing the overall burden of the proposed regulations on small entities. The Treasury Department and the IRS solicit comments on this issue.

The reporting burden for completing Form 8993 is estimated to average 24 hours for all affected entities, regardless of size. The reporting burden on small entities (those with receipts below $10 million in RAAS calculations) is estimated to average 15 hours. Based on the monetized hourly burden reported below, the annual per-entity reporting burden will be $1,067. The Treasury Department and the IRS project that compliance with the documentation requirements in the proposed regulations will have a de minimis or limited impact on all affected entities, regardless of size, as the majority of taxpayers will be able to use records that are maintained in the normal course of business. Small business entities that have less than $10 million of gross receipts in the prior taxable year, or less than $5,000 in gross receipts from a single recipient during the current taxable year, are expected to experience 0 to 5 minutes, with an average of 2.5 minutes, of recordkeeping

[4] ITA data was accessed at *http://tse.export.gov/EDB/SelectReports.aspx?DATA=ExporterDB* in December, 2018.

per transaction recipient. Taxpayers ineligible to qualify for either exception are expected to experience 0 to 30 minutes, with an average of 15 minutes, of recordkeeping per transaction recipient. These hourly estimates were derived by RAAS based the existence of exceptions available to small businesses, as well as based on the previously noted overlap between acceptable documentation and records kept in the normal course of business, suggesting limited impact. The hourly estimates include all associated activities: recordkeeping, tax planning, learning about the law, gathering tax materials, form completion and submissions, and time with a tax preparer or use of tax software. The estimated monetized burden for compliance is $71.14 per hour, a figure computed from the IRS Business Taxpayer Burden model which assigns each firm in the micro data a monetization rate based on total revenue and assets reported on their tax return. See Tax Compliance Burden (John Guyton et al., July 2018) at *https://www.irs.gov/pub/irs-soi/d13315.pdf*. The assigned monetization rates include, in addition to wages, employer non-wage costs such as employment taxes, benefits, and overhead. For these reasons, the Treasury Department and the IRS have determined that the requirements in proposed §§ 1.250(a)–1 and 1.250(b)–3 through 1.250(b)–6 will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required with respect to proposed §§ 1.250(a)–1 and 1.250(b)–3 through 1.250(b)–6.

The small business entities that are subject to proposed § 1.6038–2(f)(15) are domestic small business entities that are controlling U.S. shareholders of a foreign corporation and that claim a deduction under section 250 by reason of having FDII. For these purposes, a domestic small business entity controls a foreign corporation by owning more than 50 percent of that foreign corporation's stock, measured either by value or voting power. The data to assess the number of small entities potentially affected by § 1.6038–2(f)(15) are not readily available. However, businesses that are controlling U.S. shareholders of a foreign corporation are generally not small businesses because the ownership of sufficient stock in a foreign corporation in order to be a controlling U.S. shareholder generally entails significant resources and investment. Therefore, the Treasury Department and the IRS project that a substantial number of domestic small business entities will not be subject to proposed § 1.6038–2(f)(15). Consequently, the Treasury Department and the IRS have determined that proposed § 1.6038–2(f)(15) will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required with respect to the collection of information requirements of proposed § 1.6038–2(f)(15).

The small business entities that are subject to proposed § 1.6038–3(g)(4) are domestic small entities that are controlling fifty-percent partners or controlling ten-percent partners of a foreign partnership and that claim a deduction under section 250 by reason of having FDII. A controlling fifty-percent partner is a U.S. person that owns more than a fifty-percent interest in a foreign partnership. A controlling ten-percent partner is a U.S. person that owns a ten-percent or greater interest in a foreign partnership that is controlled by U.S. persons owning at least a ten-percent interest. For these purposes, a fifty percent interest or ten percent interest in a partnership is an interest equal to fifty percent or ten percent of the capital or profits interest in a partnership, or an interest to which fifty percent or ten percent of the deductions or losses of the partnership are allocated, respectively. The data to assess the number of small entities potentially affected by proposed § 1.6038–3(g)(4) are not readily available. However, businesses that are controlling fifty-percent partners or controlling ten-percent partners of a foreign partnership are generally not small businesses because the ownership of a sufficient interest in a foreign partnership in order to be a controlling fifty-percent partner or a controlling ten-percent partner generally entails significant resources and investment. Therefore, the Treasury Department and the IRS have determined that proposed § 1.6038–3(g)(4) will not affect a substantial number of domestic small business entities. Moreover, any increase in costs imposed by the rule is likely to be small, relative to total costs, for any entity. Consequently, the Treasury Department and the IRS have determined that proposed § 1.6038–3(g)(4) will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required with respect to the collection of information requirements of proposed § 1.6038–3(g)(4).

The small business entities that are subject to proposed § 1.6038A–2(b)(5)(iv) are domestic small entities that are at least 25-percent foreign-owned, by vote or value, that claim a deduction under section 250 by reason of having FDII. The data to assess the number of small entities potentially affected by proposed § 1.6038A–2(b)(5)(iv) is not readily available. However, domestic corporations that are at least 25-percent foreign-owned are generally not small businesses because a foreign person's ownership of at least 25 percent of a domestic corporation, whether by vote or value, generally entails significant resources and investment, and a foreign person is unlikely to expend such resources to invest in a small domestic entity. Therefore, the Treasury Department and the IRS project that a substantial number of domestic small business entities will not be subject to proposed § 1.6038A–2(b)(5)(iv). Consequently, the Treasury Department and the IRS have determined that that proposed § 1.6038A–2(b)(5)(iv) will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required with respect to the collection of information requirements of proposed § 1.6038A–2(b)(5)(iv).

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public on both the number of entities affected and the economic impact of this proposed rule on small entities.

Pursuant to section 7805(f) of the Code, 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 businesses.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2018, that threshold is approximately $150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This proposed rule does not have federalism implications, does not impose substantial direct compliance costs on state and local governments, and does not preempt state law within the meaning of the Executive Order.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** section. Comments are requested on all aspects of the proposed regulations. In addition, the Treasury Department and the IRS solicit comments regarding the appropriateness of the numerical thresholds in the following provisions, along with data, other evidence, and models that can enhance the rigor of the process by which such thresholds are determined: proposed § 1.250(b)–4(c)(2)(ii), (d)(2)(iii)(C), (d)(2)(iv), (d)(3)(ii) and (iii); proposed § 1.250(b)–5(c)(5), (c)(6), (d)(3)(ii), (e)(3)(ii), and (h); and proposed § 1.250(b)–6(c)(1)(ii) and (d)(2).

All comments will be available at *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 these proposed regulations are Kenneth Jeruchim of the Office of the Associate Chief Counsel (International) and Michelle A. Monroy and Austin Diamond-Jones of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

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 for §§ 1.250–1 and 1.250(a)–1 through 1.250(b)–6, revising the entries for §§ 1.1502–12 and 1.1502–13, and adding an entry in numerical order for § 1.1502–50 to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

Sections 1.250–1 and 1.250(a)–1 through 1.250(b)–6 also issued under 26 U.S.C. 250(c).

Sections 1.250(a)–1 and 1.250(b)–1 also issued under 26 U.S.C. 6001 and 6011(a).

* * * * *

Section 1.1502–12 also issued under 26 U.S.C. 250(c) and 1502.

Section 1.1502–13 also issued under 26 U.S.C. 250(c) and 1502.

* * * * *

Section 1.1502–50 also issued under 26 U.S.C. 250(c) and 1502.

* * * * *

■ **Par. 2.** Sections 1.250–0, 1.250–1, and 1.250(a)–1 through 1.250(b)–6 are added to read as follows:

Sec.

* * * * *

1.250–0 Table of contents.
1.250–1 Introduction.
1.250(a)–1 Deduction for foreign-derived intangible income and global intangible low-taxed income.
1.250(b)–1 Computation of foreign-derived intangible income (FDII).
1.250(b)–2 Qualified business asset investment.
1.250(b)–3 FDDEI transactions.
1.250(b)–4 FDDEI sales.
1.250(b)–5 FDDEI services.
1.250(b)–6 Related party transactions.

* * * * *

§ 1.250–0 Table of contents.

This section lists the table of contents for §§ 1.250–1 through 1.250(b)–6.

§ 1.250–1 Introduction.

(a) Overview.
(b) Applicability dates.

§ 1.250(a)–1 Deduction for foreign-derived intangible income and global intangible low-taxed income.

(a) Scope.
(b) Allowance of deduction.
(1) In general.
(2) Taxable income limitation.
(3) Reduction in deduction for taxable years after 2025.
(4) Treatment under section 4940.
(c) Definitions.
(1) Domestic corporation.
(2) Foreign-derived intangible income.
(3) Global intangible low-taxed income.
(4) Section 250(a)(2) amount.
(d) Reporting requirement.
(e) Determination of deduction for consolidated groups.
(f) Examples.

§ 1.250(b)–1 Computation of foreign-derived intangible income (FDII).

(a) Scope.
(b) Definition of foreign-derived intangible income.
(c) Definitions.
(1) Controlled foreign corporation.
(2) Deduction eligible income.
(3) Deemed intangible income.
(4) Deemed tangible income return.
(5) Dividend.
(6) Domestic corporation.
(7) Domestic oil and gas extraction income.
(8) FDDEI sale.
(9) FDDEI service.
(10) FDDEI transaction.
(11) Foreign branch income.
(12) Foreign-derived deduction eligible income.
(13) Foreign-derived ratio.
(14) Gross DEI.
(15) Gross FDDEI.
(16) Gross non-FDDEI.
(17) Modified affiliated group.
(i) In general.
(ii) Special rule for noncorporate entities.
(iii) Definition of control.
(18) Qualified business asset investment.
(19) Related party.
(20) United States shareholder.
(d) Treatment of cost of goods sold and allocation and apportionment of deductions.
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(2) Deductions properly allocable to gross DEI and gross FDDEI.
(i) In general.
(ii) Determination of deductions to allocate.
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(e) Domestic corporate partners.
(1) In general.
(2) Reporting requirement for partnership with domestic corporate partners.

(3) Examples.
(f) Determination of foreign-derived intangible income for consolidated groups.
(g) Determination of foreign-derived intangible income for tax-exempt corporations.

§ 1.250(b)–2 Qualified business asset investment.

(a) Scope.
(b) Definition of qualified business asset investment.
(c) Specified tangible property.
(1) In general.
(2) Tangible property.
(d) Dual use property.
(1) In general.
(2) Dual use ratio.
(3) Example.
(e) Determination of adjusted basis of specified tangible property.
(1) In general.
(2) Effect of change in law.
(3) Specified tangible property placed in service before enactment of section 250.
(f) Special rules for short taxable years.
(1) In general.
(2) Determination of quarter closes.
(3) Reduction of qualified business asset investment.
(4) Example.
(g) Partnership property.
(1) In general.
(2) Definitions related to partnership QBAI.
(i) In general.
(ii) Partnership QBAI ratio.
(iii) Partnership specified tangible property.
(3) Determination of adjusted basis.
(4) Example.
(h) Anti-avoidance rule for certain transfers of property.
(1) In general.
(2) Rule for structured arrangements.
(3) Per se rules for certain transactions.
(4) Definitions related to anti-avoidance rule.
(i) Disqualified period.
(ii) FDII-eligible related party.
(iii) Specified related party.
(iv) Transfer.
(5) Examples.

§ 1.250(b)–3 FDDEI transactions.

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(b) Definitions.
(1) FDII filing date.
(2) Foreign person.
(3) General property.
(4) Intangible property.
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(6) Renderer.
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(8) Seller.
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(10) United States person.
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(c) Foreign military sales.
(d) Reliability of documentation.
(e) Transactions with multiple elements.
(f) Treatment of certain loss transactions.
(1) In general.
(2) Example.
(g) Treatment of partnerships.
(1) In general.
(2) Examples.

§ 1.250(b)–4 FDDEI sales.

(a) Scope.
(b) Definition of FDDEI sale.
(c) Foreign person.
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(2) Documentation of status as a foreign person.
(i) In general.
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(A) Special rule for small businesses.
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(d) Foreign use for general property.
(1) In general.
(2) Determination of foreign use.
(i) In general.
(ii) Determination of domestic use.
(iii) Determination of manufacture, assembly, or other processing.
(A) In general.
(B) Property subject to a physical and material change.
(C) Property incorporated into second product as a component.
(iv) Determination of foreign use for transportation property.
(3) Documentation of foreign use of general property.
(i) In general.
(ii) Special rules.
(A) Special rule for small businesses.
(B) Special rule for small transactions.
(iii) Sales of fungible mass of general property.
(4) Examples.
(e) Foreign use for intangible property.
(1) In general.
(2) Determination of foreign use.
(i) In general.
(ii) Sales in exchange for periodic payments.
(iii) Sales in exchange for a lump sum.
(3) Documentation of foreign use of intangible property.
(i) Documentation for sales for periodic payments.
(ii) Certain sales to foreign unrelated parties
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(4) Examples.
(f) Special rule for certain financial instruments.

§ 1.250(b)–5 FDDEI services.

(a) Scope.
(b) Definition of FDDEI service.
(c) Definitions.
(1) Benefit.
(2) Business recipient.
(3) Consumer.
(4) General service.
(5) Property service.
(6) Proximate service.
(7) Transportation service.
(d) General services provided to consumers.
(1) In general.
(2) Location of consumer.
(3) Documentation of location of consumer.
(i) In general.
(ii) Special rules
(A) Special rule for small businesses.
(B) Special rule for small transactions.
(e) General services provided to business recipients.
(1) In general.
(2) Location of business recipient.
(i) In general.
(A) Determination of business operations that benefit from the service.
(B) Determination of amount of benefit conferred on operations outside the United States.
(ii) Location of business recipient's operations.
(3) Documentation of location of business recipient.
(i) In general.
(ii) Special rules.
(A) Special rule for small businesses.
(B) Special rule for small transactions.
(4) Related parties.
(5) Examples.
(f) Proximate services.
(g) Property services.
(h) Transportation services.

§ 1.250(b)–6 Related party transactions.

(a) Scope.
(b) Definitions.
(1) Foreign related party.
(2) Foreign unrelated party.
(3) Related party sale.
(4) Related party service.
(5) Unrelated party transaction.
(c) Related party sales.
(1) In general.
(i) Sale of property in an unrelated party transaction.
(ii) Use of property in an unrelated party transaction.
(2) Treatment of foreign related party as seller or renderer.
(3) Transactions between a foreign related party and other foreign related parties.
(4) Example.
(d) Related party services.
(1) In general.
(2) Substantially similar services.
(3) Location of recipient of services provided by related party.
(4) Examples.

§ 1.250–1 Introduction.

(a) *Overview.* Sections 1.250(a)–1 through 1.250(b)–6 provide rules to determine a domestic corporation's section 250 deduction. Section 1.250(a)–1 provides rules to determine the amount of a domestic corporation's deduction for foreign-derived intangible income and global intangible low-taxed income. Section 1.250(b)–1 provides general rules and definitions regarding the computation of foreign-derived intangible income. Section 1.250(b)–2 provides rules for determining a domestic corporation's qualified business asset investment. Section 1.250(b)–3 provides general rules and definitions regarding the determination of gross foreign-derived deduction eligible income. Section 1.250(b)–4 provides rules regarding the determination of gross foreign-derived deduction eligible income from the sale of property. Section 1.250(b)–5 provides rules regarding the determination of gross foreign-derived deduction eligible income from the provision of a service. Section 1.250(b)–6 provides rules regarding the sale of property or provision of a service to a related party.

(b) *Applicability dates.* Sections 1.250(a)–1 through 1.250(b)–6 apply to taxable years ending on or after March 4, 2019. However, for taxable years beginning on or before March 4, 2019, taxpayers may use any reasonable documentation maintained in the ordinary course of the taxpayer's business that establishes that a recipient is a foreign person, property is for a foreign use (within the meaning of § 1.250(b)–4(d) and (e)), or a recipient of a general service is located outside the United States (within the meaning of § 1.250(b)–5(d)(2) and (e)(2)), as applicable, in lieu of the documentation required in §§ 1.250(b)–4(c)(2), (d)(3), and (e)(3) and 1.250(b)–5(d)(3) and (e)(3), provided that such documentation meets the reliability requirements described in § 1.250(b)–3(d).

§ 1.250(a)–1 Deduction for foreign-derived intangible income and global intangible low-taxed income.

(a) *Scope.* This section provides rules for determining the amount of a domestic corporation's deduction for foreign-derived intangible income and global intangible low-taxed income. Paragraph (b) of this section provides general rules for determining the amount of the deduction. Paragraph (c) of this section provides definitions relevant for determining the amount of the deduction. Paragraph (d) of this section provides reporting requirements for a domestic corporation claiming the deduction. Paragraph (e) of this section provides a rule for determining the amount of the deduction of a member of a consolidated group. Paragraph (f) of this section provides examples illustrating the application of this section.

(b) *Allowance of deduction*—(1) *In general.* A domestic corporation is allowed a deduction for any taxable year equal to the sum of—

(i) 37.5 percent of its foreign-derived intangible income for the year; and

(ii) 50 percent of—

(A) Its global intangible low-taxed income for the year; and

(B) The amount treated as a dividend received by the corporation under section 78 which is attributable to its global intangible low-taxed income for the year.

(2) *Taxable income limitation.* In the case of a domestic corporation with a section 250(a)(2) amount for a taxable year, for purposes of applying paragraph (b)(1) of this section for the year—

(i) The corporation's foreign-derived intangible income for the year (if any) is reduced (but not below zero) by an amount that bears the same ratio to the corporation's section 250(a)(2) amount that the corporation's foreign-derived intangible income for the year bears to the sum of the corporation's foreign-derived intangible income and global intangible low-taxed income for the year; and

(ii) The corporation's global intangible low-taxed income for the year (if any) is reduced (but not below zero) by the excess of the corporation's section 250(a)(2) amount over the amount of the reduction described in paragraph (b)(2)(i) of this section.

(3) *Reduction in deduction for taxable years after 2025.* For any taxable year of a domestic corporation beginning after December 31, 2025, paragraph (b)(1) of this section applies by substituting—

(i) 21.875 percent for 37.5 percent in paragraph (b)(1)(i) of this section; and

(ii) 37.5 percent for 50 percent in paragraph (b)(1)(ii) of this section.

(4) *Treatment under section 4940.* For purposes of section 4940(c)(3)(A), a deduction under section 250(a) is not treated as an ordinary and necessary expense paid or incurred for the production or collection of gross investment income.

(c) *Definitions.* The following definitions apply for purposes of this section.

(1) *Domestic corporation.* The term *domestic corporation* has the meaning set forth in section 7701(a), but does not include a regulated investment company (as defined in section 851), a real estate investment trust (as defined in section 856), or an S corporation (as defined in section 1361).

(2) *Foreign-derived intangible income.* The term *foreign-derived intangible income* has the meaning set forth in § 1.250(b)–1(b).

(3) *Global intangible low-taxed income.* The term *global intangible low-taxed income* means, with respect to a domestic corporation for a taxable year, the sum of the corporation's GILTI inclusion amount under § 1.951A–1(c) for the taxable year and the corporation's distributive share of any U.S. shareholder partnership's GILTI inclusion amount under § 1.951A–5(b)(2).

(4) *Section 250(a)(2) amount.* The term *section 250(a)(2) amount* means, with respect to a domestic corporation for a taxable year, the excess (if any) of the sum of the corporation's foreign-derived intangible income and global intangible low-taxed income (determined without regard to section 250(a)(2) and paragraph (b)(2) of this section), over the corporation's taxable income determined with regard to all items of income, deduction, or loss, except for the deduction allowed under section 250 and this section. Therefore, for example, a domestic corporation's taxable income under the previous sentence is determined taking into account the application of sections 163(j) and 172(a). For a corporation that is subject to the unrelated business income tax under section 511, taxable income is determined only by reference to that corporation's unrelated business taxable income defined under section 512.

(d) *Reporting requirement.* Each domestic corporation (or individual making an election under section 962) that claims a deduction under section 250 for a taxable year must make an annual return on Form 8993, ''Section 250 Deduction for Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI)'' (or any successor form) for such year, setting forth the information, in such form and manner, as Form 8993 (or any successor form) or its instructions prescribe. Returns on Form 8993 (or any successor form) for a taxable year must be filed with the domestic corporation's (or in the case of a section 962 election, the individual's) income tax return on or before the due date (taking into account extensions) for filing the corporation's (or in the case of a section 962 election, the individual's) income tax return.

(e) *Determination of deduction for consolidated groups.* A member of a consolidated group (as defined in § 1.1502–1(h)) determines its deduction under section 250(a) and this section under the rules provided in § 1.1502–50(b).

(f) *Examples.* The following examples illustrate the application of this section. For purposes of the examples, it is assumed that DC is a domestic corporation that is not a member of a consolidated group and the taxable year of DC begins after 2017 and before 2026.

(1) *Example 1: Application of the taxable income limitation*—(i) *Facts.* For the taxable year, without regard to section 250(a)(2) and paragraph (b)(2) of this section, DC has foreign-derived intangible income of $100x and global intangible low-taxed income of $300x. DC's taxable income (without regard to section 250(a) and this section) is $300x.

(ii) *Analysis.* DC has a section 250(a)(2) amount of $100x, which is equal to the excess of the sum of DC's foreign-derived intangible income and global intangible low-taxed income of $400x ($100x + $300x) over its taxable income of $300x. As a result, DC's foreign-derived intangible income and global intangible low-taxed income are reduced, in the aggregate, by $100x under section 250(a)(2) and paragraph (b)(2) of this section for purposes of calculating DC's deduction allowed under section 250(a)(1) and paragraph (b)(1) of this section. DC's foreign-derived intangible income is reduced by $25x, the amount that bears the same ratio to the section 250(a)(2) amount ($100x) as DC's foreign-derived intangible income ($100x) bears to the sum of DC's foreign-derived intangible income and global intangible low-taxed income ($400x). DC's global intangible low-taxed income is reduced by $75x, which is the remainder of the section 250(a)(2) amount ($100x − $25x). Therefore, for purposes of calculating its deduction under section 250(a)(1) and paragraph (b)(1) of this section, DC's foreign-derived intangible income is $75x ($100x − $25x) and its global intangible low-taxed income is $225x ($300x − $75x). Accordingly, DC is allowed a deduction for the taxable year under section 250(a)(1) and paragraph (b)(1) of this section of $140.63x ($75x × 0.375 + $225x × 0.50).

(2) *Example 2: Interaction of sections 163(j), 172, and 250*—(i) *Facts.* For the taxable year, DC has gross DEI (as defined in § 1.250(b)–1(c)(14)) and gross FDDEI (as defined in § 1.250(b)–1(c)(15)) of $300x. DC has no income for the taxable year other than income included in gross DEI. DC also has a net operating loss carryover to the taxable year under section 172(b) of $130x and business interest (as defined in section 163(j)(5), without regard to any carryforwards described in section 163(j)(2)) of $100x. Under § 1.250(b)–1(d)(2), all of DC's interest expense is allocable to gross FDDEI and the net operating loss carryover, to the extent absorbed in the taxable year, is allocable to gross FDDEI. DC has no other allowable deductions, qualified business asset investment (as defined in § 1.250(b)–2(b)), or global intangible low-taxed income for the taxable year. DC has no floor plan financing interest (as defined in section 163(j)(9)) for the taxable year and no business interest income (as defined in section 163(j)(6)) for the taxable year.

(ii) *Analysis*—(A) *Calculation of tentative section 250 deduction for purposes of section 163(j).* First, for purposes of applying section 163(j), the amount of the deduction allowed to DC under section 250(a)(1) is determined without regard to the application of section 163(j) and the section 163(j) regulations, without regard to section 172, and without regard to section 250(a)(2) and paragraph (b)(2) of this section (*tentative section 250 deduction*). See § 1.163(j)–1(b)(37)(ii); see also § 1.250(b)–1(d)(2)(ii). Therefore, solely for purposes of calculating DC's tentative section 250 deduction, DC's allowable deductions under § 1.250(b)–1(d)(2)(ii) for computing its foreign-derived intangible income are $100x, the amount of its business interest before the application of section 163(j). DC's deduction eligible income (as defined in § 1.250(b)–1(c)(2)) is $200x, the excess of its gross DEI (as defined in § 1.250(b)–1(c)(14)) of $300x, over its deductions properly allocable to gross DEI of $100x. DC's foreign-derived deduction eligible income (as defined in § 1.250(b)–1(c)(12)) is also $200x, the excess of its gross FDDEI of $300x over its deductions properly allocable to gross FDDEI of $100x. DC's foreign-derived ratio (as defined in § 1.250(b)–1(c)(13)) is 100%, which is the ratio of DC's foreign-derived deduction eligible income of $200x to DC's deduction eligible income of $200x. DC's deemed intangible income (as defined § 1.250(b)–1(c)(3)) is $200x, the excess of its deduction eligible income of $200x over its qualified business asset investment of $0. Therefore, DC's foreign-derived intangible income for purposes of the tentative section 250 deduction is $200x, which is equal to DC's deemed intangible income of $200x multiplied by its foreign-derived ratio of 100%. Accordingly, DC's tentative section 250 deduction is $75x ($200x × 0.375).

(B) *Calculation of disallowance under section 163(j)(1).* Second, the amount of DC's business interest deduction allowed under section 163(j) is determined taking into account the tentative section 250 deduction, but without regard to section 172(a). See section 163(j)(8)(A)(iii). Under section 163(j)(1) and § 1.163(j)–2(b), DC's deduction for business interest is limited to 30% of adjusted taxable income plus the amount of any business interest income for the taxable year and the amount of any floor plan financing interest for the taxable year. In this case, DC has no business interest income or floor plan financing interest for the taxable year and therefore DC's deduction for business interest is limited to 30% of DC's adjusted taxable income for the taxable year. DC's adjusted taxable income is equal to DC's taxable income with the relevant adjustments set forth under section 163(j)(8) and the regulations under section 163(j). For this purpose, DC's taxable income is computed without regard to DC's business interest and the amount of any net operating loss deduction under section 172, but taking into account the tentative section 250 deduction. Taking into account the tentative section 250 deduction, DC's adjusted taxable income is $225x ($300x—$75x). Therefore, the amount of DC's allowable deduction for business interest is $67.5x ($225x × 0.30) and the remaining $32.5x of DC's business interest expense will be carried forward to the succeeding taxable year.

(C) *Calculation of net operating loss deduction under section 172(a).* Third, the amount of DC's net operating loss deduction under section 172(a) is determined taking into account section 163(j), but without regard to section 250(a) and paragraph (b)(1) of this section. See § 1.250(b)–1(d)(2)(ii). Under section 172(a)(2), the amount of DC's net operating loss deduction is limited to 80% of taxable income. Taking into account the allowable deduction for business interest (but not its deduction allowed under section 250(a)), DC's taxable income is $232.5x ($300x − $67.5x), and its taxable income limitation under section 172(a)(2) is $186x ($232.5x × 0.80). DC is entitled to a net operating loss deduction equal to its entire net operating loss carryover of $130x, because such amount is less than $186x.

(D) *Calculation of FDII.* Fourth, the amount of DC's foreign-derived intangible income is determined, taking into account the deductions allowed after the application of sections 163(j) and 172(a). DC's allowable deductions under § 1.250(b)–1(d)(2)(ii) for computing its foreign-derived intangible income are $197.5x, which is equal to its allowed deduction for business interest of $67.5x plus its net operating loss deduction of $130x. Accordingly, DC's deduction eligible income (as defined in § 1.250(b)–1(c)(2)) is $102.5x, the excess of its gross DEI (as defined in § 1.250(b)–1(c)(14)) of $300x, over its deductions properly allocable to gross DEI of $197.5x. DC's foreign-derived deduction eligible income (as defined in § 1.250(b)–1(c)(12)) is also $102.5x, the excess of its gross FDDEI of $300x, over its deductions properly allocable to gross FDDEI of $197.5x. DC's foreign-derived ratio (as defined in § 1.250(b)–1(c)(13)) is 100%, which is the ratio of DC's foreign-derived deduction eligible income of $102.5x to DC's deduction eligible income of $102.5x. DC's deemed intangible income (as defined in § 1.250(b)–1(c)(3)) is $102.5x, the excess of its deduction eligible income of $102.5x over its qualified business asset investment of $0. Accordingly, DC's foreign-derived intangible income before application of section 250(a)(2) and paragraph (b)(2) of this section is

$102.5x, which is equal to DC's deemed intangible income of $102.5x multiplied by its foreign-derived ratio of 100%.

(E) *Calculation of section 250 deduction.* Finally, the amount of DC's deduction under section 250 is determined after the application of section 250(a)(2), which is applied taking into account DC's business interest allowed under section 163(j) and its net operating loss deduction under section 172(a). DC's taxable income for purposes of section 250(a)(2) and paragraph (b)(2) of this section is $102.5x, which is $300x of gross income minus $197.5x, which is equal to its deduction for business interest of $67.5x plus its net operating loss deduction of $130x. DC does not have a section 250(a)(2) amount (as defined in paragraph (c)(4) of this section) for the year because DC's foreign-derived intangible income of $102.5x, determined without regard to section 250(a)(2) and paragraph (b)(2) of this section, does not exceed DC's taxable income of $102.5x. Therefore, the amount of DC's foreign-derived intangible income is not reduced under section 250(a)(2) and paragraph (b)(2) of this section. Accordingly, for the taxable year, DC is allowed a deduction under section 250(a)(1) and paragraph (b)(1) of this section of $38.44x ($102.5x × 0.375).

§ 1.250(b)–1 Computation of foreign-derived intangible income (FDII).

(a) *Scope.* This section provides rules for computing foreign-derived intangible income. Paragraph (b) of this section defines foreign-derived intangible income. Paragraph (c) of this section provides definitions that are relevant for computing foreign-derived intangible income. Paragraph (d) of this section provides rules for computing gross income and allocating and apportioning deductions for purposes of computing deduction eligible income and foreign-derived deduction eligible income. Paragraph (e) of this section provides rules for computing the deduction eligible income and foreign-derived deduction eligible income of a domestic corporate partner. Paragraph (f) of this section provides a rule for computing the foreign-derived intangible income of a member of a consolidated group. Paragraph (g) of this section provides a rule for computing the foreign-derived intangible income of a tax-exempt corporation.

(b) *Definition of foreign-derived intangible income.* Subject to the provisions of this section, the term *foreign-derived intangible income* means, with respect to a domestic corporation for a taxable year, the corporation's deemed intangible income for the year multiplied by the corporation's foreign-derived ratio for the year.

(c) *Definitions.* This paragraph (c) provides definitions that apply for purposes of this section and §§ 1.250(b)-2 through 1.250(b)-6.

(1) *Controlled foreign corporation.* The term *controlled foreign corporation* has the meaning set forth in section 957(a).

(2) *Deduction eligible income.* The term *deduction eligible income* means, with respect to a domestic corporation for a taxable year, the excess (if any) of the corporation's gross DEI for the year, over the deductions properly allocable to gross DEI for the year, as determined under paragraph (d)(2) of this section.

(3) *Deemed intangible income.* The term *deemed intangible income* means, with respect to a domestic corporation for a taxable year, the excess (if any) of the corporation's deduction eligible income for the year, over the corporation's deemed tangible income return for the year.

(4) *Deemed tangible income return.* The term *deemed tangible income return* means, with respect to a domestic corporation and a taxable year, 10 percent of the corporation's qualified business asset investment for the year.

(5) *Dividend.* The term *dividend* has the meaning set forth in section 316, and includes any amount treated as a dividend under any other provision of subtitle A of the Internal Revenue Code or the regulations thereunder (for example, under section 78, 356(a)(2), 367(b), or 1248).

(6) *Domestic corporation.* The term *domestic corporation* has the meaning set forth in § 1.250(a)–1(c)(1).

(7) *Domestic oil and gas extraction income.* The term *domestic oil and gas extraction income* means income described in section 907(c)(1), substituting ''within the United States'' for ''without the United States.''

(8) *FDDEI sale.* The term *FDDEI sale* has the meaning set forth in § 1.250(b)–4(b).

(9) *FDDEI service.* The term *FDDEI service* has the meaning set forth in § 1.250(b)–5(b).

(10) *FDDEI transaction.* The term *FDDEI transaction* means a FDDEI sale or a FDDEI service.

(11) *Foreign branch income.* The term *foreign branch income* means gross income attributable to a foreign branch of a domestic corporation or a partnership under § 1.904–4(f)(2), except that the term also includes any income or gain that would not be treated as gross income attributable to a foreign branch under § 1.904–4(f) but that arises from the direct or indirect sale (as defined in § 1.250(b)–3(b)(7)) of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or interest in a partnership. See also § 1.904–4(f)(2)(v) (providing that if a principal purpose of recording or failing to record an item of gross income on the books and records of a foreign branch is the avoidance of the purposes of section 250 (in connection with section 250(b)(3)(A)(i)(VI)), the item must be attributed to one or more foreign branches of the foreign branch owner in a manner that reflects the substance of the transaction).

(12) *Foreign-derived deduction eligible income.* The term *foreign-derived deduction eligible income* means, with respect to a domestic corporation for a taxable year, the excess (if any) of the corporation's gross FDDEI for the year, over the deductions properly allocable to gross FDDEI for the year, as determined under paragraph (d)(2) of this section.

(13) *Foreign-derived ratio.* The term *foreign-derived ratio* means, with respect to a domestic corporation for a taxable year, the ratio (not to exceed one) of the corporation's foreign-derived deduction eligible income for the year to the corporation's deduction eligible income for the year. If a domestic corporation has no foreign-derived deduction eligible income for a taxable year, the corporation's foreign-derived ratio is zero for the year.

(14) *Gross DEI.* The term *gross DEI* means, with respect to a domestic corporation or a partnership for a taxable year, the gross income of the corporation or partnership for the year determined without regard to the following items of gross income—

(i) Amounts included in gross income under section 951(a)(1);

(ii) Global intangible low-taxed income (as defined in § 1.250(a)–1(c)(3));

(iii) Financial services income (as defined in section 904(d)(2)(D) and § 1.904–4(e)(1)(ii));

(iv) Dividends received from a controlled foreign corporation with respect to which the corporation or partnership is a United States shareholder;

(v) Domestic oil and gas extraction income; and

(vi) Foreign branch income.

(15) *Gross FDDEI.* The term *gross FDDEI* means, with respect to a domestic corporation or a partnership for a taxable year, the portion of the gross DEI of the corporation or partnership for the year which is

derived from all of its FDDEI transactions.

(16) *Gross non-FDDEI.* The term *gross non-FDDEI* means, with respect to a domestic corporation for a taxable year, the portion of the corporation's gross DEI that is not included in gross FDDEI.

(17) *Modified affiliated group*—(i) *In general.* The term *modified affiliated group* means an affiliated group as defined in section 1504(a) determined by substituting ''more than 50 percent'' for ''at least 80 percent'' each place it appears, and without regard to section 1504(b)(2) and (3).

(ii) *Special rule for noncorporate entities.* Any person (other than a corporation) that is controlled by one or more members of a modified affiliated group (including one or more persons treated as a member or members of a modified affiliated group by reason of this paragraph (c)(17)(ii)) or that controls any such member is treated as a member of the modified affiliated group.

(iii) *Definition of control.* For purposes of paragraph (c)(17)(ii) of this section, the term *control* has the meaning set forth in section 954(d)(3).

(18) *Qualified business asset investment.* The term *qualified business asset investment* has the meaning set forth in § 1.250(b)–2(b).

(19) *Related party.* The term *related party* means, with respect to any person, any member of a modified affiliated group that includes such person.

(20) *United States shareholder.* The term *United States shareholder* has the meaning set forth in section 951(b) and § 1.951–1(g).

(d) *Treatment of cost of goods sold and allocation and apportionment of deductions*—(1) *Cost of goods sold for determining gross DEI and gross FDDEI.* For purposes of determining the gross income included in gross DEI and gross FDDEI of a domestic corporation or a partnership, the cost of goods sold of the corporation or partnership is attributed to gross receipts with respect to gross DEI or gross FDDEI under any reasonable method. Cost of goods sold must be attributed to gross receipts with respect to gross DEI or gross FDDEI regardless of whether certain costs included in cost of goods sold can be associated with activities undertaken in an earlier taxable year (including a year before the effective date of section 250). A domestic corporation or partnership may not segregate cost of goods sold with respect to a particular product into component costs and attribute those component costs disproportionately to gross receipts with respect to amounts excluded from gross DEI or gross FDDEI, as applicable.

(2) *Deductions properly allocable to gross DEI and gross FDDEI*—(i) *In general.* For purposes of determining a domestic corporation's deductions that are properly allocable to gross DEI and gross FDDEI, the corporation's deductions are allocated and apportioned to gross DEI and gross FDDEI under the rules of §§ 1.861–8 through 1.861–14T and 1.861–17 by treating section 250(b) as an operative section described in § 1.861–8(f). In allocating and apportioning deductions under §§ 1.861–8 through 1.861–14T and 1.861–17, gross FDDEI and gross non-FDDEI are treated as separate statutory groupings. The deductions allocated and apportioned to gross DEI equal the sum of the deductions allocated and apportioned to gross FDDEI and gross non-FDDEI. All items of gross income described in paragraphs (c)(14)(i) through (vi) of this section are in the residual grouping. For purposes of this paragraph (d)(2)(i), research and experimental expenditures are allocated and apportioned in accordance with § 1.861–17 without taking into account the exclusive apportionment rule of § 1.861–17(b).

(ii) *Determination of deductions to allocate.* All deductions allowed to a domestic corporation are allocated and apportioned to gross DEI and gross FDDEI for a taxable year under paragraph (d)(2)(i) of this section, other than the deduction allowed under section 250(a) and § 1.250(a)–1(b). For this purpose, the amount of the net operating loss deduction under section 172(a) is determined without regard to section 250. See also § 1.163(j)–1(b)(37)(ii) (for purposes of determining the limitation under section 163(j)(1), the deduction under section 250(a)(1) is determined without regard to the application of section 163(j) and the section 163(j) regulations and without regard to the taxable income limitation of section 250(a)(2) and § 1.250(a)–1(b)(2)).

(3) *Examples.* The following example illustrates the application of this paragraph (d).

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC is a domestic corporation that is not a member of a consolidated group.

(B) All sales and services are provided to persons that are not related parties.

(C) All sales and services to foreign persons qualify as FDDEI transactions.

(ii) *Examples.*

(A) *Example 1: Allocation of deductions*—(*1*) *Facts.*

For a taxable year, DC manufactures products A and B in the United States. DC sells products A and B and provides services associated with products A and B to United States and foreign persons. DC's qualified business asset investment for the taxable year is $1,000x. DC has $300x of deductible interest expense allowed under section 163. DC has assets with a tax book value of $2,500x. The tax book value of DC's assets used to produce products A and B and services is split evenly between assets that produce gross FDDEI and assets that produce gross non-FDDEI. DC has $840x of supportive deductions, as defined in § 1.861–8(b)(3), attributable to general and administrative expenses incurred for the purpose of generating the class of gross income that consists of gross DEI. DC apportions the $840x of deductions on the basis of gross income in accordance with § 1.861–8T(c)(1). For purposes of determining gross FDDEI and gross DEI under paragraph (d)(1) of this section, DC attributes $200x of cost of goods sold to Product A and $400x of cost of goods sold to Product B, and then attributes the cost of goods sold for each product ratably between the gross receipts of such product sold to foreign persons and the gross receipts of such product sold to United States persons. The manner in which DC attributes the cost of goods sold is a reasonable method. DC has no other items of income, loss, or deduction. For the taxable year, DC has the following income tax items relevant to the determination of its foreign-derived intangible income:

TABLE 1 TO PARAGRAPH (d)(3)(ii)(A)(*1*)

	Product A	Product B	Services	Total
Gross receipts from U.S. persons	$200x	$800x	$100x	$1,100x
Gross receipts from foreign persons	200x	800x	100x	1,100x
Total gross receipts	400x	1,600x	200x	2,200x
Cost of goods sold for gross receipts from U.S. persons	100x	200x	0	300x
Cost of goods sold for gross receipts from foreign persons	100x	200x	0	300x
Total cost of goods sold	200x	400x	0	600x
Gross income	200x	1,200x	200x	1,600x

TABLE 1 TO PARAGRAPH (d)(3)(ii)(A)(*1*)—Continued

	Product A	Product B	Services	Total
Tax book value of assets used to produce products/services	500x	500x	1,500x	2,500x

(*2*) *Analysis*—(*i*) *Determination of gross FDDEI and gross non-FDDEI.* Because DC does not have any income described in section 250(b)(3)(A)(i)(I) through (VI) and paragraphs (c)(14)(i) through (vi) of this section, none of its gross income is excluded from gross DEI. DC's gross DEI is $1,600x ($2,200x total gross receipts less $600x total cost of goods sold). DC's gross FDDEI is $800x ($1,100x of gross receipts from foreign persons minus attributable cost of goods sold of $300x).

(*ii*) *Determination of foreign-derived deduction eligible income.* To calculate its foreign-derived deduction eligible income, DC must determine the amount of its deductions that are allocated and apportioned to gross FDDEI and then subtract those amounts from gross FDDEI. DC's interest deduction of $300x is allocated and apportioned to gross FDDEI on the basis of the average total value of DC's assets in each grouping. DC has assets with a tax book value of $2,500x split evenly between assets that produce gross FDDEI and assets that produce gross non-FDDEI. Accordingly, an interest expense deduction of $150x is apportioned to DC's gross FDDEI. With respect to DC's supportive deductions of $840x that are related to DC's gross DEI, DC apportions such deductions between gross FDDEI and gross non-FDDEI on the basis of gross income. Accordingly, supportive deductions of $420x are apportioned to DC's gross FDDEI. Thus, DC's foreign-derived deduction eligible income is $230x, which is equal to its gross FDDEI of $800x less $150x of interest expense deduction and $420x of supportive deductions.

(*iii*) *Determination of deemed intangible income.* DC's deemed tangible income return is $100x, which is equal to 10% of its qualified business asset investment of $1,000x. DC's deduction eligible income is $460x, which is equal to its gross DEI of $1,600x less $300x of interest expense deductions and $840x of supportive deductions. Therefore, DC's deemed intangible income is $360x, which is equal to the excess of its deduction eligible income of $460x over its deemed tangible income return of $100x.

(*iv*) *Determination of foreign-derived intangible income.* DC's foreign-derived ratio is 50%, which is the ratio of DC's foreign-derived deduction eligible income of $230x to DC's deduction eligible income of $460x. Therefore, DC's foreign-derived intangible income is $180x, which is equal to DC's deemed intangible income of $360x multiplied by its foreign-derived ratio of 50%.

(B) *Example 2: Allocation of deductions with respect to a partnership*—(*1*) *Facts*—(*i*) *DC's operations.* DC is engaged in the production and sale of products consisting of two separate product groups in three-digit Standard Industrial Classification (SIC) Industry Groups, hereafter referred to as Group AAA and Group BBB. All of the gross income of DC is included in gross DEI. DC incurs $250x of research and experimental (R&E) expenditures in the United States that are deductible under section 174. None of the R&E is legally mandated as described in § 1.861–17(a)(4) and none is included in cost of goods sold. For purposes of determining gross FDDEI and gross DEI under paragraph (d)(1) of this section, DC attributes $210x of cost of goods sold to Group AAA products and $900x of cost of goods sold to Group BBB products, and then attributes the cost of goods sold with respect to each such product group ratably between the gross receipts with respect to such product group sold to foreign persons and the gross receipts with respect to such product group not sold to foreign persons. The manner in which DC attributes the cost of goods sold is a reasonable method. For the taxable year, DC has the following income tax items relevant to the determination of its foreign-derived intangible income:

TABLE 2 TO (d)(3)(ii)(B)(*1*)(*i*)

	Group AAA products	Group BBB products	Total
Gross receipts from U.S. persons	$200x	$800x	$1,000x
Gross receipts from foreign persons	100x	400x	500x
Total gross receipts	300x	1,200x	1,500x
Cost of goods sold for gross receipts from U.S. persons	140x	600x	750x
Cost of goods sold for gross receipts from foreign persons	70x	300x	370x
Total cost of goods sold	210x	900x	1,110x
Gross income	90x	300x	390x
R&E deductions	40x	210x	250x

(*ii*) *PRS's operations.* In addition to its own operations, DC is a partner in PRS, a partnership that also produces products described in SIC Group AAA. DC is allocated 50% of all income, gain, loss, and deductions of PRS. During the taxable year, PRS sells Group AAA products solely to foreign persons, and all of its gross income is included in gross DEI. PRS has $400 of gross receipts from sales of Group AAA products for the taxable year and incurs $100x of research and experimental (R&E) expenditures in the United States that are deductible under section 174. None of the R&E is legally mandated as described in § 1.861–17(a)(4) and none is included in cost of goods sold. For purposes of determining gross FDDEI and gross DEI under paragraph (d)(1) of this section, PRS attributes $200x of cost of goods sold to Group AAA products, and then attributes the cost of goods sold with respect to such product group ratably between the gross receipts with respect to such product group sold to foreign persons and the gross receipts with respect to such product group not sold to foreign persons. The manner in which PRS attributes the cost of goods sold is a reasonable method. DC's distributive share of PRS taxable items is $100x of gross income and $50x of R&E deductions, and DC's share of PRS's gross receipts from sales of Group AAA products for the taxable year is $200x under § 1.861–17(f)(3).

(*iii*) *Election to use sales method to allocate and apportion R&E.* DC has elected to use the sales method to apportion its R&E deductions under § 1.861–17. Neither DC nor PRS licenses or sells its intangible property to controlled or uncontrolled corporations in a manner that necessitates including the sales by such corporations for purposes of apportioning DC's R&E deductions.

(*2*) *Analysis*—(*i*) *Determination of gross DEI and gross FDDEI.* Under paragraph (e)(1) of this section, DC's gross DEI, gross FDDEI, and deductions allocable to those amounts include its distributive share of gross DEI, gross FDDEI, and deductions of PRS. Thus, DC's gross DEI for the year is $490x ($390x attributable to DC and $100x attributable to DC's interest in PRS). DC's gross income from sales of Group AAA products to foreign persons is $30x ($100x of gross receipts minus attributable cost of goods sold of $70x). DC's gross income from sales of Group BBB products to foreign persons is $100x ($400x of gross receipts minus attributable cost of goods sold of $300x). DC's gross FDDEI for the year is $230x ($30x from DC's sale of Group AAA products plus $100x from DC's sale of Group BBB products plus DC's distributive of PRS's gross FDDEI of $100x).

(*ii*) *Allocation and apportionment of R&E deductions.* To determine foreign-derived deduction eligible income, DC must allocate and apportion its R&E expense of $300x ($250x incurred directly by DC and $50x incurred indirectly through DC's interest in PRS). In accordance with § 1.861–17, R&E expenses are first allocated to a class of gross income related to a three-digit SIC group code. DC's R&E expenses related to products in Group AAA are $90x ($40x incurred directly by DC and $50x incurred indirectly through DC's interest in PRS) and its expenses related to Group BBB are $210x. None of those expenses were legally mandated by a particular country and therefore do not require the allocation of R&E expense solely to income arising from that jurisdiction. The exclusive apportionment rule in § 1.861–17(b) does not apply for purposes of apportioning R&E to gross DEI and gross FDDEI. See paragraph (d)(2)(i) of this section. Accordingly, all R&E expense attributable to a particular SIC group code is apportioned on the basis of the amounts of sales within that SIC group code. Total sales within Group AAA were $500x ($300x directly by DC and $200x attributable to DC's interest in PRS), $300x of which were made to foreign persons ($100x directly by DC and $200x attributable to DC's interest in PRS). Therefore, the $90x of R&E expense related to Group AAA is apportioned $54x to gross FDDEI ($90x × $300x/$500x) and $36x to gross non-FDDEI ($90x × $200x/$500x). Total sales within Group BBB were $1,200x, $400x of which were made to foreign persons. Therefore, the $210x of R&E expense related to products in Group BBB is apportioned $70x to gross FDDEI ($210x × $400x/$1,200x) and $140x to gross non-FDDEI ($210x × $800x/$1,200x). Accordingly, DC's foreign-derived deduction eligible income for the tax year is $106x ($230x gross FDDEI minus $124x of R&E ($54x + $70x) allocated and apportioned to gross FDDEI).

(e) *Domestic corporate partners*—(1) *In general.* A domestic corporation's deduction eligible income and foreign-derived deduction eligible income for a taxable year are determined taking into account the corporation's share of gross DEI, gross FDDEI, and deductions of any partnership (whether domestic or foreign) in which the corporation is a direct or indirect partner. For purposes of the preceding sentence, a domestic corporation's share of each such item of a partnership is determined in accordance with the corporation's distributive share of the underlying items of income, gain, deduction, and loss of the partnership that comprise such amounts. See § 1.250(b)–2(g) for rules calculating the increase to a domestic corporation's qualified business asset investment by the corporation's share of partnership QBAI.

(2) *Reporting requirement for partnership with domestic corporate partners.* A partnership that has one or more direct or indirect partners that are domestic corporations and that is required to file a return under section 6031 must furnish to each such partner on or with such partner's Schedule K–1 (Form 1065 or any successor form) by the due date (including extensions) for furnishing Schedule K–1 the partner's share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI (as determined under § 1.250(b)–2(g)) for each taxable year in which the partnership has gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI or gross FDDEI, or partnership specified tangible property (as defined in § 1.250(b)–2(g)(2)(iii)).

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

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC, a domestic corporation, is a partner in PRS, a partnership.

(B) FP and FP2 are foreign persons.

(C) FC is a foreign corporation.

(D) The allocations under PRS's partnership agreement satisfy the requirements of section 704.

(E) No partner of PRS is a related party of DC.

(F) DC, PRS, and FC all use the calendar year as their taxable year.

(G) PRS has no items of income, loss, or deduction for its taxable year, except the items of income described.

(ii) *Examples.*

(A) *Example 1: Sale by partnership to foreign person*—(*1*) *Facts.* Under the terms of the partnership agreement, DC is allocated 50% of all income, gain, loss, and deductions of PRS. For the taxable year, PRS recognizes $20x of gross income on the sale of general property (as defined in § 1.250(b)–3(b)(3)) to FP, a foreign person (as determined under § 1.250(b)–4(c)), for a foreign use (as determined under § 1.250(b)–4(d)). The gross income recognized on the sale of property is not described in section 250(b)(3)(A)(I) through (VI) or paragraphs (c)(14)(i) through (vi) of this section.

(*2*) *Analysis.* PRS's sale of property to FP is a FDDEI sale as described in § 1.250(b)–4(b). Therefore, the gross income derived from the sale ($20x) is included in PRS's gross DEI and gross FDDEI, and DC's share of PRS's gross DEI and gross FDDEI ($10x) is included in DC's gross DEI and gross FDDEI for the taxable year.

(B) *Example 2: Sale by partnership to foreign person attributable to foreign branch*—(*1*) *Facts.* The facts are the same as in paragraph (e)(3)(ii)(A)(*1*) of this section (the facts in *Example 1*), except the income from the sale of property to FP is attributable to a foreign branch of PRS.

(*2*) *Analysis.* PRS's sale of property to FP is excluded from PRS's gross DEI under section 250(b)(3)(A)(VI) and paragraph (c)(14)(vi) of this section. Accordingly, DC's share of PRS's gross income of $10x from the sale is not included in DC's gross DEI or gross FDDEI for the taxable year.

(C) *Example 3: Partnership with a loss in gross FDDEI*—(*1*) *Facts.* The facts are the same as in paragraph (e)(3)(ii)(A)(*1*) of this section (the facts in *Example 1*), except that in the same taxable year, PRS also sells property to FP2, a foreign person (as determined under § 1.250(b)–4(c)), for a foreign use (as determined under § 1.250(b)–4(d)). After taking into account both sales, PRS has a gross loss of $30x.

(*2*) *Analysis.* Both the sale of property to FP and the sale of property to FP2 are FDDEI sales because each sale is described in § 1.250(b)–4(b). DC's share of PRS's gross loss ($15x) from the sales is included in DC's gross DEI and gross FDDEI.

(D) *Example 4: Sale by partnership to foreign related party of the partnership*—(*1*) *Facts.* Under the terms of the partnership agreement, DC has 25% of the capital and profits interest in the partnership and is allocated 25% of all income, gain, loss, and deductions of PRS. PRS owns 100% of the single class of stock of FC. In the taxable year, PRS has $20x of gain on the sale of general property (as defined in § 1.250(b)–3(b)(3)) to FC, and FC makes a material physical change to the property within the meaning of § 1.250(b)–4(d)(2)(iii) outside the United States before selling the property to customers in the United States. PRS satisfies the documentation requirement of § 1.250(b)–4(d)(3) with respect to the sale.

(*2*) *Analysis.* The sale of property by PRS to FC is described in § 1.250(b)–4(b) without regard to the application of § 1.250(b)–6, since the sale is to a foreign person (as determined under § 1.250(b)–4(c)) for a foreign use (as determined under § 1.250(b)–4(d)). However, FC is a foreign related party of PRS within the meaning of section 250(b)(5)(D) and § 1.250(b)–6(b)(1), because FC and PRS are members of a modified affiliated group within the meaning of paragraph (c)(17) of this section. Therefore, the sale by PRS to FC is a related party sale within the meaning of § 1.250(b)–6(b)(3). Under section 250(b)(5)(C)(i) and § 1.250(b)–6(c), because FC did not sell the property, or use the property in connection with other property sold or the provision of a service, to a foreign unrelated party before the property was subject to a domestic use, the sale by PRS to FC is not a FDDEI sale. See § 1.250(b)–6(c)(1). Accordingly, the gain from the sale ($20x) is included in PRS's gross DEI but not its gross FDDEI, and DC's share of PRS's gain ($5x) is included in DC's gross DEI but not gross FDDEI. This is the result notwithstanding that FC is not a related party of DC because FC and DC are not members of a modified affiliated group within the meaning of paragraph (c)(17) of this section.

(f) *Determination of foreign-derived intangible income for consolidated groups.* A member of a consolidated group (as defined in § 1.1502–1(h)) determines its foreign-derived intangible income under the rules provided in § 1.1502–50.

(g) *Determination of foreign-derived intangible income for tax-exempt corporations.* The foreign-derived intangible income of a corporation that is subject to the unrelated business income tax under section 511 is determined only by reference to that corporation's items of income, gain, deduction, or loss, and adjusted bases in property, that are taken into account in computing the corporation's unrelated business taxable income (as defined in section 512). For example, if a corporation that is subject to the unrelated business income tax under section 511 has tangible property used in the production of both unrelated business income and gross income that is not unrelated business income, only the portion of the basis of such property taken into account in computing the corporation's unrelated business taxable income is taken into account in determining the corporation's qualified business asset investment. Similarly, if a corporation that is subject to the unrelated business income tax under section 511 has tangible property that is used in both the production of gross DEI and the production of gross income that is not gross DEI, only the corporation's unrelated business income is taken into account in determining the corporation's dual use ratio with respect to such property under § 1.250(b)–2(d)(2).

§ 1.250(b)–2 Qualified business asset investment.

(a) *Scope.* This section provides general rules for determining the qualified business asset investment of a domestic corporation for purposes of determining its deemed tangible income return under § 1.250(b)–1(c)(4). Paragraph (b) of this section defines qualified business asset investment. Paragraph (c) of this section defines tangible property and specified tangible property. Paragraph (d) of this section provides rules for determining the portion of property that is specified tangible property when the property is used in the production of both gross DEI and gross income that is not gross DEI. Paragraph (e) of this section provides rules for determining the adjusted basis of specified tangible property. Paragraph (f) of this section provides rules for determining qualified business asset investment of a domestic corporation with a short taxable year. Paragraph (g) of this section provides rules for increasing the qualified business asset investment of a domestic corporation by reason of property owned through a partnership. Paragraph (h) of this section provides an anti-avoidance rule that disregards certain transfers when determining the qualified business asset investment of a domestic corporation.

(b) *Definition of qualified business asset investment.* The term *qualified business asset investment* means the average of a domestic corporation's aggregate adjusted bases as of the close of each quarter of a domestic corporation's taxable year in specified tangible property that is used in a trade or business of the domestic corporation and is of a type with respect to which a deduction is allowable under section 167. See paragraph (f) of this section for rules relating to the qualified business asset investment of a domestic corporation with a short taxable year.

(c) *Specified tangible property*—(1) *In general.* The term *specified tangible property* means, subject to paragraph (d) of this section, tangible property used in the production of gross DEI.

(2) *Tangible property.* For purposes of paragraph (c)(1) of this section, the term *tangible property* means property for which the depreciation deduction provided by section 167(a) is eligible to be determined under section 168 without regard to section 168(f)(1), (2), or (5) and the date placed in service.

(d) *Dual use property*—(1) *In general.* In the case of tangible property (as defined in paragraph (c)(2) of this section) of a domestic corporation that is used in both the production of gross DEI and the production of gross income that is not gross DEI in a domestic corporation's taxable year, the portion of the adjusted basis in the property treated as adjusted basis in specified tangible property for the domestic corporation's taxable year is determined by multiplying the average of the domestic corporation's adjusted basis in the property by the dual use ratio with respect to the property for the domestic corporation's taxable year.

(2) *Dual use ratio.* The term *dual use ratio* means, with respect to specified tangible property—

(i) In the case of specified tangible property that produces directly identifiable income for a domestic corporation's taxable year, the ratio of the gross DEI produced by the property for the taxable year to the total amount of gross income produced by the property for the taxable year.

(ii) In the case of specified tangible property that does not produce directly identifiable income for a domestic corporation's taxable year, the ratio of the gross DEI of the domestic corporation for the taxable year to the total amount of gross income of the domestic corporation for the taxable year.

(3) *Example.* The following example illustrates the application of this paragraph (d).

(i) *Facts.* DC, a domestic corporation, owns a machine that produces both gross DEI and domestic oil and gas extraction income. For the taxable year, the machine produces gross DEI of $750x and domestic oil and gas extraction income of $250x. The average adjusted basis of the machine for the taxable year in the hands of DC is $4,000x. DC also owns an office building for its administrative functions with an average adjusted basis for the taxable year of $10,000x. The office building does not produce directly identifiable income. DC has no other specified tangible property. For the taxable year, DC's gross DEI is $2,000x and its gross income is $5,000x.

(ii) *Analysis.* The machine and office building are both property for which the depreciation deduction provided by section 167(a) are eligible to be determined under section 168. Therefore, under paragraph (c)(2) of this section, the machine and office building are tangible property. The machine and office building are used in both the production of gross income that is included in gross DEI and gross income that is not included in gross DEI, because domestic oil and gas extraction income is an item of gross income excluded from gross DEI under section 250(b)(3)(A)(i)(V) and § 1.250(b)–1(c)(14)(v). Therefore, under paragraph (d)(1) of this section, the portion of the basis in the machine treated as basis in specified tangible property is equal to DC's average basis in the machine for the year ($4,000x), multiplied by the dual use ratio under paragraph (d)(2)(i) of this section (0.75), which is the proportion that the gross DEI produced by the property ($750x) bears to the total gross income produced with respect to the property ($1,000x). Accordingly, $3,000x ($4,000x × 0.75) of DC's adjusted basis in the machine is taken into account in determining DC's qualified business asset investment. Under paragraph (d)(1) of this section, the portion of the basis in the office building treated as basis in specified tangible property is equal to DC's average basis in the office building for the year ($10,000x), multiplied by the dual use ratio under paragraph (d)(2)(ii) of this section (0.40), which is the ratio of DC's gross DEI for the taxable year ($2,000x) to DC's total gross income for the taxable year ($5,000x). Accordingly, $4,000x ($10,000x × 0.40) of DC's adjusted basis in the office building is taken into account in determining DC's qualified business asset investment under paragraph (b) of this section. Accordingly, DC's total qualified business asset investment is $7,000x ($3,000x + $4,000x).

(e) *Determination of adjusted basis of specified tangible property*—(1) *In general.* The adjusted basis in specified tangible property is determined by using the alternative depreciation system under section 168(g), and by allocating the depreciation deduction with respect to such property for the domestic corporation's taxable year ratably to each day during the period in the taxable year to which such depreciation relates.

(2) *Effect of change in law.* The determination of adjusted basis for purposes of paragraph (b) of this section is made without regard to any provision of law enacted after December 22, 2017, unless such later enacted law specifically and directly amends the definition of qualified business asset investment under section 250 or section 951A.

(3) *Specified tangible property placed in service before enactment of section 250.* The adjusted basis in property placed in service before December 22, 2017, is determined using the alternative depreciation system under section 168(g), as if this system had applied from the date that the property was placed in service.

(f) *Special rules for short taxable years*—(1) *In general.* In the case of a domestic corporation that has a taxable year that is less than twelve months (a *short taxable year*), the rules for determining the qualified business asset investment of the domestic corporation under this section are modified as provided in paragraphs (f)(2) and (3) of this section with respect to the taxable year.

(2) *Determination of quarter closes.* For purposes of determining quarter closes, in computing the qualified business asset investment of a domestic corporation for a short taxable year, the quarters of the domestic corporation for purposes of this section are the full quarters beginning and ending within the short taxable year (if any), determining quarter length as if the domestic corporation did not have a short taxable year, plus one or more short quarters (if any).

(3) *Reduction of qualified business asset investment.* The qualified business asset investment of a domestic corporation for a short taxable year is the sum of—

(i) The sum of the domestic corporation's aggregate adjusted bases in specified tangible property as of the close of each full quarter (if any) in the domestic corporation's taxable year divided by four; plus

(ii) The domestic corporation's aggregate adjusted bases in specified tangible property as of the close of each short quarter (if any) in the domestic corporation's taxable year multiplied by the sum of the number of days in each short quarter divided by 365.

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

(i) *Facts.* A, an individual, owns all of the stock of DC, a domestic corporation. A owns DC from the beginning of the taxable year. On July 15 of the taxable year, A sells DC to USP, a domestic corporation that is unrelated to A. DC becomes a member of the consolidated group of which USP is the common parent and as a result, under § 1.1502–76(b)(2)(ii), DC's taxable year is treated as ending on July 15. USP and DC both use the calendar year as their taxable year. DC's aggregate adjusted bases in specified tangible property for the taxable year are $250x as of March 31, $300x as of June 30, $275x as of July 15, $500x as of September 30, and $450x as of December 31.

(ii) *Analysis*—(A) *Determination of short taxable years and quarters.* DC has two short taxable years during the taxable year. The first short taxable year is from January 1 to July 15, with two full quarters (January 1–March 31 and April 1–June 30) and one short quarter (July 1–July 15). The second taxable year is from July 16 to December 31, with one short quarter (July 16–September 30) and one full quarter (October 1–December 31).

(B) *Calculation of qualified business asset investment for the first short taxable year.* Under paragraph (f)(2) of this section, for the first short taxable year, DC has three quarter closes (March 31, June 30, and July 15). Under paragraph (f)(3) of this section, the qualified business asset investment of DC for the first short taxable year is $148.80x, the sum of $137.50x (($250x + $300x)/4) attributable to the two full quarters and $11.30x ($275x × 15/365) attributable to the short quarter.

(C) *Calculation of qualified business asset investment for the second short taxable year.* Under paragraph (f)(2) of this section, for the second short taxable year, DC has two quarter closes (September 30 and December 31). Under paragraph (f)(3) of this section, the qualified business asset investment of DC for the second short taxable year is $217.98x, the sum of $112.50x ($450x/4) attributable to the one full quarter and $105.48x ($500x × 77/365) attributable to the short quarter.

(g) *Partnership property*—(1) *In general.* For purposes of paragraph (b) of this section, if a domestic corporation holds an interest in one or more partnerships as of the close of the domestic corporation's taxable year, the qualified business asset investment of the domestic corporation for its taxable year is increased by the sum of the domestic corporation's partnership QBAI with respect to each partnership for the domestic corporation's taxable year.

(2) *Definitions related to partnership QBAI*—(i) *In general.* The term *partnership QBAI* means the sum of the domestic corporation's share of the partnership's adjusted basis in partnership specified tangible property as of the close of a partnership taxable year that ends with or within a domestic corporation's taxable year. A domestic corporation's share of the partnership's adjusted basis in partnership specified tangible property is determined separately with respect to each partnership specified tangible property of the partnership by multiplying the partnership's adjusted basis in the property by the partnership QBAI ratio with respect to the property. If the partnership's taxable year is less than twelve months, the principles of paragraph (f) of this section apply in determining a domestic corporation's partnership QBAI with respect to the partnership.

(ii) *Partnership QBAI ratio.* The term *partnership QBAI ratio* means, with respect to partnership specified tangible property—

(A) In the case of partnership specified tangible property that produces directly identifiable income for a partnership taxable year, the ratio of the domestic corporation's distributive share of the gross income produced by the property for the partnership taxable year that is included in the gross DEI of the domestic corporation for its taxable year to the total gross income produced by the property for the partnership taxable year.

(B) In the case of partnership specified tangible property that does not produce directly identifiable income for a partnership taxable year, the ratio of the domestic corporation's distributive share of the gross income of the partnership for the partnership taxable year that is included in the gross DEI of the domestic corporation for its taxable year to the total amount of gross income of the partnership for the partnership taxable year.

(iii) *Partnership specified tangible property.* The term *partnership specified tangible property* means tangible property (as defined in paragraph (c)(2) of this section) of a partnership that is—

(A) Used in the trade or business of the partnership;

(B) Of a type with respect to which a deduction is allowable under section 167; and

(C) Used in the production of gross DEI.

(3) *Determination of adjusted basis.* For purposes of this paragraph (g), a partnership's adjusted basis in partnership specified tangible property is determined based on the average of the partnership's adjusted basis in the property as of the close of each quarter in the partnership taxable year. The principles of paragraphs (e) and (h) of this section apply for purposes of

determining a partnership's adjusted basis in partnership specified tangible property and the portion of such adjusted basis taken into account in determining a domestic corporation's partnership QBAI.

(4) *Example.* The following example illustrates the rules of this paragraph (g).

(i) *Facts.* DC, a domestic corporation, is a partner in PRS. Both DC and PRS use the calendar year as their taxable year. PRS owns two assets, Asset A and Asset B, both of which are tangible property used in PRS's trade or business that it depreciates under section 168. Asset A and Asset B are used solely in the production of gross DEI. The average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset A is $100x, and the average of PRS's adjusted basis as of the close of each quarter of PRS's taxable year in Asset B is $50x. Asset A produces $10x of directly identifiable gross income for the taxable year, and Asset B produces $50x of directly identifiable gross income for the taxable year. DC's distributive share of the gross income from Asset A is $8x and its distributive share of the gross income from Asset B is $10x. DC's entire distributive share of income from Asset A and Asset B is included in DC's gross DEI for the taxable year. See § 1.250(b)–1(e)(1). DC's distributive share satisfies the requirements of section 704(b).

(ii) *Analysis.* Each of Asset A and Asset B is partnership specified tangible property because each is tangible property, of a type with respect to which a deduction is allowable under section 167, used in PRS's trade or business, and used in the production of gross DEI. DC's partnership QBAI ratio for Asset A is 80%, the ratio of DC's distributive share of the gross income from Asset A for the taxable year that is included in DC's gross DEI ($8x) to the total gross income produced by Asset A for the taxable year ($10x). DC's partnership QBAI ratio for Asset B is 20%, the ratio of DC's distributive share of the gross income from Asset B for the taxable year that is included in DC's gross DEI ($10x) to the total gross income produced by Asset B for the taxable year ($50x). DC's share of the average of PRS's adjusted basis of Asset A is $80x, PRS's adjusted basis in Asset A of $100x multiplied by DC's partnership QBAI ratio for Asset A of 80%. DC's share of the average of PRS's adjusted basis of Asset B is $10x, PRS's adjusted basis in Asset B of $50x multiplied by DC's partnership QBAI ratio for Asset B of 20%. Therefore, DC's partnership QBAI with respect to PRS is $90x ($80x + $10x). Accordingly, under paragraph (g)(1) of this section, DC increases its qualified business asset investment for the taxable year by $90x.

(h) *Anti-avoidance rule for certain transfers of property*—(1) *In general.* If, with a principal purpose of decreasing the amount of its deemed tangible income return, a domestic corporation transfers specified tangible property (*transferred property*) to a specified related party of the domestic corporation and, within the disqualified period, the domestic corporation or an FDII-eligible related party of the domestic corporation leases the same or substantially similar property from any specified related party, then, solely for purposes of determining the qualified business asset investment of the domestic corporation under paragraph (b) of this section, the domestic corporation is treated as owning the transferred property from the later of the beginning of the term of the lease or date of the transfer of the property until the earlier of the end of the term of the lease or the end of the recovery period of the property.

(2) *Rule for structured arrangements.* For purposes of paragraph (h)(1) of this section, a transfer of specified tangible property to a person that is not a related party or lease of property from a person that is not a related party is treated as a transfer to or lease from a specified related party if the transfer or lease is pursuant to a structured arrangement. A structured arrangement exists only if either paragraph (h)(2)(i) or (ii) of this section is satisfied.

(i) The reduction in the domestic corporation's deemed tangible income return is a material factor in the pricing of the arrangement with the transferee.

(ii) Based on all the facts and circumstances, the reduction in the domestic corporation's deemed tangible income return is a principal purpose of the arrangement. Facts and circumstances that indicate the reduction in the domestic corporation's deemed tangible income return is a principal purpose of the arrangement include—

(A) Marketing the arrangement as tax-advantaged where some or all of the tax advantage derives from the reduction in the domestic corporation's deemed tangible income return;

(B) Primarily marketing the arrangement to domestic corporations which earn foreign-derived deduction eligible income;

(C) Features that alter the terms of the arrangement, including the return, in the event the reduction in the domestic corporation's deemed tangible income return is no longer relevant; or

(D) A below-market return absent the tax effects or benefits resulting from the reduction in the domestic corporation's deemed tangible income return.

(3) *Per se rules for certain transactions.* For purposes of paragraph (h)(1) of this section, a transfer of property by a domestic corporation to a specified related party (including a party deemed to be a specified related party under paragraph (h)(2) of this section) followed by a lease of the same or substantially similar property by the domestic corporation or an FDII-eligible related party from a specified related party (including a party deemed to be a specified related party under paragraph (h)(2) of this section) is treated per se as occurring pursuant to a principal purpose of decreasing the amount of the domestic corporation's deemed tangible income return if both the transfer and the lease occur within a six-month period.

(4) *Definitions related to anti-avoidance rule.* The following definitions apply for purpose of this paragraph (h).

(i) *Disqualified period.* The term *disqualified period* means, with respect to a transfer, the period beginning one year before the date of the transfer and ending the earlier of the end of the remaining recovery period (under the system described in section 951A(d)(3)(A)) of the property or one year after the date of the transfer.

(ii) *FDII-eligible related party.* The term *FDII-eligible related party* means, with respect to a domestic corporation, a member of the same consolidated group as the domestic corporation or a partnership with respect to which at least 80 percent of the interests in partnership capital and profits are owned, directly or indirectly, by the domestic corporation or one or more members of the consolidated group that includes the domestic corporation.

(iii) *Specified related party.* The term *specified related party* means, with respect to a domestic corporation, a related party (as defined in § 1.250(b)–1(c)(19)) other than an FDII-eligible related party.

(iv) *Transfer.* The term *transfer* means any disposition, exchange, contribution, or distribution of property, and includes an indirect transfer. For example, a transfer of an interest in a partnership is treated as a transfer of the assets of the partnership. In addition, if paragraph (h)(1) of this section applies to treat a domestic corporation as owning specified tangible property by reason of a lease of the property, the termination or lapse of the lease of the property is treated as a transfer of the property by the domestic corporation to the lessor.

(5) *Examples.* The following examples illustrate the application of this paragraph (h).

(i) *Example 1: Sale-leaseback with a related party*—(A) *Facts.* DC, a domestic corporation, owns Asset A, which is specified tangible property. DC also owns all the single class of stock of DS, a domestic corporation, and FS1 and FS2, each a controlled foreign corporation. DC and DS are members of the same consolidated group. On January 1, Year 1, DC sells Asset A to FS1. At the time of the sale, Asset A had a remaining recovery period of 10 years under the alternative depreciation system. On February 1, Year 1, FS2 leases Asset B, which is substantially similar to Asset A, to DS for a five-year term ending on January 31, Year 6.

(B) *Analysis.* Because DC transfers specified tangible property (Asset A), to a specified related party of DC (FS1), and, within a six month period (January 1, Year 1 to February 1, Year 1), an FDII-eligible related party of DC (DS) leases a substantially similar property (Asset B), DC's transfer of Asset A and lease of Asset B are treated as per se occurring pursuant to a principal purpose of decreasing the amount of its deemed tangible income return. Accordingly, for purposes of determining DC's qualified business asset investment, DC is treated as owning Asset A from February 1, Year 1, the later of the date of the transfer of Asset A (January 1, Year 1) and the beginning of the term of the lease of Asset B (February 1, Year 1), until January 31, Year 6, the earlier of the end of the term of the lease of Asset B (January 31, Year 6) or the remaining recovery period of Asset A (December 31, Year 10).

(ii) *Example 2: Sale-leaseback with a related party; lapse of initial lease*—(A) *Facts.* The facts are the same as in paragraph (h)(5)(i)(A) of this section (the facts in *Example 1*). In addition, DS allows the lease of Asset B to expire on February 1, Year 6. On June 1, Year 6, DS and FS2 renew the lease for a five-year term ending on May 31, Year 11.

(B) *Analysis.* Because DC is treated as owning Asset A under paragraph (h)(1) of this section, the lapse of the lease of Asset B is treated as a transfer of Asset A to FS2 on February 1, Year 6, under paragraph (h)(4)(iv) of this section. Further, because DC is deemed to transfer specified tangible property (Asset A) to a specified related party (FS2) upon the lapse of the lease, and within a six month period (February 1, Year 6 to June 1, Year 6), an FDII-eligible related party of DC (DS) leases a substantially similar property (Asset B), DC's deemed transfer of Asset A under paragraph (h)(4)(iv) of this section and lease of Asset B are treated as per se occurring pursuant to a principal purpose of decreasing the amount of its deemed tangible income return. Accordingly, for purposes of determining DC's qualified business asset investment, DC is treated as owning Asset A from June 1, Year 6, the later of the date of the deemed transfer of Asset A (February 1, Year 6) and the beginning of the term of the lease of Asset B (June 1, Year 6), until December 31, Year 10, the earlier of the end of the term of the lease of Asset B (May 31, Year 11) or the remaining recovery period of Asset A (December 31, Year 10).

§ 1.250(b)–3 FDDEI transactions.

(a) *Scope.* This section provides rules related to the determination of whether a sale of property or provision of a service is a FDDEI transaction. Paragraph (b) of this section provides definitions related to the determination of whether a sale of property or provision of a service is a FDDEI transaction. Paragraph (c) of this section provides rules regarding a sale of property or provision of a service to a foreign government or an international organization. Paragraph (d) of this section provides rules for determining the reliability of documentation. Paragraph (e) of this section provides a rule for characterizing a transaction with both sales and services elements. Paragraph (f) of this section provides a rule for treating certain loss transactions as FDDEI transactions. Paragraph (g) of this section provides a rule for determining whether a sale of property or provision of a service to a partnership is a FDDEI transaction.

(b) *Definitions.* This paragraph (b) provides definitions that apply for purposes of this section and §§ 1.250(b)–4 through 1.250(b)–6.

(1) *FDII filing date.* The term *FDII filing date* means, with respect to a sale of property by a seller or provision of a service by a renderer, the date, including extensions, by which the seller or renderer is required to file an income tax return (or in the case of a seller or renderer that is a partnership, a return of partnership income) for the taxable year in which the gross income from the sale of property or provision of a service is included in the gross income of the seller or renderer.

(2) *Foreign person.* The term *foreign person* means a person that is not a United States person, and includes a foreign government or an international organization.

(3) *General property.* The term *general property* means any property other than—

(i) Intangible property;

(ii) A security (as defined in section 475(c)(2)); or

(iii) A commodity (as defined in section 475(e)(2)(B) through (D)).

(4) *Intangible property.* The term *intangible property* has the meaning set forth in section 367(d)(4).

(5) *Recipient.* The term *recipient* means a person that purchases property or services from a seller or renderer.

(6) *Renderer.* The term *renderer* means a person that provides a service to a recipient.

(7) *Sale.* The term *sale* means any sale, lease, license, exchange, or disposition of property, and includes any transfer of property in which gain or income is recognized under section 367.

(8) *Seller.* The term *seller* means a person that sells property to a recipient.

(9) *United States.* The term *United States* has the meaning set forth in section 7701(a)(9), as expanded by section 638(1) with respect to mines, oil and gas wells, and other natural deposits.

(10) *United States person.* The term *United States person* has the meaning set forth in section 7701(a)(30), except that the term does not include an individual that is a bona fide resident of a United States territory within the meaning of section 937(a).

(11) *United States territory.* The term *United States territory* means American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands.

(c) *Foreign military sales.* For purposes of determining whether a sale of property or a provision of a service is a FDDEI transaction, if a sale of property or a provision of a service is made to the United States or an instrumentality thereof pursuant to 22 U.S.C. 2751 *et seq.* under which the United States or an instrumentality thereof purchases the property or service for resale or on-service, on commercial terms, to a foreign government or agency or instrumentality thereof, and the contract between the seller or renderer and the United States or an instrumentality thereof provides that the sale or service is purchased for resale or on-service to such foreign government or agency or instrumentality thereof, then the sale of property or provision of a service is treated as a sale of property or a provision of a service to the foreign government.

(d) *Reliability of documentation.* For purposes of the documentation requirements described in §§ 1.250(b)–4 through 1.250(b)–6, documentation is reliable only if each of the requirements described in paragraphs (d)(1) through (3) of this section is satisfied.

(1) As of the FDII filing date, the seller or renderer does not know and does not have reason to know that the documentation is unreliable or incorrect. For this purpose, a seller or renderer has reason to know that documentation is unreliable or incorrect if its knowledge of all the relevant facts or statements contained in the documentation is such that a reasonably prudent person in the position of the seller or renderer would question the accuracy or reliability of the documentation.

(2) The documentation is obtained by the seller or renderer by the FDII filing date with respect to the sale or service.

(3) The documentation is obtained no earlier than one year before the date of the sale or service.

(e) *Transactions with multiple elements.* If a transaction includes both a sale component and a service component, the transaction is classified according to the overall predominant character of the transaction for purposes of determining whether the transaction is subject to § 1.250(b)–4 or § 1.250(b)–5.

(f) *Treatment of certain loss transactions*—(1) *In general.* If a seller knows or has reason to know that property is sold to a foreign person for a foreign use (within the meaning of § 1.250(b)–4(d)(2) or (e)(2)) or a renderer knows or has reason to know that a general service (as defined in § 1.250(b)–5(c)(4)) is provided to a person located outside the United States (within the meaning of § 1.250(b)–5(d)(2) or (e)(2)), but the seller or renderer does not satisfy the documentation requirements described in § 1.250(b)–4(c)(2), (d)(3), or (e)(3) or § 1.250(b)–5(d)(3) or (e)(3), as applicable, the transaction is deemed to be a FDDEI transaction with respect to a domestic corporation if not treating the transaction as a FDDEI transaction would increase the amount of the corporation's foreign-derived deduction eligible income for the taxable year relative to its foreign-derived deduction eligible income that would be determined if the transaction were treated as a FDDEI transaction. If a seller or renderer engages in more than one transaction described in the preceding sentence in a taxable year, the previous sentence applies by comparing the corporation's foreign-derived deduction eligible income if each such transaction were not treated as a FDDEI transaction to its foreign-derived deduction eligible income if each such transaction were treated as a FDDEI transaction.

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

(i) *Facts.* During a taxable year, DC, a domestic corporation, manufactures products A and B in the United States. DC sells product A for $200x and product B for $800x. DC knows or has reason to know that all of its sales of product A and product B are to foreign persons for a foreign use. DC establishes that its sales of product B are to foreign persons for a foreign use but does not obtain documentation establishing that any sales of product A are to foreign person for a foreign use. DC's cost of goods sold is $450x. For purposes of determining gross FDDEI, under § 1.250(b)–1(d)(1) DC attributes $250x of cost of goods sold to product A and $200x of cost of goods sold to product B, and then attributes the cost of goods sold for each product ratably between the gross receipts of such product sold to foreign persons and the gross receipts of such product not sold to foreign persons. The manner in which DC attributes the cost of goods sold is a reasonable method. DC has no other items of income, loss, or deduction.

TABLE 1 TO PARAGRAPH (f)(2)(i)

	Product A	Product B	Total
Gross receipts	$200x	$800x	$1,000x
Cost of Goods Sold	250x	200x	450x
Gross Income (Loss)	(50x)	600x	550x

(ii) *Analysis.* By not treating the sales of product A as FDDEI sales, the amount of DC's foreign-derived deduction eligible income would increase by $50x relative to its foreign-derived deduction eligible income if the sales of product A were treated as FDDEI sales. Accordingly, because DC knows or has reason to know that its sales of product A are to foreign persons for a foreign use, the sales of product A constitute FDDEI sales under paragraph (f)(1) of this section, and thus the $50x loss from the sale of product A is included in DC's gross FDDEI.

(g) *Treatment of partnerships*—(1) *In general.* For purposes of determining whether a sale of property to or by a partnership or a provision of a service to or by a partnership is a FDDEI transaction, a partnership is treated as a person. Accordingly, for example, a partnership may be a seller, renderer, recipient, or related party, including a foreign related party (as defined in § 1.250(b)–6(b)(1)).

(2) *Examples.* The following examples illustrate the application of this paragraph (g).

(i) *Example 1: Domestic partner sale to foreign partnership with a foreign branch*—(A) *Facts.* DC, a domestic corporation, is a partner in PRS, a foreign partnership. DC and PRS are not related parties. PRS has a foreign branch within the meaning of § 1.904–4(f)(3)(iii). DC and PRS both use the calendar year as their taxable year. For the taxable year, DC recognizes $20x of gain on the sale of general property to PRS for a foreign use (as determined under § 1.250(b)–4(d)). During the same taxable year, PRS recognizes an additional $20x of gain on the sale of the property to a foreign person for a foreign use (as determined under § 1.250(b)–4(d)). PRS's income on the sale of the property is attributable to its foreign branch.

(B) *Analysis.* DC's sale of property to PRS, a foreign partnership, is a FDDEI sale because it is a sale to a foreign person for a foreign use. Therefore, DC's gain of $20x on the sale to PRS is included in DC's gross DEI and gross FDDEI. However, PRS's gain of $20x is not included in the gross DEI or gross FDDEI of PRS because the gain is foreign branch income within the meaning of § 1.250(b)–1(c)(11). Accordingly, none of PRS's gain on the sale of property is included in DC's gross DEI or gross FDDEI under § 1.250(b)–1(e)(1).

(ii) *Example 2: Domestic partner sale to domestic partnership without a foreign branch*—(A) *Facts.* The facts are the same as in paragraph (g)(2)(i)(A) of this section (the facts in *Example 1*), except PRS is a domestic partnership that does not have a foreign branch within the meaning of § 1.904–4(f)(3)(iii).

(B) *Analysis.* DC's sale of property to PRS, a domestic partnership, is not a FDDEI sale because the sale is to a United States person. Therefore, the gross income from DC's sale to PRS is included in DC's gross DEI, but is not included in its gross FDDEI. However, PRS's subsequent sale is a FDDEI sale, and therefore the gain of $20x is included in the gross DEI and gross FDDEI of PRS. Accordingly, DC includes its distributive share of PRS's gain from the sale in determining DC's gross DEI and gross FDDEI for the taxable year under § 1.250(b)–1(e)(1).

§ 1.250(b)–4 FDDEI sales.

(a) *Scope.* This section provides rules for determining whether a sale of property is a FDDEI sale. Paragraph (b) of this section defines a FDDEI sale. Paragraph (c) of this section provides rules for determining whether a recipient is a foreign person. Paragraph (d) of this section provides rules for determining whether general property is sold for a foreign use. Paragraph (e) of this section provides rules for determining whether intangible property is sold for a foreign use. Paragraph (f) of this section provides a special rule for the sale of certain financial instruments.

(b) *Definition of FDDEI sale.* Except as provided in § 1.250(b)–6(c), the term *FDDEI sale* means a sale of general property or intangible property to a foreign person (as determined under paragraph (c) of this section) for a foreign use (as determined under paragraphs (d) and (e) of this section).

(c) *Foreign person*—(1) *In general.* A recipient is a foreign person for purposes of paragraph (b) of this section only if the seller establishes that the recipient is a foreign person by obtaining the documentation described in paragraph (c)(2) of this section (which meets the reliability requirements described in § 1.250(b)–3(d)) and, as of the FDII filing date, the seller does not know or have reason to know that the recipient is not a foreign person.

(2) *Documentation of status as a foreign person*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, a seller establishes the status of a recipient as a foreign person by obtaining one or more of the following types of documentation with respect to the person—

(A) A written statement by the recipient that the recipient is a foreign person;

(B) With respect to a recipient that is an entity, documentation that establishes that the entity is organized or created under the laws of a foreign jurisdiction;

(C) With respect to an individual, any valid identification issued by a foreign government or an agency thereof that is typically used for identification purposes;

(D) Documents filed with a government or an agency or instrumentality thereof that provide the foreign jurisdiction of organization or residence of an entity (for example, a publicly traded corporation's annual report filed with the U.S. Securities and Exchange Commission that includes the jurisdiction of organization or residence of foreign subsidiaries of the corporation); or

(E) Any other forms of documentation as prescribed by the Secretary in forms, instructions, or other guidance.

(ii) *Special rules*—(A) *Special rule for small businesses.* A seller that receives less than $10,000,000 in gross receipts during a prior taxable year establishes the status of any recipient as a foreign person for a taxable year if the seller's shipping address for the recipient is outside the United States. If the seller's prior taxable year was less than 12 months (a short period), gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period.

(B) *Special rule for small transactions.* A seller that receives less than $5,000 in gross receipts during a taxable year from a recipient establishes the status of such recipient as a foreign person for such taxable year if the seller's shipping address for the recipient is outside the United States.

(d) *Foreign use for general property*—(1) *In general.* The sale of general property is for a foreign use only if the seller establishes that the property is for a foreign use within the meaning of paragraph (d)(2) of this section by obtaining the documentation described in paragraph (d)(3) of this section (which meets the reliability requirements described in § 1.250(b)–3(d)) and, as of the FDII filing date, the seller does not know or have reason to know that the property is not for a foreign use within the meaning of paragraph (d)(2) of this section.

(2) *Determination of foreign use*—(i) *In general.* Except as provided in paragraph (d)(2)(iv) of this section, the sale of general property is for a foreign use if—

(A) The property is not subject to a domestic use within three years of the date of delivery; or

(B) The property is subject to manufacture, assembly, or other processing outside the United States before the property is subject to a domestic use.

(ii) *Determination of domestic use.* General property is subject to domestic use if—

(A) The property is subject to any use, consumption, or disposition within the United States; or

(B) The property is subject to manufacture, assembly, or other processing within the United States.

(iii) *Determination of manufacture, assembly, or other processing*—(A) *In general.* General property is subject to manufacture, assembly, or other processing only if the property is physically and materially changed (as described in paragraph (d)(2)(iii)(B) of this section) or the property is incorporated as a component into a second product (as described in paragraph (d)(2)(iii)(C) of this section).

(B) *Property subject to a physical and material change.* For purposes of paragraph (d)(2)(iii)(A) of this section, the determination of whether general property is subject to a physical and material change is made based on all the relevant facts and circumstances. However, general property is not considered subject to physical and material change if it is subject only to minor assembly, packaging, or labeling.

(C) *Property incorporated into second product as a component.* For purposes of paragraph (d)(2)(iii)(A) of this section, general property is treated as a component incorporated into a second product only if the fair market value of such property when it is delivered to the recipient constitutes no more than 20 percent of the fair market value of the second product, determined when the second product is completed. For purposes of the preceding sentence, all general property that is sold by the seller and incorporated into the second product is treated as a single item of property.

(iv) *Determination of foreign use for transportation property.* In the case of aircraft, railroad rolling stock, vessel, motor vehicle, or similar property that provides a mode of transportation and is capable of traveling internationally (*international transportation property*), such property is for a foreign use only if, during the three year period from the date of delivery, the property is located outside the United States more than 50 percent of the time and more than 50 percent of the miles traversed in the use of the property are traversed outside the United States. For purposes of the preceding sentence, international transportation property is deemed to be within the United States at all times during which it is engaged in transport between any two points within the United States, except where the transport constitutes uninterrupted international air transportation within the meaning of section 4262(c)(3) and the regulations under that section (relating to tax on air transportation of persons).

(3) *Documentation of foreign use of general property*—(i) *In general.* Except as provided in paragraphs (d)(3)(ii) and (iii) of this section, a seller establishes that general property, or a portion of a particular class of fungible general property, is for a foreign use only if the seller obtains one or more of the following types of documentation with respect to the sale—

(A) A written statement from the recipient or a related party of the recipient that the recipient's use or intended use of the property is for a foreign use (within the meaning of paragraph (d)(2) of this section);

(B) A binding contract between the seller and the recipient which provides that the recipient's use or intended use of the property is for a foreign use (within the meaning of paragraph (d)(2) of this section);

(C) Except in the case of international transportation property, documentation of shipment of the general property (including both property located within the United States or outside the United States, such as in a warehouse, storage facility, or assembly site located outside United States) to a location outside the United States (for example, a copy of the export bill of lading issued by the carrier which delivered the property, or a copy of the certificate of lading for the property executed by a customs officer of the country to which the property is delivered); or

(D) Any other forms of documentation as prescribed by the Secretary in forms, instructions, or other guidance.

(ii) *Special rules*—(A) *Special rule for small businesses.* A seller that receives less than $10,000,000 in gross receipts during the prior taxable year establishes that the sale of general property in a taxable year to any recipient is for a foreign use for the taxable year if the seller's shipping address for the recipient is outside the United States. If the seller's prior taxable year was a short period, gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period.

(B) *Special rule for small transactions.* A seller that receives less than $5,000 in gross receipts during a taxable year from a recipient establishes that the sale of general property to the recipient is for a foreign use for the taxable year if the seller's shipping address for the recipient is outside the United States.

(iii) *Sales of fungible mass of general property.* In the case of sales of multiple items of general property, which because of their fungible nature cannot reasonably be specifically traced to the location of use (*fungible mass*), as an alternative to obtaining the documentation described in paragraphs (d)(3)(i)(A) through (D) of this section, a seller may establish that a portion of the fungible mass is for a foreign use through market research, including statistical sampling, economic modeling and other similar methods indicating that the property will be subject to a foreign use. If, under the preceding sentence, the seller establishes that 90 percent or more of a fungible mass is for a foreign use, then the entire fungible mass is for a foreign use. If, under the first sentence of this paragraph (d)(3)(iii), the seller does not establish that 10 percent or more of the sale of a fungible mass is for a foreign use, then no portion of the fungible mass is for a foreign use.

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

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC is a domestic corporation.

(B) FP is a foreign person that is a foreign unrelated party (as defined in § 1.250(b)–6(b)(2)) with respect to DC, and DC obtains documentation establishing that FP is a foreign person.

(C) Any documentation obtained meets the reliability requirements described in § 1.250(b)–3(d).

(D) The treatment of any sale as a FDDEI sale would not reduce DC's foreign-derived deduction eligible income for the year.

(ii) *Examples.*

(A) *Example 1: Manufacturing outside the United States*—(*1*) *Facts.* DC sells general property for $18x to FP for manufacture outside the United States and obtains documentation of shipment of the property to a location outside the United States. DC does not know or have reason to know that the property will be subject to a domestic use before manufacture, but DC knows or has reason to know that the property will be subject to a domestic use after manufacture and within three years of delivery to FP. FP will incorporate the property into a second product outside the United States that FP will sell to a United States person for $100x. The property is not physically or materially changed in the process of its incorporation into the second product.

(*2*) *Analysis.* Because the fair market value of the general property FP purchases from DC and incorporates into the second product does not exceed 20% of the fair market value of the second product, the general property FP purchases from DC is a component, and therefore the property is treated as subject to manufacture, assembly, or other processing outside the United States. See paragraphs (d)(2)(iii)(A) and (B) of this section. As a result, notwithstanding that DC knows or has reason to know that the property will be subject to a domestic use within three years of delivery, DC does not know or have reason to know that its sale of general property to FP is not for a foreign use. See paragraph (d)(2)(i)(B) of this section. Accordingly, DC's sale of property to FP is for a foreign use under paragraph (d)(2) of this section, and the sale is a FDDEI sale.

(B) *Example 2: Manufacturing outside the United States*—(*1*) *Facts.* The facts are the same as in paragraph (d)(2)(iv)(A)(*1*) of this section (the facts in *Example 1*), except FP purchases the general property from DC for $25x.

(*2*) *Analysis.* Because the fair market value of the general property FP purchases from DC and incorporates into the second product exceeds 20% of the fair market value of the second product, the general property is not treated as a component of the second product. Because the property is also not subject to a physical and material change in the process of incorporation into the second product, the property is not subject to manufacture, assembly, or other processing outside the United States. As a result, because DC knows or has reason to know that FP will sell the second product, which includes the property, for domestic use, DC knows or has reason to know that its sale of general property to FP is not for a foreign use. Accordingly, DC's sale of the property to FP is not for a foreign use under paragraph (d)(2) of this section, and the sale is not a FDDEI sale.

(C) *Example 3: Sale of a fungible mass of products*—(*1*) *Facts.* DC and persons other than DC sell multiple units of fungible general property to FP during the taxable year. DC obtains documentation of shipment of the property to a location outside the United States, but it knows or has reason to know that some portion of the property will be resold back to customers in the United States. DC also engages in reliable market research that determines that approximately 25% of the fungible general property FP sold during the taxable year is for domestic use.

(*2*) *Analysis.* Notwithstanding that the documentation of shipment meets the reliability requirements of § 1.250(b)–3(d), DC knows or has reason to know that certain units of the property are not for a foreign use. See paragraphs (d)(1) and (2) of this section. However, DC can establish foreign use of a portion of the fungible property through its market research. See paragraphs (d)(1) and (d)(3)(iii) of this section. Based on its market research, DC knows that approximately 25% of the total units of fungible general property that FP purchased from all persons in the taxable year is sold by FP for domestic use. Accordingly, DC satisfies the test for a foreign use under paragraph (d)(2) of this section with respect to 75% of its sales of the property to FP.

(e) *Foreign use for intangible property*—(1) *In general.* A sale of intangible property is for a foreign use only to the extent the seller establishes that the sale is for a foreign use within the meaning of paragraph (e)(2) of this section by obtaining documentation described in paragraph (e)(3) of this section (which meets the reliability requirements described in § 1.250(b)-3(d)) and, as of the FDII filing date, the seller does not know or have reason to know that the portion of the sale of the intangible property for which the seller establishes foreign use is not for a foreign use within the meaning of paragraph (e)(2) of this section.

(2) *Determination of foreign use*—(i) *In general.* A sale of intangible property is for a foreign use only to the extent that the intangible property generates revenue from exploitation outside the United States. A sale of intangible property rights providing for exploitation both within the United States and outside the United States is for a foreign use in proportion to the revenue generated from exploitation of the intangible property outside the United States over the total revenue generated from the exploitation of the intangible property. For intangible property used in the development, manufacture, sale, or distribution of a product, the intangible property is treated as exploited at the location of the end user when the product is sold to the end user. Paragraphs (e)(2)(ii) and (iii) of this section provide rules for how and when to determine revenue from exploitation with respect to different types of sales of intangible property.

(ii) *Sales in exchange for periodic payments.* In the case of a sale of intangible property to a foreign person in exchange for periodic payments, the extent to which the sale is for a foreign use is determined on an annual basis based on the actual revenue earned by the recipient for the taxable year in which a periodic payment is received.

(iii) *Sales in exchange for a lump sum.* In the case of a sale of intangible property to a foreign person for a lump sum, the extent to which the sale is for a foreign use is determined based on the ratio of the total net present value of revenue the seller would have reasonably expected to earn from the exploitation of the intangible property outside the United States to the total net present value of revenue the seller would have reasonably expected to earn from the exploitation of the intangible property.

(3) *Documentation of foreign use of intangible property*—(i) *Documentation for sales for periodic payments.* Except as provided in paragraph (e)(3)(ii) of this section, a seller establishes the extent to which a sale of intangible property described in paragraph (e)(2)(ii) of this section is for a foreign use by obtaining one or more of the following types of documentation with respect to the sale—

(A) A written statement from the recipient providing the amount of the annual revenue from sales or sublicenses of the intangible property or sales of products with respect to which the intangible property is used that is generated as a result of exploitation of the intangible property outside the United States and the total amount of revenue from such sales or sublicenses worldwide;

(B) A binding contract for the sale of the intangible property that provides that the intangible property can be exploited solely outside the United States;

(C) Audited financial statements or annual reports of the recipient stating the amount of annual revenue earned within the United States and outside the United States from sales of products with respect to which the intangible property is used;

(D) Any statements or documents used by the seller and the recipient to determine the amount of payment due for exploitation of the intangible property if those statements or documents provide reliable data on revenue earned within the United States and outside the United States; or

(E) Any other forms of documentation as prescribed by the Secretary in forms, instructions, or other guidance.

(ii) *Certain sales to foreign unrelated parties.* In the case of a sale of intangible property described in paragraph (e)(2)(ii) of this section that are not contingent on revenue or profit to a foreign unrelated party (as defined in § 1.250(b)–6(b)(2)), where the seller is unable to obtain the documentation described in paragraph (e)(3)(i) of this section without undue burden, a seller establishes the extent to which the sale of intangible property is for a foreign use using the principles of paragraph (e)(3)(iii) of this section, except that the seller must make reasonable projections on an annual basis.

(iii) *Documentation for sales in exchange for a lump sum.* A seller establishes the extent to which a sale of intangible property described in paragraph (e)(2)(iii) of this section is for a foreign use through documentation containing reasonable projections of the amount and location of revenue that the seller would have reasonably expected to earn from exploiting the intangible property. To be considered reasonable, the projections must be consistent with the financial data and projections used by the seller to determine the price it sold the intangible property to the foreign person.

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

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC is a domestic corporation.

(B) Except as otherwise provided, FP and FP2 are foreign persons that are foreign unrelated parties (as defined in § 1.250(b)–6(b)(2)) with respect to DC.

(C) Any documentation obtained meets the reliability requirements described in § 1.250(b)–3(d).

(D) All of DC's income is deduction eligible income.

(E) The treatment of any sale as a FDDEI sale would not reduce DC's foreign-derived deduction eligible income for the year.

(ii) *Examples.*

(A) *Example 1: License of worldwide rights with documentation*—(*1*) *Facts.* DC licenses to FP worldwide rights to the copyright to composition A in exchange for annual royalties of $60x. FP sells composition A to customers through digital downloads from servers. In the taxable year, FP earns $100x in revenue from sales of copies of composition A to customers, of which $60x is from customers located in the United States and the remaining $40x is from customers located outside the United States. FP provides DC with records showing the amount of revenue earned in the taxable year from sales of composition A to establish the royalties owed to DC. These records also provide DC with the amount of revenue earned from sales of composition A in different countries, including the United States.

(*2*) *Analysis.* Based on the information provided, DC has obtained documentation establishing that 40% ($40x/$100x) of the revenue generated by the copyright during the taxable year is earned outside the United States. Accordingly, a portion of DC's license to FP is for a foreign use under paragraph (e)(2) of this section and therefore such portion is a FDDEI sale. The $24x of royalty ($0.40 \times \$60x$) derived with respect to such portion is included in DC's gross FDDEI for the taxable year.

(B) *Example 2: License of worldwide rights without documentation*—(*1*) *Facts.* The facts are the same as in paragraph (e)(4)(ii)(A)(*1*) of this section (the facts in *Example 1*), except FP does not provide DC with data showing how much revenue was earned from sales in different countries.

(*2*) *Analysis.* DC has not obtained documentation establishing the amount of revenue FP earned from sales of composition A outside the United States. Accordingly, DC's license of the copyright is not for a foreign use under paragraph (e)(2) of this section and is not a FDDEI sale.

(C) *Example 3: Sale of patent rights protected in the United States and other countries; documentation through financial projections*—(*1*) *Facts.* DC owns a patent for an active pharmaceutical ingredient (''API'') approved for treatment of disease A (''indication A'') in the United States and in Countries A, B, and C. The patent is registered in the United States and in Countries A, B, and C. DC sells to FP all of its patent rights to the API for indication A for a lump sum payment of $1,000x. DC has no basis in the patent rights. To determine the sales price for the patent rights, DC projected that the net present value of the revenue it would earn from selling a pharmaceutical product incorporating the API for indication A was $5,000x, with 15% of the revenue earned from sales within the United States and 85% of the revenue earned from sales outside the United States.

(*2*) *Analysis.* Based on the financial projections DC used to determine the sales price, DC has obtained documentation establishing that 85% of the revenue that will be generated by the patent rights will be outside the United States. Accordingly, a portion of DC's sale to FP is for a foreign use under paragraph (e)(2) of this section and such portion is a FDDEI sale. The $850x ($85\% \times \$1,000x$) of gain derived with respect to such portion is included in DC's gross FDDEI for the taxable year.

(D) *Example 4: Limited use license of copyrighted computer software; documentation through public filing*—(*1*) *Facts.* DC provides FP with a limited use license to copyrighted computer software in exchange for an annual fee of $100x. The limited use license restricts FP's use of the computer software to 100 of FP's employees. The limited use license prohibits FP from using the computer software in any way other than as an end-user, which includes prohibiting sublicensing, selling, reverse engineering, or modifying the computer software. FP's annual report for the taxable year indicates that all of FP's employees are physically located outside the United States.

(*2*) *Analysis.* The software licensed to FP is exploited where its employees that use the software are located. The revenue DC earns from the limited use license to FP is based on the number of FP's employees allowed to use the computer software as end-users. Based on FP's annual report for the taxable year, DC has obtained documentation establishing that all the revenue generated for the use of the copyrighted computer software is earned outside the United States for the taxable year. Accordingly, DC's license to FP is for a foreign use and therefore a FDDEI sale. The entire $100x of the license fee is included in DC's gross FDDEI for the taxable year.

(E) *Example 5: Limited use license of copyrighted computer software; documentation through public filing*—(*1*) *Facts.* The facts are the same as in paragraph (e)(4)(ii)(D)(*1*) of this section (the facts in *Example 4*), except that FP's annual report for the taxable year indicates that FP has offices both within and outside the United States, and that 50% of FP's revenue is earned within the United States.

(*2*) *Analysis.* Based on FP's annual report for the taxable year, DC has obtained documentation establishing that 50% of the revenue generated from the use of the copyrighted computer software is outside the United States for the taxable year. Accordingly, a portion of DC's license to FP is for a foreign use and therefore such portion is a FDDEI sale. The $50x of license fee derived with respect to such portion is included in DC's gross FDDEI for the taxable year.

(F) *Example 6: Deemed sale in exchange for contingent payments under section 367(d)*—(*1*) *Facts.* DC owns 100% of the stock of FP, a foreign related party (as defined in § 1.250(b)–6(b)(1)) with respect to DC. FP manufactures and sells product A. For the taxable year, DC contributes to FP exclusive worldwide rights to patents, trademarks, knowhow, customer lists, and goodwill and going concern value (collectively, intangible property) related to product A in an exchange described in section 351. As a result, DC is required to report an annual income inclusion on its Federal income tax return based on the productivity, use, or disposition of the contributed intangible property under section 367(d). DC includes a percentage of FP's revenue in its gross income under section 367(d) each year. In the current taxable year, FP earns $1,000x of revenue from sales of product A. Based on FP's sales records for the taxable year, $300x of its revenue is earned from sales of product A to customers within the United States, and $700x of its revenue is earned from sales of product A to customers outside the United States.

(*2*) *Analysis.* DC's deemed sale of the intangible property to FP in exchange for payments contingent upon the productivity, use, or disposition of the intangible property related to product A under section 367(d) is a sale for purposes of section 250 and this section. See § 1.250(b)–3(b)(7). Based on FP's sales records, DC has obtained documentation that 70% ($700/$1,000x) of the revenue generated by the intangible property is generated outside the United States in the taxable year. Accordingly, for the taxable year, 70% of DC's deemed sale to FP is for a foreign use, and 70% of DC's income inclusion under section 367(d) derived with respect to such portion is included in DC's gross FDDEI for the taxable year.

(f) *Special rule for certain financial instruments.* The sale of a security (as defined in section 475(c)(2)) or a commodity (as defined in section 475(e)(2)(B) through (D)) is not a FDDEI sale.

§ 1.250(b)–5 FDDEI services.

(a) *Scope.* This section provides rules for determining whether a provision of a service is a FDDEI service. Paragraph (b) of this section defines a FDDEI service. Paragraph (c) of this section provides definitions relevant for determining whether a provision of a service is a FDDEI service. Paragraph (d) of this section provides rules for determining whether a general service is provided to a consumer located outside the United States. Paragraph (e) of this section provides rules for determining whether a general service is provided to a business recipient located outside the United States. Paragraph (f) of this section provides rules for determining whether a proximate service is provided to a recipient located outside the United States. Paragraph (g) of this section provides rules for determining whether a service is provided with respect to property located outside the United States. Paragraph (h) of this section provides rules for determining whether a transportation service is provided to a recipient, or with respect to property, located outside the United States.

(b) *Definition of FDDEI service.* Except as provided in § 1.250(b)–6(d), the term *FDDEI service* means a provision of a service described in one of paragraphs (b)(1) through (5) of this section. If only a portion of a service is treated as provided to a person, or with respect to property, outside the United States, the provision of the service is a FDDEI service only to the extent of the gross income derived with respect to such portion.

(1) The provision of a general service to a consumer located outside the United States (as determined under paragraph (d) of this section).

(2) The provision of a general service to a business recipient located outside the United States (as determined under paragraph (e) of this section).

(3) The provision of a proximate service to a recipient located outside the United States (as determined under paragraph (f) of this section).

(4) The provision of a property service with respect to tangible property located outside the United States (as determined under paragraph (g) of this section).

(5) The provision of a transportation service to a recipient, or with respect to property, located outside the United States (as determined under paragraph (h) of this section).

(c) *Definitions.* This paragraph (c) provides definitions that apply for purposes of this section and § 1.250(b)–6.

(1) *Benefit.* The term *benefit* has the meaning set forth in § 1.482–9(l)(3).

(2) *Business recipient.* The term *business recipient* means a recipient other than a consumer.

(3) *Consumer.* The term *consumer* means a recipient that is an individual that purchases a general service for personal use.

(4) *General service.* The term *general service* means any service other than a property service, proximate service, or transportation service.

(5) *Property service.* The term *property service* means a service, other than a transportation service, provided with respect to tangible property, but only if substantially all of the service is performed at the location of the property and results in physical manipulation of the property such as through assembly, maintenance, or repair. Substantially all of a service is performed at the location of property if the renderer spends more than 80 percent of the time providing the service at or near the location of the property.

(6) *Proximate service.* The term *proximate service* means a service, other than a property service or a transportation service, provided to a recipient, but only if substantially all of the service is performed in the physical presence of the recipient or, in the case of a business recipient, its employees. Substantially all of a service is performed in the physical presence of the recipient or its employees if the renderer spends more than 80 percent of the time providing the service in the physical presence of the recipient or its employees.

(7) *Transportation service.* The term *transportation service* means a service to transport a person or property using aircraft, railroad rolling stock, vessel, motor vehicle, or any similar mode of transportation.

(d) *General services provided to consumers*—(1) *In general.* A general service is provided to a consumer located outside the United States only if the renderer establishes that the consumer is located outside the United States by obtaining the documentation described in paragraph (d)(3) of this section (which meets the reliability requirements described in § 1.250(b)–3(d)) and, as of the FDII filing date, the renderer does not know or have reason to know that the consumer is located within the United States (as determined under paragraph (d)(2) of this section) when the service is provided.

(2) *Location of consumer.* For purposes of paragraph (d)(1) of this section, the consumer of a general service is located where the consumer resides when the service is provided.

(3) *Documentation of location of consumer*—(i) *In general.* Except as

provided in paragraph (d)(3)(ii) of this section, a renderer establishes that a consumer is located outside the United States only if the renderer obtains one or more of the following types of documentation with respect to the consumer—

(A) A written statement by the consumer indicating that the consumer resides outside the United States when the service is provided;

(B) Any valid identification issued by a foreign government or an agency thereof that is typically used for identification purposes; or

(C) Any other forms of documentation as prescribed by the Secretary in forms, instructions, or other guidance.

(ii) *Special rules*—(A) *Special rule for small businesses.* A renderer that receives less than $10,000,000 in gross receipts during the prior taxable year establishes that any consumer of a service provided in the taxable year is located outside the United States if the renderer's billing address for the consumer is outside of the United States. If a renderer has a prior taxable year of fewer than 12 months (a short period), gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period.

(B) *Special rule for small transactions.* A renderer that receives less than $5,000 in gross receipts during a taxable year from a consumer establishes that such consumer is located outside the United States for such taxable year if the renderer's billing address for the consumer is outside the United States.

(e) *General services provided to business recipients*—(1) *In general.* A general service is provided to a business recipient located outside the United States only to the extent that the renderer establishes that the service is provided to a business recipient located outside the United States (as determined under paragraph (e)(2) of this section) by obtaining the documentation described in paragraph (e)(3) of this section (which meets the reliability requirements described in § 1.250(b)–3(d)) and, as of the FDII filing date, the renderer does not know or have reason to know that the portion of the service which the seller establishes is provided to a business recipient located outside the United States is provided to a business recipient that is located within the United States when the service is provided.

(2) *Location of business recipient*—(i) *In general.* A service is provided to a business recipient located outside of the United States to the extent that the gross income derived by the renderer from such service is allocated to the business recipient's operations outside the United States under the rules in paragraphs (e)(2)(i)(A) and (B) of this section. A service is provided to a business recipient located within the United States to the extent that a service is not provided to a business recipient located outside the United States.

(A) *Determination of business operations that benefit from the service.* If the renderer provides a service that provides a benefit to the operations of the business recipient in specific locations, gross income of the renderer is allocated to a business recipient's operations outside the United States to the extent that the benefit of the service is conferred on operations of the business recipient that are located outside the United States. However, if the renderer is unable to obtain reliable information regarding the specific locations of the operations of the business recipient to which a benefit is conferred, or if the renderer provides a service that does not provide a benefit to specific locations of the business recipient's operations but rather will generally confer a benefit on all locations of the business recipient's operations, gross income of the renderer is allocated ratably to all of the business recipient's operations at the time the service is provided.

(B) *Determination of amount of benefit conferred on operations outside the United States.* The amount of the benefit conferred on a business recipient's operations located outside the United States is determined under any method that is reasonable under the circumstances. In determining whether a method is reasonable, the principles of § 1.482–9(k) apply, treating the business recipient's operations in different locations as if they were ''recipients'' and treating the renderer's gross income as if they were ''costs'' as those terms are used in § 1.482–9(k). Reasonable methods may include, for example, allocations based on time spent or costs incurred by the renderer or gross receipts, revenue, profits, or assets of the business recipient.

(ii) *Location of business recipient's operations.* For purposes of this paragraph (e), a business recipient is treated as having operations in any location where it maintains an office or other fixed place of business.

(3) *Documentation of location of business recipient*—(i) *In general.* A renderer establishes that a business recipient is located outside the United States only if the renderer obtains one or more of the types of documentation described in paragraphs (e)(3)(i)(A) through (E) of this section. The documentation must also support the renderer's allocation of income described in paragraph (e)(2)(i) of this section.

(A) A written statement from the business recipient that specifies the locations of the operations of the business recipient that benefit from the service.

(B) A binding contract that specifies the locations of the operations of the business recipient that benefit from the service.

(C) Documentation obtained in the ordinary course of the provision of the service that specifies the locations of the operations of the business recipient that benefit from the service.

(D) Publicly available information that establishes the locations of the operations of the business recipient.

(E) Any other forms of documentation as prescribed by the Secretary in forms, instructions, or other guidance.

(ii) *Special rules*—(A) *Special rule for small businesses.* A renderer that receives less than $10,000,000 in gross receipts during a prior taxable year establishes that a business recipient of a service provided in a taxable year is located outside the United States if the renderer's billing address for the business recipient is outside of the United States. If the renderer's prior taxable year is less than 12 months (a short period), gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period.

(B) *Special rule for small transactions.* A renderer that receives less than $5,000 in gross receipts during a taxable year from services provided to a business recipient in such taxable year establishes that such business recipient is located outside the United States if the renderer's billing address for the business recipient is outside the United States.

(4) *Related parties.* For purposes of this paragraph (e), a reference to a business recipient includes a reference to any related party of the business recipient.

(5) *Examples.* The following examples illustrate the application of this paragraph (e).

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC is a domestic corporation.

(B) A and R are not related parties of DC.

(C) Any documentation obtained meets the reliability requirements described in § 1.250(b)–3(d).

(D) The treatment of any service as a FDDEI service would not reduce DC's foreign-derived deduction eligible income for the year.

(ii) *Examples.*

(A) *Example 1: Service that benefits specific aspects of the business recipient's business*—(*1*) *Facts.* For the taxable year, DC provides a marketing service to R, a company that operates restaurants within and outside of the United States, in exchange for $150×. Publicly available information indicates that 50% of the revenue earned by R and its related parties is from customers located outside of the United States. However, the marketing service that DC provides relates specifically to a single chain of restaurants that R operates. Sales information that R provides to DC indicates that 70% of the revenue of the restaurant chain is from locations within the United States and 30% of the revenue is from locations outside the United States.

(*2*) *Analysis.* R is located outside the United States in part under paragraph (e)(2)(i) of this section because DC's services benefit both R's operations within the United States and its operations outside the United States. Under paragraph (e)(2)(i) of this section, the portion of the service provided by DC that is treated as provided to a person located outside the United States is determined by the amount of DC's gross income from the service that is allocated to R's operations outside the United States. Because DC provides a service that provides a benefit to R's operations in specific locations, and reliable information about the specific locations of the operations that receive a benefit is available, DC must determine R's location based on information relating specifically to R's business operations that benefits from DC's service. See paragraph (e)(2)(i)(A) of this section. In this case, allocation of DC's gross income based on the revenue of the business recipient is a reasonable method. See paragraph (e)(2)(i)(B) of this section. Therefore, 30% of the provision of the marketing service is treated as the provision of a service to a person located outside the United States and a FDDEI service under paragraph (b)(2) of this section. Accordingly, $45× ($150× × 0.30) of DC's gross income from the provision of the marketing service is included in DC's gross FDDEI for the taxable year.

(B) *Example 2: Service that benefits the business recipient's operations generally*—(*1*) *Facts.* The facts are the same as in paragraph (e)(5)(ii)(A)(*1*) of this section (the facts in *Example 1*), except that DC provides an information technology service to R that benefits R's entire business.

(*2*) *Analysis.* Because the service that DC provides relate to R's entire business, DC may rely on publicly available information indicating that 50% of R's operations are outside of the United States. See paragraph (e)(2)(i)(A) of this section. Therefore, 50% of the provision of the information technology service is treated as a service to a person located outside the United States and a FDDEI service under paragraph (b)(2) of this section. Accordingly, $75x ($150x × 0.50) of DC's gross income from the provision of the information technology service is included in DC's gross FDDEI for the taxable year.

(C) *Example 3: No reliable information about which operations benefit from the service*—(*1*) *Facts.* The facts are the same as in paragraph (e)(5)(ii)(A)(*1*) of this section (the facts in *Example 1*), except that no information is available to DC about the specific chain of restaurants for which the service is provided.

(*2*) *Analysis.* Because the only information available to DC relates to R's entire business, DC may rely on publicly available information indicating that 50% of R's operations are outside of the United States to determine the portion of the service treated as provided to a person located outside the United States. See paragraph (e)(2)(i)(A) of this section. Therefore, 50% of the provision of the marketing service is treated as a service to a person located outside the United States and a FDDEI service under paragraph (b)(2) of this section. Accordingly, $75x ($150x × 0.50) of DC's gross income from the provision of the marketing service is included in DC's gross FDDEI for the taxable year.

(D) *Example 4: Service provided to a domestic intermediary*—(*1*) *Facts.* A, a domestic corporation that operates solely in the United States, enters into a services agreement with R, a company that operates solely outside the United States. Under the agreement, A agrees to perform a consulting service for R. A hires DC to provide a service to A that A will use in the provision of a consulting service to R.

(*2*) *Analysis.* A is located within the United States because the service that DC provides A confers a benefit solely to A's operations within the United States. R is located outside the United States because the service that A provides to R confers a benefit solely to R's operations outside the United States. See paragraph (e)(2)(i) of this section. Because DC provides a service to A, a person located within the United States, DC's provision of the service to A is not a FDDEI service under paragraph (b)(2) of this section, even though the service is used by A in providing a service to R, a person located outside the United States. See also section 250(b)(5)(B)(ii). However, A's provision of the consulting service to R may be a FDDEI service, in which case A's gross income from the provision of such service would be included in A's gross FDDEI.

(f) *Proximate services.* A proximate service is provided with respect to a recipient located outside the United States if the proximate service is performed outside the United States. In the case of a proximate service performed partly within the United States and partly outside of the United States, a proportionate amount of the service is treated as provided to a recipient located outside the United States corresponding to the portion of time the renderer spends providing the service outside of the United States.

(g) *Property services.* A property service is provided with respect to tangible property located outside the United States only if the property is located outside the United States for the duration of the period the service is performed.

(h) *Transportation services.* Except as provided in this paragraph (h), a transportation service is provided to a recipient, or with respect to property, located outside the United States only if both the origin and the destination of the service are outside of the United States. However, in the case of a transportation service provided to a recipient, or with respect to property, where either the origin or the destination of the service is outside of the United States, but not both, then 50 percent of the transportation service is considered provided to a recipient, or with respect to property, located outside the United States.

§ 1.250(b)–6 Related party transactions.

(a) *Scope.* This section provides additional rules for determining whether a sale of property or a provision of a service to a related party is a FDDEI transaction. Paragraph (b) of this section provides additional definitions relevant for determining whether a sale of property or a provision of a service to a related party is a FDDEI transaction. Paragraph (c) of this section provides additional rules for determining whether a sale of general property to a foreign related party is a FDDEI sale. Paragraph (d) of this section provides additional rules for determining whether the provision of a general service to a business recipient that is a related party is a FDDEI service.

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

(1) *Foreign related party.* The term *foreign related party* means, with respect to a seller or renderer, any foreign person that is a related party of the seller or renderer.

(2) *Foreign unrelated party.* The term *foreign unrelated party* means, with respect to a seller, a foreign person that is not a related party of the seller.

(3) *Related party sale.* The term *related party sale* means a sale of general property to a foreign related party that satisfies the requirements described in § 1.250(b)–4(b) without regard to paragraph (c) of this section. See § 1.250(b)–1(e)(3)(ii)(D) (*Example 4*) for an illustration of a related party sale in the case of a seller that is a partnership.

(4) *Related party service.* The term *related party service* means a provision of a general service to a business recipient that is a related party of the renderer and that is described in § 1.250(b)–5(b)(2) without regard to paragraph (d) of this section.

(5) *Unrelated party transaction.* The term *unrelated party transaction* means, with respect to property purchased in a related party sale from a seller—

(i) A sale of the property by a foreign related party to a foreign unrelated party with respect to the seller;

(ii) A sale of property by a foreign related party to a foreign unrelated party with respect to the seller if the property sold in the related party sale is a component of the property sold to the foreign unrelated party;

(iii) A sale of property by a foreign related party to a foreign unrelated party with respect to the seller, other than a sale described in paragraph (b)(5)(ii) of this section, if the property sold in the related party sale is used in connection with the property sold to the foreign unrelated party; or

(iv) A provision of a service by a foreign related party to a foreign unrelated party with respect to the seller, if the property sold in the related party sale was used in connection with the provision of the service.

(c) *Related party sales*—(1) *In general.* A related party sale is a FDDEI sale only if the requirements described in either paragraph (c)(1)(i) or (ii) of this section are satisfied with respect to the related party sale. Section 250(b)(5)(C)(i) and this paragraph (c) does not apply to determine whether a sale of intangible property to a foreign related party is a FDDEI sale.

(i) *Sale of property in an unrelated party transaction.* A related party sale is a FDDEI sale if an unrelated party transaction described in paragraph (b)(5)(i) or (ii) of this section occurs with respect to the property purchased in the related party sale, such unrelated party transaction is described in § 1.250(b)–4(b), and, except as provided in this paragraph (c)(1)(i), the unrelated party transaction occurs on or before the FDII filing date. In the case of an unrelated party transaction that occurs after the FDII filing date with respect to a related party sale, a taxpayer may file an amended return for the taxable year in which the related party sale occurred, within the period of limitations provided by section 6511, claiming the related party sale as a FDDEI sale for purposes of determining the taxpayer's foreign-derived intangible income for that taxable year.

(ii) *Use of property in an unrelated party transaction.* A related party sale is a FDDEI sale if, as of the FDII filing date, the seller in the related party sale reasonably expects that one or more unrelated party transactions described in paragraph (b)(5)(iii) or (iv) of this section will occur with respect to the property purchased in the related party sale, such unrelated party transaction or transactions would be described in § 1.250(b)–4(b) or § 1.250(b)–5(b) without regard to the documentation rules in § 1.250(b)–4 or § 1.250(b)–5, and more than 80 percent of the revenue earned by the foreign related party with respect to the property will be earned from such unrelated party transaction or transactions.

(2) *Treatment of foreign related party as seller or renderer.* For purposes of determining whether a sale of property or provision of a service by a foreign related party is, or would be, described in § 1.250(b)–4 or § 1.250(b)–5 (except for purposes of obtaining documentation), the foreign related party that sells the property or provides the service is treated as a seller or renderer, as applicable, and the foreign unrelated party is treated as the recipient. In the case of an unrelated party transaction described in paragraph (b)(5)(i) or (ii) of this section, the seller in the related party sale must obtain the documentation required in § 1.250(b)–4.

(3) *Transactions between a foreign related party and other foreign related parties.* All foreign related parties of the seller are treated as if they were a single foreign related party for purposes of applying paragraphs (c)(1) and (2) of this section. Accordingly, if a foreign related party sells or uses property purchased in a related party sale in a transaction with a second foreign related party of the seller, transactions between the second foreign related party and unrelated parties may be treated as an unrelated party transaction for purposes of applying paragraph (c)(1) of this section to a related party sale.

(4) *Example.* The following example illustrates the application of paragraph (c) of this section.

(i) *Facts.* DC, a domestic corporation, sells a machine to FC, a foreign related party of DC in a transaction described in § 1.250(b)–4(b) (without regard to § 1.250(b)–6(c)). FC uses the machine solely to manufacture product A. As of the FDII filing date for the taxable year, FC reasonably expects that more than 80% of future revenue from sales of product A will be from sales that would be described in § 1.250(b)–4(b) without regard to the documentation requirements of § 1.250(b)–4(c) and (d).

(ii) *Analysis.* The sale by DC to FC is a related party sale. Because FC uses the machine to make product A, but the machine is not a component of product A, FC's sale of product A is an unrelated party transaction described in paragraph (b)(5)(iii) of this section. Therefore, DC's sale of the machine is only a FDDEI sale if the requirements of paragraph (c)(1)(ii) of this section are satisfied. Because DC reasonably expects that more than 80% of the revenue from future sales of product A will be from unrelated party transactions that would be described in § 1.250(b)–4(b), DC's sale of the machine to FC is a FDDEI sale.

(d) *Related party services*—(1) *In general.* Except as provided in this paragraph (d)(1), a related party service is a FDDEI service only if the related party service is not substantially similar to a service provided by the related party to a person located within the United States. However, if a related party service is substantially similar to a service provided (in whole or in part) by the related party to a person located in the United States solely by reason of paragraph (d)(2)(ii) of this section, the amount of gross income from the related party service attributable to a FDDEI service is equal to the gross income from the related party service multiplied by a fraction, the numerator of which is the sum of the benefits conferred by the related party service to persons not located within the United States and the denominator of which is the sum of all benefits conferred by the related party service. Section 250(b)(5)(C)(ii) and this paragraph (d)(1) apply only to a general service provided to a business recipient and are not applicable with respect to any other service provided to a foreign related party.

(2) *Substantially similar services.* A related party service is substantially similar to a service provided by the related party to a person located within the United States only if the related party service is used by the related party to provide a service to a person located within the United States and either—

(i) 60 percent or more of the benefits conferred by the related party service are to persons located within the United States; or

(ii) 60 percent or more of the price paid by persons located within the United States for the service provided by the related party is attributable to the related party service.

(3) *Location of recipient of services provided by related party.* For purposes of paragraph (d) of this section, the location of a consumer or business recipient with respect to a related party service is determined under the principles of § 1.250(b)–5(d)(2) and (e)(2), respectively.

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

(i) *Presumed facts.* The following facts are assumed for purposes of the examples—

(A) DC is a domestic corporation.

(B) FC is a foreign corporation and a foreign related party of DC that operates solely outside the United States.

(C) The service DC provides to FC is a general service provided to a business recipient located outside the United States as described in § 1.250(b)–5(b)(2) without regard to the application of paragraph (d) of this section.

(D) The benefits conferred by DC's service to FC's customers are not indirect or remote within the meaning of § 1.482–9(l)(3)(ii).

(ii) *Examples.*

(A) *Example 1: Services that are substantially similar services under paragraph (d)(2)(i) of this section*—(*1*) *Facts.* FC enters into a services agreement with R, a company that operates restaurant chains within and outside the United States. Under the agreement, FC agrees to furnish a design for the renovation of a chain of restaurants that R owns, which design will include architectural plans. FC hires DC to provide an architectural service to FC that FC will use in the provision of its design service to R. The architectural service that DC provides to FC will serve no other purpose than to enable FC to provide its service to R. The architectural service will benefit solely R's operations within the United States. FC pays an arm's length price of $50x to DC for the architectural service and DC recognizes $50x of gross income from the service. FC incurs additional costs to add additional design elements to the plans and charges R a total of $100x for its service.

(*2*) *Analysis.* The service that DC provides to FC is used in the provision of a service to R. R is treated as entirely located within the United States under paragraph (d)(3) of this section and the principles of § 1.250(b)–5(e)(2) because only its U.S. operations benefit from the service provided by DC. Because FC uses DC's architectural service to provide its design service to R, and the architectural service that DC provides to FC will serve no purpose other than to enable FC to provide its service to R, 100% of the benefits conferred by DC's architectural service are to R, a person located within the United States. Therefore, the service provided by DC to FC is substantially similar to the service provided by FC to R under paragraph (d)(2)(i) of this section. Accordingly, DC's provision of the architectural service to FC is not a FDDEI service under paragraph (d)(1) of this section and DC's gross income from the architectural service ($50x) is not included in its gross FDDEI.

(B) *Example 2: Services that are substantially similar services under paragraph (d)(2)(ii) of this section*—(*1*) *Facts.* The facts are the same as paragraph (d)(4)(ii)(A)(*1*) (the facts in *Example 1*), except that FC pays an arm's length price of $75× to DC for the architectural service, DC recognizes $75× of gross income from the service, and 90% of the benefits of DC's architectural service are conferred on R's operations outside the United States.

(*2*) *Analysis*—(*i*) *Analysis under paragraph (d)(2)(i) of this section.* R is treated as located within the United States with respect to DC's architectural service under paragraph (d)(3) of this section to the extent of the benefits conferred on its operations within the United States by the architectural service. See § 1.250(b)–5(e)(2). Because 90% of the benefits of DC's architectural service are conferred on R's operations outside the United States, only 10% of the benefits of DC's architectural service are treated as conferred on persons located within the United States under paragraph (d)(3) of this section. Therefore, the architectural service provided by DC to FC is not substantially similar to the design service provided by FC to persons located within the United States under paragraph (d)(2)(i) of this section.

(*ii*) *Analysis under paragraph (d)(2)(ii) of this section.* Because 10% of the benefits of FC's architectural design services are conferred on R's operations within the United States, $10x of the amount paid by R for FC's services (10% x $100) is treated as paid by persons located within the United States. Similarly, because 10% of the benefits of DC's architectural services are conferred on R's operations within the United States, of the $10x paid with respect to R's operations within the United States, $7.5x (10% x $75x) is attributable to DC's architectural service. Accordingly, because 75% ($7.5 × /$10x) of the price paid by R to FC for the design service is attributable to the architectural service provided by DC to FC, and R is a person located within the United States under paragraph (d)(3) of this section and the principles of § 1.250(b)–5(e)(2), the architectural service provided by DC to FC is substantially similar to the design service provided by FC to persons located within the United States under paragraph (d)(2)(ii) of this section.

(*iii*) *Application of paragraph (d)(1) of this section.* Because DC's architectural service is substantially similar to FC's design service provided to R, a person located in the United States, solely by reason of paragraph (d)(2)(ii) of this section, the amount of gross income from DC's architectural service included in its gross FDDEI is $67.5x, which is equal to DC's gross income from the architectural service ($75x) multiplied by 90%, which is the percentage of the benefits of DC's architectural service that are conferred on R's operations outside the United States.

■ **Par. 3.** Section 1.962–1 is amended by adding paragraphs (b)(1)(i)(A)(*2*), (b)(1)(i)(B)(*3*), and revising paragraph (d) to read as follows:

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

* * * * *

(b) * * *

(1) * * *

(i) * * *

(A) * * *

(*2*) His GILTI inclusion amount (as defined in § 1.951A–1(c)(1)) for the taxable year; plus

* * * * *

(B) * * *

(*3*) The portion of the deduction under section 250 and § 1.250(a)–1 that would be allowed to a domestic corporation equal to the percentage applicable to global intangible low-taxed income for the taxable year under section 250(a)(1)(B) (including as modified by section 250(a)(3)(B)) multiplied by the sum of the amount described in paragraph (b)(1)(i)(A)(*2*) of this section and the amount described in paragraph (b)(1)(i)(A)(*3*) of this section that is attributable to the amount described in paragraph (b)(1)(i)(A)(*2*) of this section.

* * * * *

(d) *Applicability dates.* Except as otherwise provided in this paragraph (d), 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 corporation ends. Paragraph (b)(1)(i)(B)(*3*) applies to taxable years of a foreign corporation ending on or after *March 4, 2019,* 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.

■ **Par. 4.** Section 1.1502–12, as proposed to be amended in 83 FR 51072 (Oct. 10, 2018), is further amended by adding paragraph (t) to read as follows:

§ 1.1502–12 Separate taxable income.

* * * * *

(t) See § 1.1502–50 for rules relating to the computation of a member's deduction under section 250.

■ **Par. 5.** Section 1.1502–13, as proposed to be amended in 83 FR 67490 (Dec. 28, 2018), is further amended:

■ 1. In paragraph (a)(6)(ii), under the heading ''Matching rule. (§ 1.1502–13(c)(7)(ii))'', by adding entry (T); and

■ 2. Adding paragraph (c)(7)(ii)(T).

The additions read as follows:

§ 1.1502–13 Intercompany transactions.

(a) * * *

(6) * * *

(ii) * * *

Matching rule. (§ 1.1502–13(c)(7)(ii))

* * * * *

(T) Example 20. Redetermination of attributes for section 250 purposes.

* * * * *

(c) * * *

(7) * * *

(ii) * * *

(T) *Example 20: Redetermination of attributes for section 250 purposes*—(*1*) *Facts.* S manufactures equipment in the United States and recognizes $75 of gross income included in gross DEI (as defined in § 1.250(b)–1(c)(14)) on the sale of Asset, which is not depreciable property, to B in Year 1 for $100. In Year 2, B sells Asset to X for $125 and recognizes $25 of gross income. The sale is a FDDEI sale (as defined in § 1.250(b)–1(c)(8)), and thus the $25 of income is included in B's gross FDDEI (as defined in § 1.250(b)–1(c)(15)) for Year 2.

(*2*) *Timing and attributes.* S's $75 of intercompany income is taken into account in Year 2 under the matching rule to reflect the $75 difference between B's $25 corresponding item taken into account (based on B's $100 cost basis in Asset) and the recomputed corresponding item (based on the $25 basis that B would have if S and B were divisions of a single corporation and B's basis were determined by reference to S's basis). In determining whether S's gross income included in gross DEI from the sale of Asset is included in gross FDDEI, S and B are treated as divisions of a single corporation. See paragraph (a)(6) of this section. In determining the amount of income included in gross DEI that is included in gross FDDEI, the attributes of S's intercompany item and B's corresponding item may be redetermined to the extent necessary to produce the same effect on consolidated taxable income (and consolidated tax liability) as if S and B were divisions of a single corporation. See paragraph (c)(1)(i) of this section. Applying section 250 and § 1.1502–50 on a single entity basis, all $100 of income included in gross DEI would be gross FDDEI. On a separate entity basis, S would have $75 of gross income included in gross DEI that is included in gross non-FDDEI (as defined in § 1.250(b)–1(c)(16)) and B would have $25 of gross income included in gross DEI that is included in gross FDDEI. Thus, on a separate entity basis, S and B would have, in the aggregate, $100 of gross income included in gross DEI, of which only $25 is included gross FDDEI. Accordingly, under single entity treatment, $75 that would be treated as gross income included in gross DEI that is included in gross non-FDDEI on a separate entity basis is redetermined to be included in gross FDDEI.

(*3*) *Intercompany sale for loss.* The facts are the same as in paragraph (c)(7)(ii)(T)(*1*) (the facts in *Example 20*), except that S recognizes $25 of loss on the sale of Asset. S's $25 of intercompany loss is taken into account under the matching rule to reflect the $25 difference between B's $25 corresponding item taken into account (based on B's $100 cost basis in Asset) and the recomputed corresponding item (based on the $125 basis that B would have if S and B were divisions of a single corporation and B's basis were determined by reference to S's $125 of costs). Applying section 250 and § 1.1502–50 on a single entity basis, $0 of income would be included in gross DEI. In order to reflect this result, under the matching rule, S's $25 loss is allocated and apportioned solely to B's $25 of gross income from the sale of Asset for purposes of determining B's DEI and FDDEI. Furthermore, B's $25 of gross income is not taken into account for purposes of apportioning any other deductions under section 861 and the regulations under that section for purposes of determining any member's DEI or FDDEI.

* * * * *

■ **Par. 6.** Section 1.1502–50 is added to read as follows:

§ 1.1502–50 Consolidated section 250.

(a) *In general*—(1) *Scope.* This section provides rules for applying section 250 and the regulations thereunder (the *section 250 regulations,* see §§ 1.250(a)–1 through 1.250(b)–6) to a member of a consolidated group (*member*). Paragraph (b) of this section provides rules for the determination of the amount of the deduction allowed to a member under section 250(a)(1). Paragraph (c) of this section provides rules governing the impact of intercompany transactions on the determination of a member's qualified business asset investment and the effect of intercompany transactions on the determination of a member's foreign-derived deduction eligible income. Paragraph (d) of this section provides rules governing basis adjustments to member stock resulting from the application of paragraph (b)(1) of this section. Paragraph (e) of this section provides definitions. Paragraph (f) of this section provides examples illustrating the rules of this section. Paragraph (g) of this section provides an applicability date.

(2) *Overview.* The rules of this section ensure that the aggregate amount of deductions allowed under section 250 to members appropriately reflects the income, expenses, gains, losses, and property of all members. Paragraph (b) of this section allocates the consolidated group's overall deduction amount under section 250 to each member on the basis of its contribution to the consolidated foreign-derived deduction eligible income and consolidated global intangible low-taxed income. The definitions in paragraph (e) of this section provide for the aggregation of the deduction eligible income, foreign-derived deduction eligible income, deemed tangible income return, and global intangible low-taxed income of all members in order to calculate the consolidated group's overall deduction amount under section 250.

(b) *Allowance of deduction*—(1) *In general.* A member is allowed a deduction for a consolidated return year under section 250. See § 1.250(a)–1(b). The amount of the deduction is equal to the sum of—

(i) The product of the consolidated FDII deduction amount and the member's FDII deduction allocation ratio; and

(ii) The product of the consolidated GILTI deduction amount and the member's GILTI deduction allocation ratio.

(2) *Consolidated taxable income limitation.* For purposes of applying the limitation described in § 1.250(a)–1(b)(2) to the determination of the consolidated FDII deduction amount and the consolidated GILTI deduction amount of a consolidated group for a consolidated return year—

(i) The consolidated foreign-derived intangible income (if any) is reduced (but not below zero) by an amount which bears the same ratio to the consolidated section 250(a)(2) amount that such consolidated foreign-derived intangible income bears to the sum of the consolidated foreign-derived intangible income and the consolidated global intangible low-taxed income; and

(ii) The consolidated global intangible low-taxed income (if any) is reduced (but not below zero) by the excess of the consolidated section 250(a)(2) amount over the reduction described in paragraph (b)(2)(i) of this section.

(c) *Impact of intercompany transactions*—(1) *Impact on qualified business asset investment determination.* For purposes of determining a member's qualified business asset investment, the basis of specified tangible property does not include an amount equal to any gain or loss realized with respect to such property by another member in an intercompany transaction (as defined in § 1.1502–13(b)(1)), whether or not such gain or loss is deferred. Thus, for example, if a selling member owns specified tangible property with an adjusted basis (within the meaning of section 1011) of $60x and an adjusted basis (for purposes of calculating qualified business asset investment) of $80x, and sells it for $50x to the purchasing member, the basis of such property for purposes of computing the purchasing member's qualified business asset investment is $80x.

(2) *Impact on foreign-derived deduction eligible income characterization.* For purposes of redetermining attributes of members from an intercompany transaction as foreign-derived deduction eligible income, see § 1.1502–13(c)(1)(i) and (c)(7)(ii)(T), *Example 20.*

(d) *Adjustments to the basis of a member.* For adjustments to the basis of a member related to paragraph (b)(1) of this section, see § 1.1502–32(b)(3)(ii)(B).

(e) *Definitions.* The following definitions apply for purposes of this section.

(1) *Consolidated deduction eligible income.* With respect to a consolidated group for a consolidated return year, the term *consolidated deduction eligible income* means the greater of the sum of the deduction eligible income (whether positive or negative) of all members or zero.

(2) *Consolidated deemed intangible income.* With respect to a consolidated group for a consolidated return year, the term *consolidated deemed intangible income* means the excess (if any) of the consolidated deduction eligible income,

over the consolidated deemed tangible income return.

(3) *Consolidated deemed tangible income return.* With respect to a consolidated group for a consolidated return year, the term *consolidated deemed tangible income return* means the sum of the deemed tangible income return of all members.

(4) *Consolidated FDII deduction amount.* With respect to a consolidated group for a consolidated return year, the term *consolidated FDII deduction amount* means the product of the FDII deduction rate and the consolidated foreign-derived intangible income, as adjusted by paragraph (b)(2) of this section.

(5) *Consolidated foreign-derived deduction eligible income.* With respect to a consolidated group for a consolidated return year, the term *consolidated foreign-derived deduction eligible income* means the greater of the sum of the foreign-derived deduction eligible income (whether positive or negative) of all members or zero.

(6) *Consolidated foreign-derived intangible income.* With respect to a consolidated group for a consolidated return year, the term *consolidated foreign-derived intangible income* means, except as provided in paragraph (e) of this section, the product of the consolidated deemed intangible income and the consolidated foreign-derived ratio.

(7) *Consolidated foreign-derived ratio.* With respect to a consolidated group for a consolidated return year, the term *consolidated foreign-derived ratio* means the ratio (not to exceed one) of—

(i) The consolidated foreign-derived deduction eligible income; to

(ii) The consolidated deduction eligible income.

(8) *Consolidated GILTI deduction amount.* With respect to a consolidated group for a consolidated return year, the term *consolidated GILTI deduction amount* means the product of the GILTI deduction rate and the sum of the consolidated global intangible low-taxed income, as adjusted by paragraph (b)(2) of this section, and the amounts treated as dividends received by the members under section 78 which are attributable to their global intangible low-taxed income for the consolidated return year.

(9) *Consolidated global intangible low-taxed income.* With respect to a consolidated group for a consolidated return year, the term *consolidated global intangible low-taxed income* means the sum of the global intangible low-taxed income of all members.

(10) *Consolidated section 250(a)(2) amount.* With respect to a consolidated group for a consolidated return year, the term *consolidated section 250(a)(2) amount* means the excess (if any) of the sum of the consolidated foreign-derived intangible income and the consolidated global intangible low-taxed income (determined without regard to section 250(a)(2) and paragraph (b)(2) of this section), over the consolidated taxable income of the consolidated group (within the meaning of § 1.1502–11) determined with regard to all items of income, deductions, or loss, except for the deduction allowed under section 250 and this section. Therefore, for example, consolidated taxable income under this paragraph (f)(10) is determined taking into account the application of sections 163(j) and 172(a).

(11) *Deduction eligible income.* With respect to a member for a consolidated return year, the term *deduction eligible income* means the member's gross DEI for the year (within the meaning of § 1.250(b)–1(c)(14)) reduced (including below zero) by the deductions properly allocable to gross DEI for the year (as determined under § 1.250(b)–1(d)(2)).

(12) *Deemed tangible income return.* With respect to a member for a consolidated return year, the term *deemed tangible income return* means an amount equal to 10 percent of the member's qualified business asset investment, as adjusted by paragraph (c)(1) of this section.

(13) *FDII deduction allocation ratio.* With respect to a member for a consolidated return year, the term *FDII deduction allocation ratio* means the ratio of—

(i) The member's positive foreign-derived deduction eligible income (if any); to

(ii) The sum of the positive foreign-derived deduction eligible income of all members.

(14) *FDII deduction rate.* The term *FDII deduction rate* means 37.5 percent for consolidated return years beginning before January 1, 2026, and 21.875 percent for consolidated return years beginning after December 31, 2025.

(15) *Foreign-derived deduction eligible income.* With respect to a member for a consolidated return year, the term *foreign-derived deduction eligible income* means the member's gross FDDEI for the year (within the meaning of § 1.250(b)–1(c)(15)) reduced (including below zero) by the deductions properly allocable to gross FDDEI for the year (as determined under § 1.250(b)–1(d)(2)).

(16) *GILTI deduction allocation ratio.* With respect to a member for a consolidated return year, the term *GILTI deduction allocation ratio* means the ratio of—

(i) The sum of the member's global intangible low-taxed income and the amount treated as a dividend received by the member under section 78 which is attributable to its global intangible low-taxed income for the consolidated return year; to

(ii) The sum of consolidated global intangible low-taxed income and the amounts treated as dividends received by the members under section 78 which are attributable to their global intangible low-taxed income for the consolidated return year.

(17) *GILTI deduction rate.* The term *GILTI deduction rate* means 50 percent for consolidated return years beginning before January 1, 2026, and 37.5 percent for consolidated return years beginning after December 31, 2025.

(18) *Global intangible low-taxed income.* With respect to a member for a consolidated return year, the term *global intangible low-taxed income* means the sum of the member's GILTI inclusion amount under § 1.1502–51(b) and the member's distributive share of any domestic partnership's GILTI inclusion amount under § 1.951A–5(b)(2).

(19) *Qualified business asset investment.* The term *qualified business asset investment* has the meaning provided in § 1.250(b)–2(b).

(20) *Specified tangible property.* The term *specified tangible property* has the meaning provided in § 1.250(b)–2(c)(1).

(f) *Examples.* The following examples illustrate the rules of this section.

(1) *Example 1: Calculation of deduction attributable to foreign-derived intangible income*—(i) *Facts.* P is the common parent of the P group and owns all of the only class of stock of subsidiaries USS1 and USS2. The consolidated return year of all persons is the calendar year. In 2018, P has deduction eligible income of $400x, foreign-derived deduction eligible income of $0, and qualified business asset investment of $0; USS1 has deduction eligible income of $200x, foreign-derived deduction eligible income of $200x, and qualified business asset investment of $600x; and USS2 has deduction eligible income of −$100x, foreign-derived deduction eligible income of $100x, and qualified business asset investment of $400x. The P group has consolidated taxable income that is sufficient to make inapplicable the limitation in paragraph (b)(2) of this section. No member of the P group has global intangible low-taxed income.

(ii) *Analysis.* (A) *Consolidated deduction eligible income.* Under paragraph (e)(1) of this section, the P group's consolidated deduction eligible income is $500x, the greater of the sum of the deduction eligible income (whether positive or negative) of all members ($400x + $200x–$100x) or zero.

(B) *Consolidated foreign-derived deduction eligible income.* Under paragraph (e)(5) of this section, the P group's consolidated foreign-derived deduction eligible income is

$300x, the greater of the sum of the foreign-derived deduction eligible income (whether positive or negative) of all members ($0 + $200x + $100x) or zero.

(C) *Consolidated deemed tangible income return.* Under paragraph (e)(12) of this section, a member's deemed tangible income return is 10% of its qualified business asset investment. Therefore, P's deemed tangible income return is $0 (0.10 × $0), USS1's deemed tangible income return is $60x (0.10 × $600x), and USS2's deemed tangible income return is $40x (0.10 × $400x). Under paragraph (e)(3) of this section, the P group's consolidated deemed tangible income return is $100x, the sum of the deemed tangible income return of all members ($0 + $60x + $40x).

(D) *Consolidated deemed intangible income.* Under paragraph (e)(2) of this section, the P group's consolidated deemed intangible income is $400x, the excess of its consolidated deduction eligible income over its consolidated deemed tangible income return ($500x − $100x).

(E) *Consolidated foreign-derived intangible income.* Under paragraph (e)(7) of this section, the P group's consolidated foreign-derived ratio is 0.60, the ratio of its consolidated foreign-derived deduction eligible income to its consolidated deduction eligible income ($300x/$500x). Under paragraph (e)(6) of this section, the P group's consolidated foreign-derived intangible income is $240x, the product of its consolidated deemed intangible income and its consolidated foreign-derived ratio ($400x × 0.60).

(F) *Consolidated FDII deduction amount.* Under paragraph (e)(4) of this section, the P group's consolidated FDII deduction amount is $90x, the product of the FDII deduction rate and the consolidated foreign-derived intangible income (0.375 × $240x).

(G) *Member's deduction attributable to consolidated FDII deduction amount.* Under paragraph (b)(1) of this section, a member is allowed a deduction equal, in part, to the product of the consolidated FDII deduction amount of the consolidated group to which the member belongs and the member's FDII deduction allocation ratio. Under paragraph (e)(13) of this section, a member's FDII deduction allocation ratio is the ratio of its positive foreign-derived deduction eligible income to the sum of each member's positive foreign-derived deduction eligible income for such consolidated return year. As a result, the FDII deduction allocation ratios of P, USS1, and USS2 are 0 ($0/$300x), 2⁄3 ($200x/$300x), and 1/3 ($100x/$300x), respectively. Therefore, P, USS1, and USS2 are permitted deductions under paragraph (b)(1) of this section in the amount of $0 (0 × $90x), $60x (2/3 × $90x), and $30x (1/3 × $90x), respectively.

(2) *Example 2: Limitation on consolidated foreign-derived deduction eligible income*—(i) *Facts.* The facts are the same as in paragraph (f)(1)(i) of this section (the facts in *Example 1*), except that P's foreign-derived deduction eligible income is $300x.

(ii) *Analysis.* (A) *Consolidated deduction eligible income and consolidated deemed tangible income return.* As in paragraphs (f)(1)(ii)(A) and (C) of this section (the analysis in *Example 1*), the P group's consolidated deduction eligible income is $500x and the P group's consolidated deemed tangible income return is $100x.

(B) *Consolidated foreign-derived deduction eligible income.* Under paragraph (e)(5) of this section, the P group's consolidated foreign-derived deduction eligible income is $600x, the greater of the sum of the foreign-derived deduction eligible income (whether positive or negative) of all members ($300x + $200x + $100x) or zero.

(C) *Consolidated deemed intangible income and consolidated foreign-derived intangible income.* Under paragraph (e)(2) of this section, the P group's consolidated deemed intangible income is $400x ($500x − $100x). Under paragraph (e)(7) of this section, the P group's consolidated foreign-derived ratio is 1.00 ($600x/$500x, but not in excess of one). Under paragraph (e)(6) of this section, the P group's consolidated foreign-derived intangible income is $400x ($400x × 1.00).

(D) *Consolidated FDII deduction amount and member's deduction attributable to consolidated FDII deduction amount.* Under paragraph (e)(4) of this section, the P group's consolidated FDII deduction amount is $150x (0.375 × $400x). Under paragraph (e)(13) of this section, the FDII deduction allocation ratios of P, USS1, and USS2 are 1/2 ($300/$600x), 1/3 ($200x/$600x), and 1/6 ($100x/$600x), respectively. Therefore, P, USS1, and USS2 are permitted deductions under paragraph (b)(1) of this section in the amounts of $75x (1/2 × $150x), $50x (1/3 × $150x), and $25x (1/6 × $150x), respectively.

(3) *Example 3: Member with negative foreign-derived deduction eligible income*—(i) *Facts.* The facts are the same as in paragraph (f)(1)(i) of this section (the facts in *Example 1*), except that P's foreign-derived deduction eligible income is − $100x.

(ii) *Analysis.* (A) *Consolidated deduction eligible income and consolidated deemed tangible income return.* As in paragraphs (f)(1)(ii)(A) and (C) of this section (the facts in *Example 1*), the P group's consolidated deduction eligible income is $500x and the P group's consolidated deemed tangible income return is $100x.

(B) *Consolidated foreign-derived deduction eligible income.* Under paragraph (e)(5) of this section, the P group's consolidated foreign-derived deduction eligible income is $200x, the greater of the sum of the foreign-derived deduction eligible income (whether positive or negative) of all members (− $100x + $200x + $100x) or zero.

(C) *Consolidated deemed intangible income and consolidated foreign-derived intangible income.* Under paragraphs (e)(2) and (6) of this section, the P group's consolidated deemed intangible income is $400x ($500x − $100x), and the P group's consolidated foreign-derived intangible income is $160x ($400x × ($200x/$500x)).

(D) *Consolidated FDII deduction amount and member's deduction attributable to consolidated FDII deduction amount.* Under paragraph (e)(4) of this section, the P group's consolidated FDII deduction amount is $60x (0.375 × $160x). Under paragraph (e)(13) of this section, the FDII deduction allocation ratios of P, USS1, and USS2 are 0 ($0/$300x), 2/3 ($200x/$300x), and 1/3 ($100x/$300x), respectively. Therefore, P, USS1, and USS2 are permitted deductions under paragraph (b)(1) of this section in the amounts of $0 (0 x $60x), $40x (2/3 × $60x), and $20x (1/3 × $60x), respectively.

(4) *Example 4: Calculation of deduction attributable to global intangible low-taxed income*—(i) *Facts.* The facts are the same as in paragraph (f)(1)(i) of this section (the facts in *Example 1*), except that USS1 owns CFC1 and USS2 owns CFC2. USS1 and USS2 have global intangible low-taxed income of $65x and $20x, respectively, and amounts treated as dividends received under section 78 attributable to their global intangible low-taxed income of $10x and $5x, respectively.

(ii) *Analysis.* (A) *Consolidated global intangible low-taxed income.* Under paragraph (e)(9) of this section, the P group's consolidated global intangible low-taxed income is $85x, the sum of the global intangible low-taxed income of all members ($0 + $65x + $20x).

(B) *Consolidated GILTI deduction amount.* Under paragraph (e)(8) of this section, the P group's consolidated GILTI deduction amount is $50x, the product of the GILTI deduction rate and the sum of its consolidated global intangible low-taxed income and the amounts treated as dividends received by the members under section 78 which are attributable to their global intangible low-taxed income for the consolidated return year (0.50 x ($85x + $10x + $5x)).

(C) *Member's deduction attributable to consolidated GILTI deduction amount.* Under paragraph (b)(1) of this section, a member is allowed a deduction equal, in part, to the product of the consolidated GILTI deduction amount of the consolidated group to which the member belongs and the member's GILTI deduction allocation ratio. Under paragraph (e)(16) of this section, a member's GILTI deduction allocation ratio is the ratio of the sum of its global intangible low-taxed income and the amount treated as a dividend received by the member under section 78 which is attributable to its global intangible low-taxed income for the consolidated return year to the sum of the consolidated global intangible low-taxed income and the amounts treated as dividends received by the members under section 78 which are attributable to their global intangible low-taxed income for the consolidated return year. As a result, the GILTI deduction allocation ratios of P, USS1, and USS2 are 0 ($0/($85x + $10x + $5x)), 3/4 (($65x + $10x)/($85x + $10x + $5x)), and 1/4 (($20x + $5x)/($85x + $10x + $5x)), respectively. Therefore, P, USS1, and USS2 are permitted deductions of $0 (0 × $50x), $37.50x (3/4 × $50x), and $12.50x (1/4 × $50x), respectively.

(D) *Member's deduction under section 250.* Under paragraph (b)(1) of this section, a member is allowed a deduction equal to the sum of the member's deduction attributable to the consolidated FDII deduction amount and the member's deduction attributable to the consolidated GILTI deduction amount. As a result P, USS1, and USS2 are entitled to deductions under paragraph (b)(1) of this section of $0 ($0 + $0), $97.50x ($60x + $37.50x), and $42.50x ($30x + $12.50x), respectively.

(5) *Example 5: Taxable income limitation*—(i) *Facts.* The facts are the same as in paragraph (f)(4)(i) of this section (the facts in *Example 4*), except that the P group's consolidated taxable income (within the meaning of paragraph (e)(10) of this section) is $300x.

(ii) *Analysis.* (A) *Determination of whether the limitation described in paragraph (b)(2) of this section applies.* Under paragraph (b)(2) of this section, in the case of a consolidated group with a consolidated section 250(a)(2) amount for a consolidated year, the amount of the consolidated foreign-derived intangible income and the consolidated global intangible low-taxed income otherwise taken into account in the determination of the consolidated FDII deduction amount and the consolidated GILTI deduction amount are subject to reduction. As in paragraph (f)(1)(ii)(E) of this section (the facts in *Example 1*), the P group's consolidated foreign-derived intangible income is $240x. As in paragraph (f)(4)(ii)(A) of this section (the analysis in *Example 4*), the P group's consolidated global intangible low-taxed income is $85x. The P group's consolidated taxable income is $300x. Under paragraph (e)(10) of this section, the P group's consolidated section 250(a)(2) amount is $25x (($240x + $85x) − $300x), the excess of the sum of the consolidated foreign-derived intangible income and the consolidated global intangible low-taxed income, over the P group's consolidated taxable income. Therefore, the limitation described in paragraph (b)(2) of this section applies.

(B) *Allocation of reduction.* Under paragraph (b)(2)(i) of this section, the P group's consolidated foreign-derived intangible income is reduced by an amount which bears the same ratio to the consolidated section 250(a)(2) amount as the consolidated foreign-derived intangible income bears to the sum of the consolidated foreign-derived intangible income and consolidated global intangible low-taxed income, and the P group's consolidated global intangible low-taxed income is reduced by the excess of the consolidated section 250(a)(2) amount over the reduction described in paragraph (b)(2)(i) of this section. Therefore, for purposes of determining the P group's consolidated FDII deduction amount and consolidated GILTI deduction amount, its consolidated foreign-derived intangible income is reduced to $221.54x ($240x − ($25x × ($240x/$325x))) and its consolidated global intangible low-taxed income is reduced to $78.46x ($85x − ($25x − ($25x × ($240x/$325x)))).

(C) *Calculation of consolidated FDII deduction amount and consolidated GILTI deduction amount.* Under paragraph (e)(4) of this section, the P group's consolidated FDII deduction amount is $83.08x ($221.54x × 0.375). Under paragraph (e)(8) of this section, the P group's consolidated GILTI deduction amount is $39.23x ($78.46x × 0.50).

(D) *Member's deduction attributable to the consolidated FDII deduction amount.* As in paragraph (f)(1)(ii)(G) of this section (the analysis in *Example 1*), the FDII deduction allocation ratios of P, USS1, and USS2 are 0, 2/3, and 1/3, respectively. Therefore, P, USS1, and USS2 are permitted deductions attributable to the consolidated FDII deduction amount of $0 (0 × $83.08x), $55.39x (2/3 × $83.08x), and $27.69x (1/3 × $83.08x), respectively.

(E) *Member's deduction attributable to the consolidated GILTI deduction amount.* As in paragraph (f)(4)(ii)(C) of this section (the analysis in *Example 4*), the GILTI deduction allocation ratios of P, USS1, and USS2 are 0, 3/4, and 1/4, respectively. Therefore, P, USS1, and USS2 are permitted deductions attributable to the consolidated GILTI deduction amount of $0 (0 × $39.23x), $29.42x (3/4 × $39.23x), and $9.81x (1/4 × $39.23x), respectively.

(F) *Member's deduction pursuant section 250.* Under paragraph (b)(1) of this section, a member is allowed a deduction equal to the sum of the member's deduction attributable to consolidated FDII deduction amount and the member's deduction attributable to consolidated GILTI deduction amount. As a result P, USS1, and USS2 are entitled to deductions under paragraph (b)(1) of this section of $0 ($0 + $0), $84.81x ($55.39x + $29.42x), and $37.50x ($27.69x + $9.81x), respectively.

(g) *Applicability date.* This section applies to consolidated return years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 7.** Section 1.6038–2, as proposed to be amended at 83 FR 67612 (Dec. 28, 2018), is further amended by adding paragraph (f)(15) and a sentence at the end of paragraph (m) to read as follows:

§ 1.6038–2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

* * * * *

(f) * * *

(15) *Information reporting under section 250.* If the person required to file Form 5471 (or any successor form) claims a deduction under section 250(a) that is determined, in whole or part, by reference to its foreign-derived intangible income, and any amount required to be reported under paragraph (f)(11) of this section is included in its computation of foreign-derived deduction eligible income, such person will provide on Form 5471 (or any successor form) such information that is prescribed by the form, instructions, publication, or other guidance.

* * * * *

(m) * * * Paragraph (f)(15) of this section applies with respect to information for annual accounting periods beginning on or after March 4, 2019.

■ **Par. 8.** Section 1.6038–3, as proposed to be amended at 83 FR 67612 (Dec. 28, 2018), is further amended by adding paragraph (g)(4) and a sentence to the end of paragraph (l) to read as follows:

§ 1.6038–3 Information returns required of certain United States persons with respect to controlled foreign partnerships (CFPs).

* * * * *

(g) * * *

(4) *Additional information required to be submitted by a controlling ten-percent or a controlling fifty-percent partner that has a deduction under section 250 by reason of FDII.* In addition to the information required pursuant to paragraphs (g)(1), (2), and (3) of this section, if, with respect to the partnership's tax year for which the Form 8865 is being filed, a controlling ten-percent partner or a controlling fifty-percent partner has a deduction under section 250 (by reason of having foreign-derived intangible income), determined, in whole or in part, by reference to the income, assets, or activities of the partnership, or transactions between the controlling-ten percent partner or controlling fifty-percent partner and the partnership, the controlling ten-percent partner or controlling fifty-percent partner must provide its share of the partnership's gross DEI, gross FDDEI, deductions that are definitely related to the partnership's gross DEI and gross FDDEI, and partnership QBAI (as those terms are defined in the section 250 regulations) in the form and manner and to the extent prescribed by Form 8865 (or any successor form), instruction, publication, or other guidance.

* * * * *

(l) * * * Paragraph (g)(4) of this section applies for tax years of a foreign partnership beginning on or after March 4, 2019.

■ **Par. 9.** Section 1.6038A–2, as proposed to be amended at 83 FR 67612 (Dec. 28, 2018), is further amended by adding paragraph (b)(5)(iv) and a sentence at the end of paragraph (g) to read as follows:

§ 1.6038A–2 Requirements of return.

* * * * *

(b) * * *

(5) * * *

(iv) *Information reporting under section 250.* If, for the taxable year, the reporting corporation has a deduction under section 250 (by reason of having foreign-derived intangible income) with respect to any amount required to be reported under paragraph (b)(3) or (4) of this section, the reporting corporation will provide on Form 5472 (or any successor form) such information about the deduction in the form and manner and to the extent prescribed by Form 5472 (or any successor form), instruction, publication, or other guidance.

* * * * *

(g) * * * Paragraph (b)(5)(iv) of this section applies with respect to information for annual accounting periods beginning on or after March 4, 2019.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

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