DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9865]

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Limitation on Deduction for Dividends Received From Certain Foreign Corporations and Amounts Eligible for Section 954 Look-Through Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final temporary regulations.

SUMMARY: This document contains temporary regulations under section 245A of the Internal Revenue Code (the ''Code'') that limit the dividends received deduction available for certain dividends received from current or former controlled foreign corporations. This document also contains temporary regulations that limit the applicability of the exception to foreign personal holding company income for certain dividends received by upper-tier controlled foreign corporations from lower-tier controlled foreign corporations and temporary regulations under section 6038 to facilitate administration of certain rules in the temporary regulations. The temporary regulations affect certain U.S. persons that are domestic corporations that receive certain dividends from current or former controlled foreign corporations or are United States shareholders of upper-tier controlled foreign corporations that receive certain dividends from lower-tier controlled foreign corporations. The text of the temporary regulations also serves as the text of the proposed regulations set forth in a notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

DATES:

Effective date: These regulations are effective on June 18, 2019.

Applicability dates: For dates of applicability, see §§ 1.245A–5T(k), 1.954(c)(6)–1T(b), and 1.6038–2T(m).

FOR FURTHER INFORMATION CONTACT: Logan M. Kincheloe at (202) 317–6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

I. In General

This document contains amendments to 26 CFR part 1 under sections 245A, 954(c)(6), and 6038 (the ''temporary regulations''). Any terms used but not defined in this preamble have the meanings given them in the temporary regulations. Added to the Code by section 14101(a) of the Tax Cuts and Jobs Act (the ''Act''), section 245A generally allows a domestic corporation a 100-percent dividends received deduction (the ''section 245A deduction'') for the foreign-source portion of a dividend received after December 31, 2017, from a specified 10 percent-owned foreign corporation (an ''SFC''). Section 954, which predates the Act and remains in effect, generally provides that a dividend received by a controlled foreign corporation (a ''CFC''), as defined in section 957, is included in the CFC's foreign personal holding company income (''FPHCI''), as defined in section 954(c). Pursuant to section 954(c)(6), however, a dividend received by a CFC from a related CFC is not included in the CFC's FPHCI if certain requirements are satisfied (the ''section 954(c)(6) exception'').

The temporary regulations limit the availability of the section 245A deduction and the section 954(c)(6) exception in specific and narrow cases where the deduction or exception, respectively, effectively eliminates subpart F income or income subject to tax under section 951A from the U.S. tax system. Specifically, the temporary regulations address transactions that have the effect of avoiding tax under section 965, 951A, or 951 by inappropriately converting income that should have been subject to U.S. tax into nontaxed income. The temporary regulations also include rules under section 6038 to facilitate administration of certain rules in the temporary regulations. The temporary regulations do not include general rules relating to dividends eligible for the section 245A deduction; those rules will be included in separate guidance.

II. Scope of Participation Exemption

In order to transition to the new participation exemption system provided under section 245A and certain other provisions of the Act, the Act imposed a tax on certain earnings and profits of a U.S.-owned foreign corporation that had not previously been subject to U.S. tax. *See* section 965. Section 965 was designed to ensure that previously untaxed foreign income of the foreign corporation that accrued before the advent of the participation exemption system generally is subject to U.S. tax (although at a reduced rate). This transition tax applied to the last taxable year of the foreign corporation beginning before January 1, 2018, and generally increased the subpart F income of the foreign corporation by the amount of its previously untaxed earnings as of no later than December 31, 2017.

The Act's legislative history indicates congressional concern that the new participation exemption could heighten the incentive to shift profits to low-taxed foreign jurisdictions or tax havens absent base erosion protections. *See* Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 365 (Comm. Print 2017) (''Senate Explanation''). For example, without appropriate limits, domestic corporations might be incentivized to shift income to low-taxed foreign affiliates, ''where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.'' *See id.*

This risk of base erosion is acute with respect to certain types of income, such as passive or mobile income and income derived from intangible property, which historically have posed transfer pricing challenges. To prevent base erosion, the Act retained the subpart F regime (section 951 et. seq.) and enacted a new regime under section 951A for global intangible lowed-taxed income (the ''GILTI regime''), both of which subject certain foreign income of a CFC to current U.S. taxation in the hands of the CFC's United States shareholders (within the meaning of section 951(b)) (each shareholder, a ''U.S. shareholder''). In order to avoid double taxation when a CFC distributes earnings and profits that have been taxed on a current basis to a U.S. shareholder, the earnings and profits are designated as ''previously taxed earnings and profits'' (also known as ''PTEP'') under section 959. Section 959 generally provides that PTEP are not subject to U.S. tax when distributed to a U.S. shareholder.

The subpart F regime, which was established under the Revenue Act of 1962, Public Law 87–834, sec. 12, 76 Stat. at 1006, subjects certain income earned by a CFC to U.S. taxation in the hands of the CFC's U.S. shareholders on a current basis at the full ordinary tax rate, regardless of whether the CFC distributes the earnings attributable to such income. H.R. Rep. No. 1447 at 58 (1962). In general, the subpart F regime applies to certain passive or highly mobile income in order to address base erosion concerns. Thus, for example, section 954(c) provides that subpart F income includes FPHCI. FPHCI includes certain types of passive or mobile income that are relatively easy to situate in tax-advantaged jurisdictions, such as dividends, interest, rents, and royalties.

The GILTI regime generally subjects a CFC's U.S. shareholders to current taxation on intangible income earned by the CFC in a manner similar to the treatment of a CFC's subpart F income. *See* section 951A; *see also* Senate Explanation at 366 (explaining that such income is often associated with profit shifting). Intangible income is determined for this purpose on an aggregate basis at the U.S. shareholder level and is based on a formulaic approach under which a ''normal return'' equal to 10 percent of the basis of certain tangible assets is calculated and then each dollar of income above the ''normal return'' is effectively treated as intangible income (regardless of whether such income is actually attributable to intangible property). *See* Senate Explanation at 366. However, for purposes of this determination, certain income of the CFC—such as income taxed under another Code provision (for example, under the rules for subpart F income in sections 951 through 964 or under section 882 in the case of income effectively connected with the conduct of a U.S. trade or business), immobile income (such as foreign oil and gas extraction income), or highly taxed income that is excluded from subpart F income by reason of the high-tax exception of section 954(b)(4)—is not taken into account. *See also id.* (''[C]ertain items of income earned by CFCs should be excluded from the GILTI, either because they should be exempt from U.S. tax—as they are generally not the type of income that is the source of base erosion concerns—or are already taxed currently by the United States''). The CFC's U.S. shareholders are subject to current U.S. tax on the CFC's income in excess of the CFC's normal return, potentially at a reduced rate through a deduction under section 250, at the corporate U.S. shareholder level. The differing treatment under the GILTI regime with respect to excess returns (taxed currently, though potentially at a reduced rate) versus normal returns (exempt from tax) generally has the effect of differentiating between income that poses base erosion concerns and income that does not pose such concerns. The GILTI regime applies in the first taxable year of a CFC beginning on or after January 1, 2018. Section 245A applies to distributions made by SFCs (which include CFCs) on or after that date.

The rules under section 959 generally treat PTEP (including PTEP that arise by reason of the subpart F regime, the GILTI regime, or the transition tax under section 965) as being distributed before non-previously taxed earnings and profits and also prevent section 245A from applying to PTEP. *See* section 959(c) (providing ordering rules that treat PTEP as being distributed first) and section 959(d) (providing that a distribution of PTEP to a U.S shareholder is not treated as a dividend). Thus, both the interaction of the definitions of subpart F income and tested income with the ordering rules for distributions of PTEP and the overall structure of the international provisions of the Act contemplate that only residual earnings remaining after the potential application of sections 951(a), 951A, and 965 generally are eligible for the section 245A deduction. That is, section 245A(a) applies only to certain ''dividends'' received from foreign corporations. Therefore, sections 951(a), 951A, and 965 generally have priority over section 245A because, when they apply to a foreign corporation's earnings, distributions of those earnings do not qualify as dividends under section 959(d), and, therefore, section 245A does not apply.

The statutory text of the participation exemption system under section 245A, the GILTI regime, the subpart F regime, and the PTEP rules collectively operate as a comprehensive framework with respect to a CFC's foreign earnings after the application of the transition tax under section 965. A central feature of this regime is that income derived by CFCs is eligible for the section 245A deduction only if the earnings being distributed have not been first subject to the subpart F or GILTI regimes. The scope of the section 245A deduction (and the authority set forth in section 245A(g)) is thus informed not only by the text of section 245A in isolation, but also by the role of section 245A in the overall structure of the international provisions and its interaction with the subpart F and GILTI provisions.

Section 245A(g) provides that the Secretary shall issue such regulations as are necessary or appropriate to carry out the provisions of section 245A.

III. Scope of Section 954(c)(6)

Section 954(c)(6) was enacted by the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222. In general, and subject to certain limitations, the section 954(c)(6) exception is intended to facilitate intragroup foreign-to-foreign funds flows by providing that dividends, interest, rents, and royalties received or accrued by a CFC from another related CFC are not treated as FPHCI to the extent attributable or properly allocable to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. *See* H.R. Rep. No. 109–304 at 45 (2005). Section 954(c)(6)(A) also provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provision, including regulations to prevent the abuse of the purposes of the provision. As most recently extended by the Consolidated Appropriations Act of 2016, Public Law 114–113, section 954(c)(6) applies to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2020, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Notice 2007–9, 2007–5 I.R.B. 401, provides guidance under section 954(c)(6). The notice describes additional guidance that the Treasury Department and the IRS intend to issue regarding the application of section 954(c)(6), including certain anti-abuse rules.

Explanation of Provisions

I. Overview

The transition tax, the subpart F and GILTI regimes, and the participation exemption under section 245A together form a comprehensive and closely integrated set of tax rules with respect to the earnings of foreign corporations with requisite levels of U.S. ownership. These related provisions must be read and interpreted together in order to ensure that each provision functions as part of a coherent whole, as intended. Although the section 245A deduction is generally available for untaxed foreign-source earnings, read collectively this integrated set of statutory rules can be reasonably understood to require that the deduction not apply to earnings and profits attributable to income of a type that is properly subject to the subpart F or GILTI regimes, which address base erosion-type income. Otherwise, as explained in Part II of this Explanation of Provisions, the section 245A deduction could undermine the anti-base erosion measures that Congress intended to prevent income shifting. Accordingly, and consistent with the coherent functioning of the interlocking statutory scheme for taxation of CFC earnings, the section 245A deduction generally will not apply to distributions of earnings and profits that are attributable to subpart F income or tested income. The interpretation reflected in these rules ensures that these provisions will operate compatibly with, not contradictorily to, each other.

Section 245A is designed to operate residually, such that the section 245A deduction generally applies to any earnings of a CFC to the extent that they are not first subject to the subpart F regime, the GILTI regime, or the exclusions provided in section 245A(c)(3) (and were not subject to section 965). That is, the text of the subpart F and GILTI rules explicitly defines the types of income to which they apply, and section 245A applies to any remaining untaxed foreign earnings. Under ordinary circumstances, this formulation works appropriately, as earnings are first subject to the subpart F or GILTI regimes before the determination of dividends to which section 245A could potentially apply. However, in certain atypical circumstances, a literal application of section 245A (read in isolation) could result in the section 245A deduction applying to earnings and profits of a CFC attributable to the types of income addressed by the subpart F or GILTI regimes—the specific types of earnings that Congress described as presenting base erosion concerns. These circumstances arise when a CFC's fiscal year results in a mismatch between the effective date for GILTI and the final measurement date under section 965 or involve unanticipated interactions between section 245A and the rules for allocating subpart F income and GILTI when there is a change in ownership of a CFC. Moreover, the Treasury Department and the IRS are aware that some taxpayers are undertaking transactions with a view to eliminating current or future taxation of all foreign earnings of a CFC, including earnings attributable to base erosion-type income, by structuring into these situations. These transactions have the potential to substantially undermine the anti-base erosion framework for post-2017 foreign earnings.

Based on the structure and history of the international provisions of the Code, including changes made by the Act, the Treasury Department and the IRS have concluded that section 245A was not intended to eliminate taxation with respect to the foreign earnings of a CFC that are attributable to income of a type that is subject to taxation under the subpart F or GILTI regimes. In these cases where the literal effect of section 245A would reverse the intended effect of the subpart F and GILTI regimes, this conflict is best resolved, and the structure of the statutory scheme is best preserved, by limiting section 245A's effect. The Treasury Department and the IRS do not believe Congress intended section 245A to defeat the purposes of subpart F and GILTI regimes in these instances. Accordingly, given the authority in section 245A(g) directing the Secretary to issue such regulations as are necessary or appropriate to carry out the provisions of section 245A, and the authority under section 7805(a) to issue rules and regulations made necessary by reason of changes in the tax laws, the temporary regulations under section 245A are designed to ensure that the section 245A deduction operates properly within the context of a closely coordinated set of rules and, as a result, is not available to eliminate the taxation of subpart F income and tested income in these limited circumstances. However, consistent with the broad application of section 245A, the temporary regulations apply only to certain well-defined circumstances in which subpart F or tested income earned by a CFC would otherwise escape taxation to its U.S. shareholders as a result of the unanticipated interaction of section 245A and certain rules applicable to the inclusion of subpart F income and GILTI under sections 951(a) and 951A, respectively.

To prevent the avoidance of U.S. tax in these specific and narrow circumstances, the temporary regulations limit the section 245A deduction only with respect to certain dividends received by a domestic corporation in connection with specific transactions that facilitate the avoidance of taxation of subpart F income or tested income and that, in many cases, may have been entered into with a purpose of avoiding the consequences of the new international tax regime as adopted by Congress in the Act. This limited denial ensures that the section 245A deduction will continue to apply to earnings and profits that are attributable to all other classes of income to which Congress intended them to apply. The Treasury Department and the IRS emphasize, however, that when the requirements of section 245A as properly construed are satisfied, it would not be permissible under the statute for the section 245A deduction to be denied for these other classes of income—even if, for example, taxpayers choose to generate such income to avail themselves of the benefits of the deduction. The Treasury Department and the IRS furthermore do not believe it would be permissible to modify the definition of subpart F income or tested income, or to recharacterize income as subpart F income or tested income, under the authority of section 245A(g).

Similar to section 245A, the exemption from subpart F income under section 954(c)(6) can be used in the context of certain transactions to avoid taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Such transactions are not dependent upon the availability of section 245A at the level of the United States shareholder. This type of concern was first generally described in Notice 2007–9, but has been exacerbated by the enactment of section 951A as part of the Act because (1) dividends qualifying for section 954(c)(6) generally are not treated as tested income pursuant to section 951A(c)(2)(A)(i)(IV); and (2) the same structured transactions used to avoid subpart F inclusions can also be used to avoid GILTI inclusions. Given the authority in section 954(c)(6)(A) for the Treasury Department and the IRS to issue regulations preventing the abuse of section 954(c)(6), the temporary regulations under section 954(c)(6) are designed to ensure that the section 954(c)(6) exception is not used to erode the U.S. tax base through certain transactions preventing the taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Consistent with the temporary regulations issued under section 245A, these rules are targeted to ensure that the section 954(c)(6) exception is not available for this limited category of earnings.

II. Limitation of Amounts Eligible for Section 245A Deduction

A. Scope

In the case of a dividend received by a domestic corporation from an SFC, the temporary regulations limit the amount of the section 245A deduction to the portion of a dividend not constituting an ''ineligible amount.'' *See* § 1.245A–5T(b). In general, the ineligible amount is the sum of (i) 50 percent of the portion of a dividend attributable to certain earnings and profits resulting from transactions between related parties during a period after the measurement date under section 965(a)(2) and in which the SFC was a CFC but during which section 951A did not apply to it (referred to as the ''extraordinary disposition amount'') and (ii) the portion of a dividend attributable to certain earnings and profits generated during any taxable year ending after December 31, 2017, in which the domestic corporation reduces its ownership of the CFC (referred to as the ''extraordinary reduction amount'').

B. Extraordinary Disposition Amount

Under the Act, there may be a gap between when section 951A first applies to the U.S. shareholders of a CFC (as of its first taxable year beginning after December 31, 2017) and the last date on which the earnings and profits of the CFC are measured for purposes of section 965, which, under section 965(a), is December 31, 2017 (such period, the ''disqualified period''). For example, a fiscal year CFC with a taxable year ending November 30 would have a disqualified period from January 1, 2018, the day after its final E&P measurement date under section 965, to November 30, 2018, the last date before section 951A applies with respect to its income. The Treasury Department and the IRS are aware that during the disqualified period, CFCs may have engaged in certain transactions with related parties with a goal of creating stepped-up basis for the buyer, while generating earnings and profits for the seller CFC that are not subject to any current tax and may be eligible for the section 245A deduction. Because the transactions generally are structured to avoid creating subpart F income and occur during the disqualified period, the income from these transactions generally is not subject to U.S. tax under the transition tax under section 965, the subpart F regime, or the GILTI regime. Such earnings and profits could, for example, reduce taxable gain that would otherwise be recognized on the subsequent disposition of stock of the CFC, thus potentially allowing the CFC and its future earnings to be removed from the U.S. tax system without the imposition of any U.S. tax.

The Treasury Department and the IRS have determined that it would be inconsistent with the closely interdependent set of international tax rules implemented by the Act, specifically the transition tax, the GILTI regime, and the participation exemption, for the earnings and profits resulting from these transactions to be eligible for a section 245A deduction even if the other requirements of section 245A are otherwise satisfied. Thus, the temporary regulations limit the amount of the section 245A deduction allowed to a section 245A shareholder (as defined in § 1.245A–5T(i)(21)) with respect to a dividend received from an SFC. Specifically, the deduction is limited to 50 percent of the extraordinary disposition amount, which is the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the section 245A shareholder's ''extraordinary disposition account.'' *See* § 1.245A–5T(b)(2) and (c)(1). In general, this account represents the shareholder's pro rata share of the SFC's ''extraordinary disposition E&P,'' reduced by the section 245A shareholder's prior extraordinary disposition amounts, if any. *See* § 1.245A–5T(c)((3)(i)(C)(*1*)). Extraordinary disposition E&P is an amount equal to the earnings of an SFC arising from gain recognized by reason of one or more ''extraordinary dispositions.'' *See* § 1.245A–5T(c)(3)(i)(C).

The section 245A deduction is limited to 50 percent of the extraordinary disposition amount to reflect the fact that taxpayers generally would have been eligible for a deduction under either (i) section 250(a)(1)(B) had section 951A applied to the SFC during the disqualified period or (ii) section 965(c) had the net gain been subject to the transition tax under section 965.

For a disposition by an SFC to be an extraordinary disposition, the disposition must (i) be of specified property (defined in § 1.245A–5T(c)(3)(iv) as any property other than property that produces gross income described in section 951A(c)(2)(A)(i)(I) through (V)), (ii) occur during the SFC's disqualified period (as defined in § 1.245A–5T(c)(3)(iii)) and when the SFC was a CFC, (iii) be outside of the ordinary course of the SFC's activities, and (iv) be to a related party. *See* § 1.245A–5T(c)(3)(ii). For these purposes, a disposition by an SFC includes certain indirect dispositions by the SFC through a partnership or other pass-through entities (including through ownership structures involving tiered pass-through entities). *See id.*

In addition, pursuant to an exception intended to limit compliance and administrative burdens, no dispositions by an SFC are considered to be an extraordinary disposition if they do not exceed a threshold of the lesser of $50 million or 5 percent of the gross value of the SFC's property. *See* § 1.245A–5T(c)(3)(ii)(E).

The temporary regulations provide a facts-and-circumstances rule for determining whether a disposition occurs outside of the ordinary course of an SFC's activities. The temporary regulations also provide a per se rule that a disposition is treated as outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or if the disposition is of intangible property, within the meaning of section 367(d)(4). *See id.* The temporary regulations include this latter rule because the disposition of intangible property is not an ordinary course transaction (relative to, for example, a routine sale of raw materials from one SFC to another for manufacturing); moreover, during the disqualified period taxpayers may have had a particularly strong incentive to dispose of intangible property (which often has low basis) to generate significant amounts of earnings and profits to the seller (without being subject to current tax) that may be eligible for the section 245A deduction.

As described, the Treasury Department and the IRS have determined that the extraordinary disposition rules should not apply to all earnings and profits generated by a CFC during the disqualified period. Rather, the temporary regulations focus on a narrowly and objectively defined class of earnings and profits in circumstances that are inconsistent with the international tax regime adopted by the Act. The Treasury Department and the IRS request comments on whether there should be any further refining of these rules.

The temporary regulations provide shareholder account rules to ensure that a section 245A shareholder's extraordinary disposition account is properly tracked and reduced in appropriate cases (for example, for prior extraordinary disposition amounts). *See* § 1.245A–5T(c)(3)(i). These shareholder account rules also contain successor rules for a section 245A shareholder that acquires stock of an SFC from another section 245A shareholder with respect to which there is an extraordinary disposition account and for certain section 381 transactions and distributions involving section 355 (or so much as section 356 as relates to section 355). *See* § 1.245A–5T(c)(4).

To address cases in which the section 245A deduction might be available for an SFC held through a pass-through entity or foreign corporation, the temporary regulations provide that a section 245A shareholder is treated as owning a pro rata share of stock of an SFC that is owned by a partnership, trust, or estate (domestic or foreign), or a foreign corporation in which the section 245A shareholder owns an interest or stock, as applicable. *See* § 1.245A–5T(g)(3)(i) (providing rules for stock ownership and transfers).

The Treasury Department and the IRS request comments as to how the extraordinary disposition account rules should apply in circumstances in which an SFC is transferred to a partnership, including the extent to which principles similar to section 704(c)(1)(B) apply to prevent the use of partnerships to circumvent the purposes of the temporary regulations, such as where an SFC is subsequently transferred to a non-contributing partner. As a general matter, the Treasury Department and the IRS believe that § 1.701–2(b), as well as the judicial doctrines of economic substance, substance over form, and step transaction, prevent taxpayers from forming or availing of partnerships with a principal purpose of avoiding the application of these rules. The treatment of partnerships under section 245A will be addressed in separate guidance; and it is anticipated that this guidance will provide rules ensuring that partnerships may not be formed or availed of to avoid the purposes of the temporary regulations.

The Treasury Department and the IRS further request comments on the treatment of consolidated groups under the temporary regulations, including for purposes of maintaining extraordinary disposition accounts. The Treasury Department and the IRS believe that consolidated groups generally should be treated in the same manner as a single taxpayer for the purposes of § 1.245A–5T(c). Subject to any comments received, it is expected that future rules will provide that consolidated groups generally should not be advantaged or disadvantaged as a result of owning directly or indirectly stock of an SFC through multiple members relative to a standalone corporation owning the same stock.

The Treasury Department and the IRS also request comments on whether and how the rules applicable to disqualified basis in proposed § 1.951A–2(c)(5) should be coordinated with § 1.245A–5T(c). In this regard, proposed § 1.951A–2(c)(5) provides rules for the allocation and apportionment of deductions and losses attributable to disqualified basis, which is asset basis created in certain disqualified transfers during the disqualified period. These deductions and losses are allocated and apportioned solely to gross income that is not tested income, subpart F income, or effectively connected income (defined as ''residual CFC gross income''), thereby ensuring that such ''costless'' tax basis does not inappropriately reduce future tax liability. Thus, the Treasury Department and the IRS are considering the extent to which it would be appropriate to coordinate the two sets of rules, taking into account the ability of the IRS to administer and taxpayers to comply with such rules, and request comments on this issue.

C. Extraordinary Reduction Amount

The Treasury Department and the IRS are aware that certain transactions in which a section 245A shareholder of a CFC transfers stock of the CFC, or certain transactions in which the shareholder's ownership of the CFC is diluted, could give rise to results that would be inconsistent with the integrated structure of the U.S. tax system for the taxation of CFC earnings, including section 245A, the subpart F regime, and the GILTI regime. In these cases, absent proper limitation, the section 245A deduction might be allowed inappropriately with respect to a CFC's current year income that, but for the ownership changes, would have been subject to tax under the subpart F or GILTI regimes. Unlike the transactions described in Part II.B of this Explanation of Provisions, the transactions giving rise to these results can occur in any taxable year ending after the Act (and particularly section 245A) is in effect.

These results could arise, for example, as a consequence of the application of section 951(a)(2)(B). Section 951(a)(2)(B), a longstanding provision in the subpart F regime, prevents double taxation of the same earnings by reducing a U.S. shareholder's pro rata share of subpart F income (or, following the Act, tested income as defined in section 951A(c)(2)(A)) of a CFC by dividends received by another person with respect to the same share of stock. However, if section 245A were to apply without limitation to dividends from a CFC that reduce another U.S. shareholder's pro rata share of subpart F income or tested income of the CFC under section 951(a)(2)(B), earnings that would otherwise be subject to the subpart F or GILTI regimes would escape U.S. taxation to the extent of the reduction. For example, in the case of a transfer of CFC stock from one section 245A shareholder (the transferor) to another section 245A shareholder (the transferee), a dividend (including by reason of section 1248) from the CFC to the transferor during the tax year of the transfer might both (i) be excluded from the transferor's income by reason of the section 245A deduction and (ii) reduce the transferee's pro rata share of subpart F income or tested income of the CFC by reason of section 951(a)(2)(B). The Treasury Department and the IRS have determined that it would be inconsistent with the residual definition of section 245A eligible earnings and the interaction of section 245A and the subpart F and GILTI regimes, which form an integrated set of rules to tax post-2017 foreign earnings, to allow a section 245A deduction for a dividend paid out of earnings and profits attributable to subpart F income or tested income where such dividends, by operation of section 951(a)(2)(B), and could result in double non-taxation of such income. Such a result would also be contrary to the legislative intent underlying the interaction of these provisions. *See* Senate Explanation at 365 (noting, in the absence of rules such as the new GILTI regime, the incentive to shift income to low-taxed foreign affiliates, ''where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.'').

Similar results can arise in other cases where the stock of a CFC is transferred during a CFC's tax year by a U.S. shareholder to a foreign person where, after the transfer, the CFC remains a CFC but has no U.S. shareholder that owns (within the meaning of section 958(a)) stock of the CFC. Before the Act, section 958(b)(4) prevented certain attribution of stock under section 318 from a foreign person to a U.S. person. However, the Act repealed section 958(b)(4) such that a foreign corporation may be treated as a CFC despite having no direct or indirect U.S. shareholder that owns (within the meaning of section 958(a)) stock of the CFC and that accordingly can recognize an income inclusion under section 951 or 951A. In general, a U.S. shareholder that owns stock in a CFC on the last day within the foreign corporation's year that it is a CFC is taxable on its pro rata share of the CFC's subpart F income or tested income for purposes of the GILTI regime. However, by reason of the Act's repeal of section 958(b)(4), a U.S. shareholder may transfer a CFC to a person that will not be taxed with respect to an inclusion under the subpart F or GILTI regimes without itself being subject to such an inclusion. Absent any specific limitation in these circumstances, any earnings and profits of the CFC distributed as a dividend (including by reason of section 1248) to the transferor U.S. shareholder during the CFC's taxable year might be eligible for the section 245A deduction. However, had the transfer not occurred (or had the CFC ceased to be a CFC as a result of the transfer), the earnings and profits may have been subject to tax under the subpart F or GILTI regimes and, therefore, would not have been eligible for the section 245A deduction.

In the circumstances described in this section, a broad application of section 245A would present taxpayers with a planning opportunity to completely avoid the application of the subpart F and GILTI regimes on an annual basis. The Treasury Department and the IRS have determined that this result would undermine the integrated provisions constituting the Act's framework for taxing post-2017 CFC earnings and would contravene legislative intent. To address this concern, the temporary regulations limit the amount of the section 245A deduction allowed to a ''controlling section 245A shareholder'' with respect to a dividend from a CFC to the portion of the dividend that is paid out of earnings other than the ''extraordinary reduction amount.'' *See* § 1.245A–5T(b)(1) and (e). A controlling section 245A shareholder of a CFC is a section 245A shareholder of the CFC that, taking into account ownership of the CFC by certain other persons (such as related persons), owns more than 50 percent of the stock of the CFC. *See* § 1.245A–5T(i)(2). For purposes of applying these rules, a controlling section 245A shareholder also includes any other shareholder who would not otherwise be a controlling section 245A shareholder but acts in concert with the controlling section 245A shareholder. This includes shareholders that sell their shares of the same CFC to the same buyer or buyers (or a related party with respect to the buyer or buyers) as part of the same plan as the controlling section 245A shareholder's extraordinary reduction.

Under the temporary regulations, for an extraordinary reduction amount to exist with respect to a controlling section 245A shareholder of a CFC, an ''extraordinary reduction'' must occur during the CFC's taxable year with respect to the shareholder's ownership of the CFC. *See* § 1.245A–5T(e). An extraordinary reduction generally occurs when either (i) the controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC (for example, an extraordinary reduction occurs if the shareholder owns 90 percent of the stock of the CFC and it transfers stock representing more than nine percent of the stock of the CFC) or (ii) there is a greater than ten percent change in the controlling section 245A shareholder's overall ownership of the CFC (for example, if the shareholder owns 90 percent of the stock of the CFC and, as a result of an issuance to a foreign person, the shareholder's ownership of the CFC is reduced such that it no longer owns at least 81 percent of the stock of the CFC). *See* § 1.245A–5T(e)(2)(i)(A). The temporary regulations include the first prong because if, for example, a section 245A shareholder of a CFC were to transfer shares of stock of the CFC to another section 245A shareholder of the CFC and the other shareholder were to transfer an equal number of similar shares to the first shareholder, neither of the shareholders' overall ownership of the CFC would change, but the amount taken into account by each of the shareholders by reason of section 951(a)(2)(B) might be reduced as a result of dividends paid with respect to shares transferred by the other.

An extraordinary reduction amount is earnings and profits representing the amount of dividends paid by the corporation that are attributable to subpart F income or tested income with respect to a CFC, to the extent such subpart F income or tested income (i) would have been taken into account by the controlling section 245A shareholder under section 951 or 951A had the extraordinary reduction not occurred and (ii) is not taken into account by a domestic corporation or a citizen or resident of the United States (that is, a person described in section 7701(a)(30)(A) or (C)). *See* § 1.245A–5T(e)(1) and (2).

The limitation of the section 245A deduction in the case of an extraordinary reduction will generally result in a dividend being included in the income of the controlling section 245A shareholder and not offset by a section 245A deduction. In cases where the CFC has tested income during its taxable year that would have been subject to the GILTI regime but for the extraordinary reduction, a controlling section 245A shareholder might prefer to have an income inclusion under section 951A, potentially benefitting from the deduction available under section 250. Therefore, the temporary regulations provide an election under which a controlling section 245A shareholder is not required to reduce its section 245A deduction if it elects (and, in some cases, certain other United States persons also agree) to close the CFC's taxable year for all purposes of the Code on the date of the extraordinary reduction. *See* § 1.245A–5T(e)(3)(i). The closing of the taxable year of the CFC results in all U.S. shareholders that own (within the meaning of section 958(a)) stock of the CFC on such date taking into account their pro rata share of subpart F income or tested income earned by the CFC as of that date.

In addition, pursuant to an exception intended to limit compliance and administrative burdens, for a taxable year in which an extraordinary reduction occurs, no amount is considered an extraordinary reduction amount if the sum of the CFC's subpart F income and tested income for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC's total income for the year. *See* § 1.245A–5T(e)(3)(ii).

D. Coordination Rules

To address cases in which a dividend could qualify as either a hybrid dividend under the rules of section 245A(e) or an ineligible amount under the temporary regulations, the temporary regulations provide a coordination rule pursuant to which a dividend is first subject to the hybrid dividend rules of section 245A(e) and then, to the extent not a hybrid dividend, is subject to the temporary regulations. *See* § 1.245A–5T(g)(3)(iv). In future guidance relating to proposed regulations under section 245A(e) and certain other sections (83 FR 67612), the Treasury Department and the IRS anticipate modifying those regulations to reflect this coordination rule.

In addition, to address cases in which a dividend might be either an extraordinary disposition amount under § 1.245A–5T(c) or an extraordinary reduction amount under § 1.245A–5T(e), the temporary regulations provide a coordination rule pursuant to which a dividend is first subject to the rules of § 1.245A–5T(e) and then, to the extent not an extraordinary reduction amount, is subject to the rules of § 1.245A–5T(c). *See* § 1.245A–5T(g)(5). Because of this ordering rule, the extraordinary disposition amount with respect to a dividend will not exceed the amount by which the dividend exceeds the extraordinary reduction amount with respect to the dividend.

E. Transactions Described in Section 964(e)(4)

The rules in these temporary regulations for determining eligibility for the section 245A deduction also apply to deemed dividends arising by reason of section 964(e)(4), which the Act added to the Code. Section 964(e)(4) provides in certain cases that a sale by a CFC of stock of another foreign corporation is treated as a dividend from the target foreign corporation to the selling CFC that is, in turn, treated as subpart F income of the selling CFC and included in the gross income of the U.S. shareholders of the selling CFC. Pursuant to section 964(e)(4)(A)(iii), the section 245A deduction is allowed to any U.S. shareholder with respect to such subpart F income included in gross income in the same manner as if such subpart F income were a dividend received by the shareholder from the selling CFC. Thus, section 964(e)(4) presents the same concerns as direct dividends; absent a rule to the contrary, taxpayers might use section 964(e)(4) to avoid the results applicable to actual distributions from an upper-tier CFC to a U.S. shareholder or to constructive dividends under section 1248 that are addressed elsewhere by these temporary regulations. Therefore, the rules in these temporary regulations for determining eligibility for the section 245A deduction also apply to deemed dividends arising by reason of section 964(e)(4). Moreover, all U.S. shareholders of the selling CFC are deemed to act in concert for purposes of the temporary regulations with respect to transactions described in section 964(e)(4).

III. Limitation of Amount Eligible for Section 954(c)(6) Exception With Respect to Certain Dividends

A. In General

As described in Part I of this Explanation of Provisions, the section 954(c)(6) exception may cause dividends from one CFC to another to result in tax consequences similar to, but not dependent upon, those that can be effectuated using section 245A in conjunction with the disqualified period, section 951(a)(2)(B), or the repeal of section 958(b)(4).

To protect against avoidance of the rules for extraordinary dispositions (described in Part II.B of this Explanations of Provisions), the temporary regulations rely on authority under section 954(c)(6)(A) to prevent the section 954(c)(6) exception from applying in cases where a dividend from a lower-tier CFC to an upper-tier CFC would be an extraordinary disposition amount if distributed directly to the section 245A shareholders of the lower-tier CFC. *See* § 1.245A–5T(d). In these cases, the section 954(c)(6) exception applies only to the extent that the amount of the dividend exceeds the sum of each section 245A shareholder's extraordinary disposition account with respect to the lower-tier CFC, divided by the aggregate ownership of all U.S. tax residents of the upper-tier CFC that have section 951(a) inclusions and multiplied by 50 percent. The amount is divided by the aggregate ownership of these U.S. tax residents to take into account the fact that the U.S. tax residents (including individuals) will include in gross income a pro rata share of the portion of the dividend not eligible for the section 954(c)(6) exception. The amount is multiplied by 50 percent in order to provide similar treatment for a dividend received by a section 245A shareholder from a CFC and a dividend received by an upper-tier CFC from a lower-tier CFC. In both cases, the 50 percent reduction of the section 245A deduction approximates the reduced tax rate by reason of the deduction provided under section 250(a)(1)(B) with respect to section 951A inclusions or section 965(c) with respect to the transition tax.

Unlike the disallowance of the section 245A deduction under § 1.245A–5T(b) with respect to an extraordinary disposition amount, which applies only to corporate U.S. shareholders, the limitation to the application of the section 954(c)(6) exception with respect to a dividend received by an upper-tier CFC can result in a subpart F inclusion to any U.S. shareholder, including individuals. In addition, the temporary regulations limit the section 954(c)(6) exception in these cases, rather than limiting the application of section 245A only when the lower-tier CFC earnings and profits are distributed through intervening CFCs to a section 245A shareholder. This approach prevents deferral of tax with respect to the applicable subpart F income or tested income and minimizes the administrative and compliance burdens that would be created by continuing to track the relevant earnings at the upper-tier CFC.

Similarly, to prevent these inappropriate uses of the section 954(c)(6) exception to avoid the rules for extraordinary reductions (described in Part II.C of this Explanation of Provisions), the temporary regulations apply to limit the amount of any distribution from that CFC out of earnings and profits attributable to subpart F income or tested income that can qualify for the section 954(c)(6) exception in a taxable year in which an extraordinary reduction occurs with respect to the stock of a CFC. Similar to the rules relating to extraordinary disposition amounts, the limitation to the section 954(c)(6) exception with respect to a dividend received by an upper-tier CFC can result in a subpart F inclusion to any U.S. shareholder, including individuals. To the extent a CFC-to-CFC dividend otherwise satisfies the requirements of section 954(c)(6), it is eligible for the section 954(c)(6) exception only to the extent it exceeds the distributing lower-tier CFC's "tiered extraordinary reduction amount," taking into account certain prior inclusions under section 951(a). *See* § 1.245A–5T(f)(1). Such amount is equal to the upper-tier CFC's ownership percentage in the lower-tier CFC multiplied by the lower-tier CFC's subpart F income and tested income for the taxable year, with the resulting product reduced by four amounts. The first amount is the pro rata share of the lower-tier CFC's subpart F income and tested income for the taxable year that is taken into account by U.S. tax residents and attributable to the shares of the lower-tier CFC owned by the upper-tier CFC. The second amount is the amount included in an upper-tier CFC's subpart F income resulting from prior dividends paid by the lower-tier CFC giving rise to tiered extraordinary reduction amounts or the application of section 245A(e). The third amount is for certain prior extraordinary reduction amounts with respect to the lower-tier CFC arising in cases in which the lower-tier CFC was a first-tier CFC at some point in the taxable year and paid a dividend to one or more controlling section 245A shareholders at that time. The fourth amount is for subpart F income and tested income taken into account by a U.S. tax resident as a result of an issuance of stock directly by the lower-tier CFC during the taxable year. *See* § 1.245A–5T(f)(2). Comments are requested as to whether a lower-tier CFC's tiered extraordinary reduction amount should be reduced for a pro rata portion of a dividend paid on stock of the lower-tier CFC that was held by non-U.S. shareholders before and after an extraordinary reduction. For purposes of applying § 1.245A–5T(f)(1) and (2) in taxable years of a lower-tier CFC beginning on or after January 1, 2018, and ending before June 14, 2019, a transition rule is provided such that the tiered extraordinary reduction amount of a lower-tier CFC is determined by treating the lower-tier CFC's subpart F income for the taxable year as if it were neither subpart F income nor tested income. *See* § 1.245A–5T(f)(3).

The rule in § 1.245A–5T(f)(1) applies to both actual distributions and deemed distributions that occur by reason of stock dispositions subject to section 964(e)(1) but not section 964(e)(4). Dispositions subject to section 964(e)(1) but not section 964(e)(4) are treated as dividends from the target foreign corporation (or other entity whose earnings and profits gave rise to a dividend under section 964(e)(1)) to the selling CFC and, thus, must be tested for eligibility under section 954(c)(6). Additionally, ordering and coordination rules apply with respect to the rules relating to the availability of the section 954(c)(6) exception and generally mirror the rules for the section 245A deduction by giving priority to § 1.245A–5T(f) over § 1.245A–5T(d). *See* § 1.245A–5T(g)(4)(ii). As in the rules relating to extraordinary reduction amounts, a controlling section 245A shareholder of a lower-tier CFC may elect to close the taxable year of the CFC in cases where an extraordinary reduction occurs and the CFC would have a tiered extraordinary reduction amount. *See* § 1.245A–5T(e).

Finally, the Treasury Department and the IRS are studying whether § 1.245A–5T(f), or a similar rule, should also apply to dividends received by an upper-tier CFC from a lower-tier CFC where such CFCs are owned by individuals and there may be a reduction in the individuals' ownership of the lower-tier CFC. Individuals are not eligible to claim deductions under section 245A and, therefore, dividends subject to section 954(c)(6) do not present the risk of permanently eliminating items of subpart F income, investments in United States property taxed under section 951(a)(1)(B), or tested income from the U.S. tax base. At the same time, section 954(c)(6) dividends might result in a reduction of a U.S. shareholder's pro rata share of a CFC's subpart F income or tested income, thereby resulting in deferred taxation of items that otherwise would have been taxed currently. Therefore, comments are requested as to whether § 1.245A–5T(f), or a similar rule, should be extended to CFCs owned by individuals.

B. Dividends Received by CFCs Ineligible for Section 245A Deduction

Section 245A(a), by its terms, applies only to certain dividends received by ''a domestic corporation.'' Section 1.952–2, however, which sets forth rules for determining gross income and taxable income of a foreign corporation, provides that for these purposes a foreign corporation is treated as a domestic corporation. *See* § 1.952–2(a)(1) and (b)(1). Accordingly, questions have arisen as to whether § 1.952–2 could be interpreted such that a foreign corporation could claim a section 245A deduction despite the statutory restriction in section 245A(a) expressly limiting the deduction to domestic corporations. *See* H.R. Rep. No. 115–466, at 599, fn. 1486 (2017).

The Treasury Department and the IRS intend to address issues related to the application of § 1.952–2, taking into account various comments received in connection with the Act, including in connection with the proposed section 951A regulations, in a future guidance project. This guidance will clarify that, in general, any provision that is expressly limited in its application to domestic corporations does not apply to CFCs by reason of § 1.952–2. The Treasury Department and the IRS continue to study whether, and to what extent, proposed regulations should be issued that provide that dividends received by a CFC are eligible for a section 245A deduction. The Treasury Department and the IRS have determined, however, that in no case would any person, including a foreign corporation, be allowed a section 245A deduction directly or indirectly for the portion of a dividend paid to a CFC that is not eligible for the section 954(c)(6) exception as a result of these temporary regulations. Permitting the deduction in such a case would undermine the application of the rule that reduces the amount of the dividend eligible for the section 954(c)(6) exception (discussed in Part III.A of this Explanation of Provisions).

IV. Information Reporting Under Section 6038

Under section 6038(a)(1), U.S. persons that control foreign business entities must file certain information returns with respect to those entities, which includes information listed in section 6038(a)(1)(A) through (a)(1)(E), as well as information that ''the Secretary determines to be appropriate to carry out the provisions of this title.'' The temporary regulations provide that ineligible amounts, tiered extraordinary disposition amounts, and tiered extraordinary reduction amounts must be reported on the appropriate information reporting form in accordance with section 6038. *See* § 1.6038–2T(f)(16). Because transactions subject to these temporary regulations may have occurred in taxable years for which returns have been filed before the issuance of these regulations, or for which returns will be filed before revision of forms and instructions for reporting the information required by § 1.6038–2T(f)(16), the temporary regulations provide a transition rule. The transition rule mandates that taxpayers report the required information on the first return filed following the issuance of revised forms, instructions, or other guidance with respect to reporting such information. The transition rule also requires a corporation to report the information with respect to a predecessor corporation (such as a lower-tier foreign corporation that distributes its assets to the corporation in a liquidation described in section 332) to ensure that all of the amounts are properly reported notwithstanding any intervening transactions.

V. Applicability Dates

Consistent with the applicability date of section 245A, and pursuant to section 7805(b)(2), the rules in the temporary regulations relating to eligibility of distributions for the section 245A deduction apply to distributions occurring after December 31, 2017.

Pursuant to section 7805(b)(1) and (2), the rules in the temporary regulations relating to the eligibility of dividends for the section 954(c)(6) exception also apply to distributions occurring after December 31, 2017, subject to the transition rule in § 1.245A–5T(f)(3) for determining tiered extraordinary reduction amounts.

VI. Good Cause

The Treasury Department and the IRS are issuing these temporary regulations without prior notice and the opportunity for public comment pursuant to section 553(b)(3)(B) of the Administrative Procedure Act (the ''APA''), which provides that advance notice and the opportunity for public comment are not required with respect to a rulemaking when an ''agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.'' Under the ''public interest'' prong of 5 U.S.C. 553(b)(3)(B), the good cause exception appropriately applies where notice-and-comment would harm, defeat, or frustrate the public interest, rather than serving it. The Treasury Department and the IRS are similarly utilizing the good cause exception in section 553(d)(3) of the APA to issue these temporary regulations with an immediate effective date, rather than an effective date no earlier than 30 days after the date of publication.

Among the circumstances in which the good cause exception may be invoked for impracticability or to serve the public interest are situations where the timing and disclosure requirements of the usual procedures would defeat the purpose of the proposal, including if announcement of a proposed rule would enable or increase the sort of financial manipulation the rule sought to prevent. Good cause may also apply where a delayed effective date would have a significant deleterious effect upon the parties to which the regulation applies. Additionally, the good cause exception may apply when the regulations are by their nature short term and there is an opportunity to comment before final rules are introduced. Finally, good cause is supported where regulations are required to be issued and effective by a certain statutory deadline, and in light of the circumstances affecting the agency and its functions leading up to that statutory deadline, the agency is unable during that timeframe to conduct a timely and fulsome notice-and-comment process. Here, these rationales, separately and in combination, provide good cause for the Treasury Department and the IRS's decision to bypass the notice-and-comment and delayed effective date requirements with respect to these temporary regulations. Each rationale is discussed below in turn.

First, good cause exists with respect to these temporary regulations because any period for notice and comment, as well as a delayed effective date, would provide taxpayers with the opportunity to engage in the transactions to which these rules relate with confidence that they achieve the intended tax avoidance results absent the applicability of the regulations. The Treasury Department and the IRS are aware that taxpayers have considered engaging in the transactions described in these temporary regulations, but some may have been deterred from doing so because of uncertainty about the operation and interaction of the various provisions of the Act. By limiting the deduction under section 245A for these transactions, these temporary regulations remove that uncertainty and—if subjected to notice-and-comment and a delayed effective date—could embolden some taxpayers to engage in aggressive tax planning to take advantage of the unintended interactions among the Act's provisions, with the comfort that their actions were not subject to the rules of the temporary regulations during the period of notice and comment and before the regulations' effective date. This concern applies with respect to both the extraordinary disposition and extraordinary reduction rules for an ongoing period. For the extraordinary reduction rules, both the extraordinary reduction and the associated use of section 245A can occur at any time going forward, and although the gap period for entering into extraordinary dispositions has closed, the ability to utilize the section 245A deduction for earnings generated in the extraordinary disposition would apply indefinitely absent these temporary regulations.

For example, a taxpayer who became aware of the tax effects achievable using the transactions described in these temporary regulations could, with confidence, utilize extraordinary disposition E&P or engage in an extraordinary reduction to exit the U.S. taxing jurisdiction without paying any tax during a period of notice and comment and delayed effectiveness. The proliferation of these types of transactions would cause the regulations to exacerbate the very financial manipulation that they are intended to prevent, and accordingly, this rationale supports a finding of good cause for dispensing with pre-promulgation notice and public comment, as well as foregoing a delayed effective date, for these temporary regulations pursuant to 5 U.S.C. 553(b) and (d).

The second reason for a finding of good cause arises from the fact that these temporary regulations, as applied retroactively, will affect taxable years of certain taxpayers ending in 2018. As a result, these regulations can apply to taxable years for which tax returns have been or may be due during a period of comment and delayed effectiveness. Deferring the effectiveness of the temporary regulations until after such a period could increase taxpayer compliance costs because certain taxpayers would only be able to come into compliance with the regulations by amending and refiling returns and paying additional taxes owed with interest.

Third, good cause is supported where a regulation is temporary, with public comment permitted and meaningfully considered before finalization of the temporary rule. In this regard, the temporary regulations have a fixed expiration date and are cross-referenced in a notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**. Comments are requested on all aspects of these rules, and specific comment requests contained in this preamble are incorporated by reference into the cross-referenced notice of proposed rulemaking. The Treasury Department and the IRS will consider all written comments properly and timely submitted when finalizing these temporary regulations.

Finally, these temporary regulations are part of an effort to implement the provisions of the Act, which effected sweeping and complex statutory changes to the international tax regime. In conjunction with developing and issuing these temporary regulations, the Treasury Department and the IRS have also been tasked with issuing regulations implementing the numerous provisions enacted or modified by the Act, along with attendant changes to forms and other sub-regulatory guidance and attention to the orderly administration of the U.S. tax system.

Good cause exists for the issuance of temporary regulations relating to the transactions affected by these temporary regulations partially because of the statutory deadline in section 7805(b)(2), which provides (among other rules) that a regulation may be applied retroactively if it is issued within 18 months of the date of enactment of the statutory provision to which it relates. The rules in these temporary regulations relate to sections 245A, 951A, and 965, which were enacted as part of the Act on December 22, 2017. Thus, to qualify for retroactivity under section 7805(b)(2), a regulation retroactive to the enactment of these provisions must be effective no later than June 22, 2019. These temporary regulations need to apply retroactively from the date of the underlying statutory provisions to ensure that the international tax regime enacted by Congress in the Act, and its interaction with existing tax rules, functions correctly for all affected periods. Retroactivity is also required to prevent treating taxpayers comparatively advantageously if they have engaged in the types of transactions described in these temporary regulations prior to the issuance date of these temporary regulations.

The discussion of good cause with respect to the temporary regulations in this Part VI is consistent with the Policy Statement on the Tax Regulatory Process issued on March 5, 2019, by the Treasury Department and the IRS (the ''Statement''). The Statement emphasized the Treasury Department and the IRS's obligation under the APA to issue interim final regulations without prior notice and comment only in conjunction with ''a statement of good cause explaining the basis for that finding.'' The Statement further explains that good cause for interim final regulations may exist, for example, where ''such regulations may be necessary and appropriate to stop abusive practices or to immediately resolve an injurious inconsistency between existing regulations and a new statute or judicial decision.'' As the discussion in this Part VI illustrates, this is the case with respect to these temporary regulations.

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 temporary regulations have been designated by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) as 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. OIRA has determined that the proposed rulemaking is significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by the Office of Management and Budget.

A. Background

The Tax Cuts and Jobs Act (the Act) transitioned the United States from a primarily deferral-based international tax system (subject to the immediate taxation of generally mobile or passive income under the subpart F regime) to a participation exemption system coupled with immediate taxation of certain offshore earnings (in some cases, at a reduced rate of tax).[1] This transition was effected through several interlocking provisions of the Code—sections 245A, 951A, and 965. All three provisions have different effective dates and thus the Act created periods in which some but not all of them apply. The new system also operates alongside the pre-Act subpart F regime that taxes certain offshore earnings using a longstanding rule for attributing pro rata shares of a foreign corporation's earnings to its U.S. shareholders.

1. Background: Section 245A—Dividends Received Deduction

The Act included section 245A, which provides a participation exemption system for repatriation of certain offshore earnings. Prior to the Act, dividends paid by foreign corporations to their U.S. shareholders were generally taxable. Section 245A(a) reverses this result in the case of corporate U.S. shareholders by providing, subject to certain exceptions, a 100-percent deduction for any dividend received by a corporate U.S. shareholder from a specified 10-percent owned foreign corporation.[2] A 100-percent deduction for dividends essentially means that this income is not taxed in the United States at the corporate level. The existing rules in sections 951(a) and 959 continue to apply, meaning that generally only earnings associated with income that is not taxed under the subpart F regime (or under the GILTI regime, discussed below) can, upon distribution, give rise to a dividend eligible for the section 245A deduction. Because subpart F (and GILTI) taxation is not reduced by distributions made during the year (except in the case of certain transfers of stock of a CFC during a taxable year), any distribution of earnings and profits that is taxed under the subpart F regime (or GILTI regime) is a distribution of PTEP (that is, a distribution of previously taxed earnings and profits) that is not treated as a dividend by reason of section 959(d), and thus cannot qualify for section 245A. Section 245A applies to distributions made after December 31, 2017.

Because the pre-Act international tax regime imposed U.S. tax on most non-mobile, non-passive earnings and profits only when those earnings were repatriated, a significant amount of untaxed earnings and profits had been accumulated offshore when the Act was passed. The enactment of section 245A by the Act thus presented a potential windfall, allowing taxpayers who had held earnings and profits offshore to distribute all of those earnings back to the United States tax-free. Congress did not intend for section 245A to apply to such pre-Act earnings, and thus included a so-called transition tax (section 965) ''[t]o avoid a potential windfall for corporations that deferred income, and to ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system.'' H. Rep. No. 115–409 at 375.

2. Background: Section 965—Transition Tax

Section 965 imposed a transition tax on the post-1986 earnings and profits of foreign corporations that had gone untaxed under the pre-Act international tax regime and would not be subject to the GILTI regime because the income was earned in a year prior to that regime being in effect. Absent section 965, such earnings and profits would have been eligible for tax-free distribution under section 245A. Specifically, section 965(a) increases certain foreign corporations' subpart F income for their last taxable year beginning before January 1, 2018, by the amount of their non-previously taxed earnings and profits computed as of no later than December 31, 2017. This has the effect of subjecting all offshore post-1986 untaxed earnings of most U.S. shareholders as of no later than December 31, 2017, to U.S. tax (albeit at a reduced rate by reason of section 965(c)), turning all such earnings into PTEP under section 959. As a result, none of those earnings and profits are eligible for the section 245A deduction, and such earnings and profits, once taxed under section 965, are instead treated in the same way as if they had been taxed under the pre-Act subpart F regime.

For a calendar year CFC, the transition tax generally provides a mechanism for ensuring that only earnings and profits subject to the new international tax system can qualify for the dividends received deduction under section 245A. This appears to be the intended purpose of section 965(a), as the legislative history of the Act provides that ''[t]he [transition tax applies in] the last taxable year of a deferred foreign income corporation that begins before January 1, 2018, which is that foreign corporation's last taxable year before the transition to the new corporate tax regime elsewhere in the bill goes into effect.'' H. Rep. 115–466 at 613. This is not the case, however, for fiscal year CFCs (*i.e.,* CFCs with a taxable year other than the calendar year) as there is a gap period with respect to such entities during which certain of their earnings may escape taxation.

3. Background: Section 951A—GILTI Regime

By subjecting post-1986 earnings and profits to a transition tax, section 965 was generally intended to ensure that only earnings first subjected to the anti-base erosion provisions of the Act could qualify for section 245A. While the Act preserved the existing subpart F regime, legislative history shows congressional concern that the participation exemption system could heighten the incentive to shift profits to low-taxed foreign jurisdictions or tax havens after the Act. *See* Senate Explanation at 365. For example, Congress expressed concern that a domestic corporation might allocate income susceptible to base erosion to certain foreign affiliates ''where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.'' *See id.* As a result of these concerns, the Act added another, complementary regime to address the additional base erosion incentives engendered by the participation exemption. This regime taxes a U.S. shareholder on its global intangible low-taxed income, or GILTI, with respect to its CFCs at a reduced

[1] A deferral-based system is a system in which taxable foreign-source income generally is taxed only when it is repatriated to the United States. A participation exemption system is one in which foreign-source income is generally not taxed by the resident country (in this case, the United States). As explained further below, in the United States the participation exemption system is coupled with immediate taxation of certain types of earnings to avoid erosion of the U.S. tax base. These taxed foreign earnings can then be repatriated to the United States without further tax.

[2] A specified 10-percent owned foreign corporation is any foreign corporation, other than a passive foreign investment corporation with respect to a shareholder that is not also a CFC, with at least one corporate U.S. shareholder. Section 245A(b).

rate (by reason of section 250) under new section 951A.

Section 951A(a) generally subjects a U.S. shareholder to current taxation each year on its GILTI with respect to its CFCs. The GILTI of a U.S. shareholder is generally defined as its pro rata share of its CFCs' taxable income for the year in excess of a normal return—a formulaic amount equal to 10 percent of the tax basis of the CFCs' tangible assets. *See* section 951A(b), (c), (d). For purposes of this determination, specific types of income of a CFC, including income taxed under another Code provision (including the subpart F regime), certain immobile income, or certain highly taxed income, are not taken into account. *See* Senate Explanation at 366 (explaining that such income is either already taxed or does not present base erosion concerns). The GILTI regime applies in the first taxable year of a CFC beginning after December 31, 2017. Thus, in the case of calendar year CFCs, the application of the GILTI regime generally must be taken into account with respect to all new earnings and profits of a CFC earned immediately after section 965 has caused all of the CFC's pre-Act earnings to be taxed. *See* Public Law 115–97, sec. 14201(d).

As is the case with respect to the subpart F regime, the tax base subject to the GILTI regime is not reduced by distributions made by a CFC during a taxable year (except in the case of certain transfers of stock of a CFC during a taxable year), and section 951A(f)(1)(A) provides that an income inclusion under the GILTI regime is treated in the same manner as an inclusion of subpart F income under the subpart F regime for purposes of section 959. These rules cause a CFC's earnings attributable to GILTI to be taxed under the GILTI regime in section 951A regardless of whether those earnings and profits are distributed before the end of the CFC's year, thus converting such earnings into PTEP and turning distributions (including those made before the end of the year in which the earnings and profits were earned) by the CFC into PTEP distributions that do not constitute dividends eligible for section 245A. Section 959(c), (d). Section 951(a)(2) also applies for purposes of determining a U.S. shareholder's pro rata share of its CFCs' income and other relevant items for purposes of section 951A. Section 951A(e).

B. Need for the Temporary Regulations

Sections 245A, 965, and 951A generally act to tax foreign source income equivalently across taxpayers and sources so long as a U.S. shareholder owns the same amount of stock of a calendar year CFC throughout the CFC's entire taxable year. Deviations from that condition, however, potentially allow taxpayers to avoid tax by claiming a section 245A deduction in situations where otherwise identical income would be subject to U.S. tax. This circumstance is inconsistent with the purposes of the new international tax regime enacted by Congress.[3] These temporary regulations are needed to limit section 245A to its intended scope and, thereby, prevent the provision from converting income that should be subject to U.S. tax into non-taxable dividends.

There are two situations in which deviations from the condition described in this section can give rise to these results. These are where (1) a U.S. corporation is the shareholder of a fiscal year CFC during 2018 and (2) a CFC pays a dividend and experiences a direct or indirect change in ownership during a taxable year.

The differing application of the GILTI regime with respect to fiscal year and calendar year CFCs creates one scenario where the interaction of section 245A with other new international tax provisions might be used to avoid tax. For a calendar year CFC, any earnings and profits accumulated as of no later than December 31, 2017, that had not been taxed under the subpart F regime generally were taxed under section 965 in the CFC's 2017 taxable year, turning such earnings and profits into PTEP. Then, starting in the calendar year CFC's taxable year beginning on January 1, 2018, the CFC's income became subject to the complementary subpart F and new GILTI regimes, and any income taxed under those provisions now also becomes PTEP. Concurrent with the applicability date of the GILTI regime, section 245A applies to dividends distributed after December 31, 2017, out of earnings that have not been taxed under the subpart F and GILTI regimes. These interlocking provisions create a cohesive regime in which the section 245A deduction applies only for distributions of post-2017 earnings and profits that are properly not taxed as the subpart F income or GILTI regimes. Operating in tandem, these provisions address Congress's concerns with section 245A by applying that provision (1) without granting windfalls for taxpayers that had historically kept earnings and profits offshore (by taxing all such earnings and profits under section 965 immediately before section 245A applies) and (2) without allowing a section 245A deduction for income susceptible to a heightened risk of base erosion. As a result of these provisions, only post-2017 earnings and profits that are not subject to the subpart F or GILTI regimes can qualify for a dividends received deduction under section 245A upon distribution from a calendar year CFC. Such earnings and profits are generally the normal return on a CFC's property (*i.e.,* 10 percent of tax basis in tangible property), certain immobile income, or certain highly-taxed income that Congress believed would not raise windfall or base erosion concerns.

By contrast, the provisions that apply harmoniously to a calendar year CFC fail to form a cohesive regime when applied to a fiscal year CFC for its first taxable year that ends in 2018. Consider a CFC with a taxable year ending November 30. This CFC's income is still subject to the subpart F regime for all relevant taxable years. Section 965 also applies to the CFC's historical earnings and profits as of no later than December 31, 2017, and section 245A applies to distributions made by the CFC after December 31, 2017. However, the GILTI regime does not begin to apply to the CFC's income until the first taxable year of the CFC beginning after December 31, 2017, and thus does not first apply until the CFC's taxable year that begins on December 1, 2018. As a result of the gap in these effective dates, (1) the ordinary earnings of the CFC during the gap period avoid tax (which is a direct outgrowth of the effective dates); and (2) assets can be transferred between related parties in non-ordinary course transactions during that time period in such a way that current and future earnings and profits associated with the built-in gain in those assets can permanently avoid taxation by the United States because they are not subject to the GILTI regime and are not subject to the transition tax under section 965. Such earnings and profits might nevertheless be eligible to be distributed tax-free under section 245A. Such income, however, is economically identical to income earned by a calendar year CFC. Absent the temporary regulations, similar income from CFCs that differ only in their taxable year would be subject to different taxation. This difference between calendar year and fiscal year CFCs is significant and presents the potential for substantial tax avoidance when utilized to artificially generate earnings and profits in non-ordinary course transactions between related parties.

[3] The discussion herein assumes that the transactions at issue would otherwise withstand scrutiny under section 7701(o) (*i.e.,* the economic substance doctrine) and related judicial doctrines. Taxpayers should draw no inferences from this assumption, however, as the IRS may challenge such transactions on these and other grounds.

These temporary regulations refer to the portion of a dividend attributable to earnings and profits arising from such a transaction during this period as an ''extraordinary disposition amount.'' An extraordinary disposition amount consists of certain earnings and profits resulting from transactions between related parties during the disqualified period. *See* the Explanation of Provisions section of this preamble for definitions of all relevant terms and conditions. Although the period during which extraordinary dispositions may have occurred has passed, the regulations will potentially apply to any distributions of the associated earnings and profits after 2017.

The second issue occurs because the application of the allocation rules under sections 951(a) and 951A (which determine a U.S. shareholder's pro rata share of a CFC's subpart F income or tested income for GILTI purposes) together with section 245A creates situations in which earnings and profits may not be properly subject to the new international tax regime that Congress enacted to prevent the inappropriate application of the section 245A deduction. For example, this situation may arise because of the ''dividend offset'' rule in section 951(a)(2)(B), which, subject to certain limitations, reduces a U.S. shareholder's pro rata share of subpart F income or tested income for dividends paid to another owner of the same stock of the CFC during the taxable year (such reduction being a rough approximation of the portion of subpart F income and tested income for the year that is properly attributable to the other owner).

In order to illustrate this concern, consider the following example. A corporate U.S. shareholder generally is taxed with respect to a CFC's subpart F income as of the end of the CFC's taxable year. Suppose, however, that the U.S. shareholder received a dividend from the CFC in an amount equal to its subpart F income and thereafter transferred ownership of the CFC to a new U.S. shareholder shortly before the end of the CFC's taxable year. If a section 245A deduction applied to the dividend, the corporate U.S. shareholder would not be taxed on the distribution. Furthermore, the second U.S. shareholder's subpart F inclusion for the CFC's taxable year may be reduced to approximately zero as a result of the dividend offset rule. As a consequence, absent the application of these temporary regulations, income that should have been subject to U.S. taxation under the subpart F regime could escape taxation altogether.

In contrast to the first issue, this second issue implicates the interlocking provisions of the international tax regime on an ongoing basis. As described in Part II.C of the Explanation of Provisions section of this preamble, section 245A could facilitate the avoidance of the subpart F and GILTI regimes by allowing a U.S. shareholder to transfer, before the end of a CFC's taxable year, stock of the CFC to a new shareholder who will not be taxed on the CFC's subpart F income or tested income. As a consequence of the repeal of section 958(b)(4), this new shareholder might be a foreign person who is not taxable with respect to the CFC's subpart F income or tested income. Alternatively, the new shareholder may not be taxable with respect to these amounts as a result of the dividend offset rule of section 951(a)(2)(B), notwithstanding the fact that if the prior owner of the stock is a corporate U.S. shareholder, the section 245A deduction may apply to dividends received by such prior owner. In these cases, current year subpart F income and GILTI could escape taxation altogether, a result that would undermine the post-Act system for taxing foreign earnings. These temporary regulations refer to earnings and profits representing the portion of a dividend of a CFC attributable to subpart F income or tested income of the CFC that, absent a transfer of stock of the CFC pursuant to an extraordinary reduction, would have been subject to the subpart F or GILTI regimes as an ''extraordinary reduction amount.'' An extraordinary reduction amount consists of certain earnings and profits generated during a CFC's taxable year beginning after 2017 in which a domestic corporate U.S. shareholder reduces its ownership of the CFC by certain threshold amounts (*e.g.,* a decrease in ownership of more than 10 percent). For this purpose, ''certain earnings and profits'' refers to income generally subject to inclusion under the subpart F or GILTI regimes. See the Explanation of Provisions section of this preamble for definitions of all relevant terms and conditions.

Results similar to the ones described in this section for extraordinary disposition amounts and extraordinary reduction amounts can be achieved using the exemption from subpart F income under section 954(c)(6) and lower-tier CFC dividends to upper-tier CFCs. Accordingly, the temporary regulations limit the application of the section 954(c)(6) exception in order to prevent similar results in circumstances in which a lower-tier CFC pays a dividend to another CFC, instead of directly to a U.S. shareholder.

C. Overview of the Temporary Regulations

The Treasury Department and the IRS have determined that it is appropriate to limit the section 245A deduction to distributions of earnings and profits that are attributable to certain normal return, high-taxed, or immobile income, which will ensure that similar income is taxed similarly. The temporary regulations do not permit section 245A deductions for the portions of dividends made by CFCs that are attributable to ineligible amounts, which comprise extraordinary reduction amounts and 50percent of any extraordinary disposition amounts.

To accomplish this, the temporary regulations disallow a deduction for transactions that have the effect of avoiding tax under section 951, 951A, or 965. The extraordinary disposition rules accomplish this by denying the deduction under section 245A for a narrowly and objectively defined class of earnings and profits generated by transactions undertaken in the disqualified period in circumstances that raise abuse concerns. The extraordinary reduction rules accomplish this by denying the deduction under section 245A for certain earnings distributed in the same year as reductions in ownership of CFC stock by a controlling section 245A shareholder. The temporary regulations contain similar rules with respect to section 954(c)(6).

D. Economic Analysis of the Temporary Regulations

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the temporary regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these temporary regulations.

2. Summary of Economic Effects

To assess the economic effects of these regulations, the Treasury Department and the IRS considered the economic effects of disallowing the 245A deduction for (i) extraordinary disposition amounts and (ii) extraordinary reduction amounts.

The disallowance of the dividends received deduction for extraordinary disposition amounts applies, in plain language, only to earnings and profits accrued prior to issuance of the temporary regulations. Thus, no substantive economic activities can be affected by this disallowance and the economic decisions affected are only those associated with taxpayers' financing of their tax liability.

The Treasury Department and the IRS's analysis therefore focuses on those provisions of the temporary regulations that disallow the dividends received deduction for extraordinary reduction amounts. Absent the temporary regulations, U.S. taxation of income of a CFC that would otherwise be subject to the subpart F or GILTI regime could be avoided by a transfer of ownership of the CFC to other entities in such a way that the income of the CFC would not be subject to U.S. tax. Thus, the economic effects stem from those transfers that would give rise to an extraordinary reduction amount (''ER transfers'') and that would not be undertaken as a result of the temporary regulations. The Treasury Department and the IRS project that a substantial portion of these ER transfers would have been undertaken for tax avoidance purposes only and would have negative effects on economic performance (giving rise to a positive economic effect from the temporary regulations) but that those effects would be minor because the transfers would take place among related parties and over short time frames. Thus, there would be only negligible losses in economic performance due to inefficient changes in management, risk-bearing, or other economic activity. Instead, the primary economic losses due to these transfers (and thus gains from the temporary regulations) are likely to consist of resources that would be expended in carrying out such tax planning activities. The Treasury Department and the IRS project that these saved resource costs would be small.

The Treasury Department and the IRS considered that at least some ER transfers that would not be pursued as a result of the temporary regulations would have provided positive economic benefits, such as through more efficient risk-bearing or other managerial control benefits. The Treasury Department and the IRS project that the aggregate value of these foregone benefits will be minimal because the transfers for which a deduction is disallowed and that are likely not to be undertaken as a result of the temporary regulations are not generally associated with productive economic activities. In this regard, the Treasury Department and the IRS expect that economically-motivated transfers of CFCs should not be inhibited by the temporary regulations because the temporary regulations, taking into account the election to close a CFC's taxable year, often will result in the same or similar tax liability to a seller as if the transfer had not occurred. Thus, the temporary regulations should not discourage economically-motivated transfers of CFCs. If anything, the temporary regulations will discourage transfers of CFCs that would not have occurred absent the tax results the temporary regulations seek to prevent. These transfers, which would be motivated by tax avoidance, likely would not be economically productive.

The temporary regulations will require taxpayers to compute, track, and report information relevant for determination of extraordinary dispositions and extraordinary reductions. The compliance burden component of the Treasury Department and the IRS's estimate of the economic effects of the temporary regulations reflects only those record-keeping and related compliance activities that would not have been undertaken in the absence of the temporary regulations. The Treasury Department and the IRS project that these additional costs, relative to the baseline, will be modest. In general, with respect to the initial year of an extraordinary disposition or any extraordinary reduction, taxpayers are already required to keep track of the required information for other purposes. For example, to the extent that a U.S. taxpayer sells stock in its CFC, earns income in its CFC, or receives a dividend from a CFC, the taxpayer would otherwise record the information needed to determine eligibility for the section 245A deduction under the temporary regulations. Additionally, once calculated the costs to track amounts related to extraordinary dispositions in future years are expected to be minimal. For all of these reasons, the Treasury Department and the IRS expect the non-revenue economic effects of these temporary regulations to be small.[4]

The Treasury Department and the IRS have not undertaken a quantitative estimate of the economic benefits arising from avoided transactions that constitute extraordinary reductions. Any such estimates would be highly uncertain because these tax provisions are new and because the transfers would be between related parties and primarily of short duration, both of which factors make estimation difficult. The tax planning costs of effecting these transfers are also highly uncertain because these specific tax planning efforts are new.

While it is not currently feasible for the Treasury Department and the IRS to quantify these economic effects, part I.D.3 of these Special Analyses explains the rationale behind the provisions of these temporary regulations and provides a qualitative assessment of the alternatives considered.

The Treasury Department and the IRS solicit comments on this assessment of the economic effects of the temporary regulations.

3. Analysis of Specific Provisions

i. Ordering of Distributions of Earnings and Profits With Respect to Extraordinary Disposition Amounts

a. Background and Alternatives Considered

Any transaction that gave rise to an extraordinary disposition has already taken place because the disqualified period has closed for all taxpayers. Thus, the temporary regulations should have no economic effect with respect to these transactions. Nevertheless, the denial of a section 245A deduction with respect to the related extraordinary disposition E&P may in some cases lead CFCs to retain earnings rather than distribute them in order to defer the associated U.S. tax. The undistributed earnings in this case may lead to a so-called ''lockout effect'' pursuant to which some portion of the offshore capital remains in less productive ventures than would otherwise be the case had the earnings and profits been eligible for a section 245A deduction.

The temporary regulations address this potential concern by providing an ordering rule such that extraordinary distribution E&P generally are the last earnings and profits deemed distributed by a CFC. As a result, CFCs generally may distribute all other earnings and profits that are eligible for a section 245A deduction before extraordinary disposition E&P for which a section 245A deduction is not allowed. This rule will generally minimize the capital allocation inefficiencies stemming from a potential lockout effect by deferring the application of the temporary regulations to the latest extent possible. Moreover, the Treasury Department and the IRS expect that the extraordinary disposition E&P will not often be associated with liquid assets, such as cash. An extraordinary disposition requires a non-ordinary course transaction among related parties. The Treasury Department and the IRS are aware that transactions giving rise to an extraordinary disposition typically involve the issuance of related party debt or stock. These instruments are not the sort of assets that implicate lockout effect concerns because they would

[4] This claim refers solely to the economic benefit arising from this provision and does not refer to any estimate of the tax revenue effects of the provision.

rarely be used as consideration for making a payment to a third party.

The Treasury Department and the IRS considered as an alternative not providing an ordering rule. For the reasons mentioned above, this alternative was not adopted. In particular, the lack of an ordering rule would have inhibited taxpayers from accessing future offshore earnings that had been appropriately subject to tax under Act, which would have frustrated the congressional purpose underlying the participation exemption. By essentially reviving the lockout effect that had motivated certain international aspects of the Act, this alternative approach may have trapped capital in suboptimal offshore uses.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are direct or indirect U.S. shareholders of certain foreign corporations that are eligible for the section 245A deduction or the section 954(c)(6) exception with respect to distributions from the foreign corporation, and the foreign corporation uses a fiscal year, as opposed to the calendar year, as its taxable year. The foreign corporation must have engaged in a sale of property to a related party (1) during the period between January 1, 2018, and the end of the foreign corporation's last taxable year beginning before 2018, (2) outside the ordinary course of the foreign corporation's activities, and (3) generally, while the corporation was a CFC. Additionally, the property sold must give rise to tested income and the value of the property sold must exceed the lesser of $50 million or 5 percent of the total value of the property of the foreign corporation.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged in these particular transactions is not readily available. However, based on tabulations of the 2014 Statistics of Income Study file the Treasury Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. The actual number of affected taxpayers is smaller than the number of domestic corporations with at least one fiscal year CFC, because a domestic corporation will not be affected unless its fiscal year CFC engages in a non-routine sale with a related party that is of sufficient magnitude that the temporary regulations to apply.

ii. Definition of Extraordinary Reduction

a. Background and Alternatives Considered

The temporary regulations limit the amount of the 245A deduction whenever there is an ''extraordinary reduction.'' The temporary regulations generally define an extraordinary reduction, subject to certain conditions, as when either the controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC or there is a greater than 10 percent change in the controlling section 245A shareholder's overall ownership of the CFC.

The Treasury Department and the IRS, in defining an extraordinary reduction, considered other percentage thresholds. They expect that the ownership change threshold provides an effective balance of compliance costs for taxpayers, effective administration of section 245A, and revenue considerations. The Treasury Department and the IRS do not have appropriate data or models to precisely compute an optimal percentage threshold. The Treasury Department and the IRS solicit comments on the economic and revenue consequences of the ownership change threshold and alternative thresholds. The Treasury Department and the IRS particularly solicit comments that provide data, models, or analysis suitable for evaluating alternative thresholds.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are U.S. shareholders that own directly or indirectly stock of a CFC that has a controlling U.S. shareholder that owns 50 percent or more of the stock of the CFC. Additionally, during the taxable year, the controlling U.S. shareholder generally must directly or indirectly sell stock in the CFC that exceeds 10 percent of the controlling U.S. shareholder's interest in the CFC and 5 percent of the total value of the stock of the CFC. Furthermore, in the year of the ownership reduction, the subpart F income and tested income of the CFC must exceed the lesser of $50 million or 5 percent of the CFC's total income for the year.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged or would engage in these particular transactions is not readily available. However, based on 2014 Statistics of Income tax data, the Treasury Department and the IRS estimate that there are approximately 15,000 domestic corporations with CFCs. The Treasury Department and the IRS project that the actual number of affected taxpayers is likely much smaller than the number of domestic corporations with CFCs, given that the controlling U.S. shareholder must engage in a sale of stock of a CFC in a year in which the CFC pays a dividend in order for the temporary regulations to apply.

iii. Election To Avoid Taxable Dividend by Closing the CFC's Taxable Year

a. Background and Alternatives Considered

The Treasury Department and the IRS provide taxpayers with an election to avoid having a taxable dividend with respect to an extraordinary reduction amount by closing the taxable year of the CFC for all purposes of the Code on the date of the extraordinary reduction. Such an election would subject the earnings and profits that, absent the election, would give rise to an extraordinary reduction amount instead to taxation under the subpart F or GILTI regimes, and therefore, exemption under section 245A for any remaining earnings is appropriate. By providing this election, the Treasury Department and the IRS allow taxpayers to choose the tax treatment that would have been imposed in the absence of the interactions among provisions.

In addition to ensuring that similar income is taxed similarly, this election increases the choices available to taxpayers, thus increasing flexibility and thereby minimizing the burden imposed by these regulations. To the extent taxpayers choose this election, tax burdens could be reduced relative to tax burdens under the temporary regulations in the absence of the election, because denying the section 245A deduction could result in higher tax (*i.e.,* at ordinary corporate rates) than imposition of a reduced tax under the GILTI regime. The Treasury Department and the IRS chose to allow such election because if the election were not allowed, some taxpayers would be taxed more heavily than the Treasury Department and the IRS have determined is intended under the Act.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are described in Part I.D.3.ii.b of this Special Analyses.

II. Paperwork Reduction Act

The collections of information in the temporary regulations are in §§ 1.245A–5T(e)(3) and 1.6038–2T(f)(16).

The collection of information in § 1.245A–5T(e)(3) is elective for a domestic corporation that is a controlling U.S. shareholder of a CFC receiving a dividend from the CFC and wants to elect to have none of the dividend considered an extraordinary reduction amount by closing the CFC's tax year. The collection of information is satisfied by timely filing of the ''Elective Section 245A Year-Closing Statement'' with the domestic corporation's original Form 1120, U.S. Corporation Income Tax Return, for the taxable year in which the dividend is received. For purposes of the Paperwork Reduction Act, the reporting burden associated with § 1.245A–5T will be reflected in the Paperwork Reduction Act submission associated with Form 1120 (OMB control no. 1545–0123).

The collection of information in § 1.6038–2T(f)(16) is mandatory for every U.S. person that controls a foreign corporation that has paid a dividend for which a deduction under section 245A was limited by an ineligible amount under § 1.245A–5T(b) or paid a dividend for which the section 954(c)(6) exception was limited by a tiered extraordinary disposition amount or tiered extraordinary reduction amount under § 1.245A–5T(d) and (f), respectively, during an annual accounting period and files Form 5471 for that period (OMB control number 1545–0123 in the case of business taxpayers, formerly, OMB control number 1545–0704). The collection of information in § 1.6038–2T(f)(16) is satisfied by providing information about the ineligible amount, tiered extraordinary disposition amount, or tiered extraordinary reduction amount for the corporation's accounting period as Form 5471 and its instructions may prescribe. For purposes of the Paperwork Reduction Act, the reporting burden associated with § 1.6038–2T(f)(16) will be reflected in the applicable Paperwork Reduction Act submission, associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with § 1.6038–2T(f)(16) is 12,000–18,000, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471		✓	12,000–18,000

The current status of the Paperwork Reduction Act submissions related to the new revised Form 5471 as a result of the information collections in the temporary regulations is provided in the accompanying table. The reporting burdens associated with the information collections in §§ 1.245A–5T–(e)(3) and 1.6038–2T(f)(16) are included in the aggregated burden estimates for OMB control number 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). The overall burden estimates provided in 1545–0123 are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden of the tax forms that will be 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 temporary regulations. The Treasury Department and the IRS urge readers to recognize that these numbers are duplicates of estimates provided for informational purposes in other proposed and final regulatory actions and to guard against over-counting the burden that international tax provisions imposed prior to the Act.

In September 2018, the IRS released and invited comment on drafts of new revised Form 5471 in order to give members of the public the opportunity to benefit from certain specific provisions made to the Code. The IRS received no comments on the draft revised Form 5471 on the portions of the form that relate to section 245A during the comment period. Consequently, the IRS made the form available in December 2018 for use by the public. The IRS is contemplating making additional changes to Form 5471 to implement these temporary regulations.

No burden estimates specific to the temporary regulations are currently available. The Treasury Department and the IRS have not identified any burden estimates, including those for new information collections, related to the requirements under the temporary regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the temporary regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the temporary 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. Proposed revisions to these forms that reflect the information collections contained in these temporary regulations will be made available for public comment at *www.irs.gov/draftforms* and will not be finalized until after approved by OMB under the PRA.

Information collection	Type of filer	OMB No.(s)	Status
Form 5471	Business (NEW Model)	1545–0123	Approved by OMB on 12/21/2018.
	Link: https://www.federalregister.gov/documents/2018/12/21/2018-27735/agency-information-collection-activities-submission-for-omb-review-comment-request-multiple-irs.		

III. 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 2019, that threshold is approximately $154 million. These temporary regulations do 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.

IV. 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. These temporary regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Drafting Information

The principal author of the temporary regulations is Logan M. Kincheloe, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding a sectional authority for § 1.245A–5 to read in part as follows:

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

* * * * *

Section 1.245A–5 also issued under 26 U.S.C. 245A(g), 951A(a), 954(c)(6)(A), and 965(o).

* * * * *

■ **Par. 2.** Reserved sections 1.245A–1 through 4 and § 1.245A–5T are added to read as follows:

Sec.
1.245A–1 [Reserved].
1.245A–2 [Reserved].
1.245A–3 [Reserved].
1.245A–4 [Reserved].
1.245A–5T Limitation of section 245A deduction and section 954(c)(6) exception (temporary).

§ 1.245A–5T Limitation of section 245A deduction and section 954(c)(6) exception (temporary).

(a) *Overview.* This section provides rules that limit a deduction under section 245A(a) to the portion of a dividend that exceeds the ineligible amount of such dividend or the applicability of section 954(c)(6) when a portion of a dividend is paid out of an extraordinary disposition account or when an extraordinary reduction occurs. Paragraph (b) of this section provides rules regarding ineligible amounts. Paragraph (c) of this section provides rules for determining ineligible amounts attributable to an extraordinary disposition. Paragraph (d) of this section provides rules that limit the application of section 954(c)(6) when one or more section 245A shareholders of a lower-tier CFC have an extraordinary disposition account. Paragraph (e) of this section provides rules for determining ineligible amounts attributable to an extraordinary reduction. Paragraph (f) of this section provides rules that limit the application of section 954(c)(6) when a lower-tier CFC has an extraordinary reduction amount. Paragraph (g) of this section provides special rules for purposes of applying this section. Paragraph (h) of this section provides an anti-abuse rule. Paragraph (i) of this section provides definitions. Paragraph (j) of this section provides examples illustrating the application of this section. Paragraph (k) of this section provides the applicability date of this section. Paragraph (l) of this section provides the expiration date of this section.

(b) *Limitation of deduction under section 245A*—(1) *In general.* A section 245A shareholder is allowed a section 245A deduction for any dividend received from an SFC (provided all other applicable requirements are satisfied) only to the extent that the dividend exceeds the ineligible amount of the dividend. See paragraphs (j)(2), (4), and (5) of this section for examples illustrating the application of this paragraph (b)(1).

(2) *Definition of ineligible amount.* The term *ineligible amount* means, with respect to a dividend received by a section 245A shareholder from an SFC, an amount equal to the sum of—

(i) 50 percent of the extraordinary disposition amount (as determined under paragraph (c) of this section), and

(ii) The extraordinary reduction amount (as determined under paragraph (e) of this section).

(c) *Rules for determining extraordinary disposition amount*—(1) *Definition of extraordinary disposition amount.* The term *extraordinary disposition amount* means the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder. See paragraph (j)(2) of this section for an example illustrating the application of this paragraph (c).

(2) *Determination of portion of dividend paid out of extraordinary disposition account*—(i) *In general.* For purposes of determining the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder, the following rules apply—

(A) The dividend is first considered paid out of non-extraordinary disposition E&P with respect to the section 245A shareholder; and

(B) The dividend is next considered paid out of the extraordinary disposition account to the extent of the section 245A shareholder's extraordinary disposition account balance.

(ii) *Definition of non-extraordinary disposition E&P.* The term *non-extraordinary disposition E&P* means, with respect to a section 245A shareholder and an SFC, an amount of earnings and profits of the SFC equal to the excess, if any, of—

(A) The product of—

(*1*) The amount of the SFC's earnings and profits described in section 959(c)(3), determined as of the end of the SFC's taxable year (for this purpose, without regard to distributions during the taxable year other than as provided in this paragraph (c)(2)(ii)(A)(*1*)), but, if during the taxable year the SFC pays more than one dividend, reduced (but not below zero) by the amounts of any dividends paid by the SFC earlier in the taxable year; and

(*2*) The percentage of the stock (by value) of the SFC that the section 245A shareholder owns directly or indirectly immediately after the distribution (taking into account all transactions related to the distribution); over

(B) The balance of the section 245A shareholder's extraordinary disposition account with respect to the SFC, determined immediately before the distribution.

(3) *Definitions with respect to extraordinary disposition accounts*—(i) *Extraordinary disposition account*—(A) *In general.* The term *extraordinary disposition account* means, with respect to a section 245A shareholder of an SFC, an account the balance of which is equal to the product of the extraordinary disposition ownership percentage and the extraordinary disposition E&P, reduced (but not below zero) by the

prior extraordinary disposition amount, and adjusted under paragraph (c)(4) of this section, as applicable.

(B) *Extraordinary disposition ownership percentage.* The term *extraordinary disposition ownership percentage* means the percentage of stock (by value) of a SFC that a section 245A shareholder owns directly or indirectly at the beginning of the disqualified period or, if later, on the first day during the disqualified period on which the SFC is a CFC, regardless of whether the section 245A shareholder owns directly or indirectly such stock of the SFC on the date of an extraordinary disposition giving rise to extraordinary disposition E&P; if not, see paragraph (c)(4) of this section.

(C) *Extraordinary disposition E&P.* The term *extraordinary disposition E&P* means an amount of earnings and profits of an SFC equal the sum of the net gain recognized by the SFC with respect to specified property in each extraordinary disposition. In the case of an extraordinary disposition with respect to the SFC arising as a result of a disposition of specified property by a specified entity (other than a foreign corporation), an interest of which is owned directly or indirectly (through one or more other specified entities that are not foreign corporations) by the SFC, the net gain taken into account for purposes of the preceding sentence is the SFC's distributive share of the net gain recognized by the specified entity with respect to the specified property.

(D) *Prior extraordinary disposition amount*—(*1*) *General rule.* The term *prior extraordinary disposition amount* means, with respect to an SFC and a section 245A shareholder, the sum of the extraordinary disposition amount of each prior dividend received by the section 245A shareholder from the SFC by reason of paragraph (c) of this section and 200 percent of the sum of the amounts included in the section 245A shareholder's gross income under section 951(a) by reason of paragraph (d) of this section (in the case in which the SFC is, or has been, a lower-tier CFC). A section 245A shareholder's prior extraordinary disposition amount also includes—

(*i*) A prior dividend received by the section 245A shareholder from the SFC to the extent not an extraordinary reduction amount and to the extent the dividend was not eligible for the section 245A deduction by reason of section 245A(e) or the holding period requirement of section 246 not being satisfied but would have been an extraordinary disposition amount had paragraph (c) of this section applied to the dividend;

(*ii*) The portion of a prior dividend (to the extent not a tiered extraordinary disposition amount by reason of paragraph (d) of this section) received by an upper-tier CFC from the SFC that by reason of section 245A(e) was included in the upper-tier CFC's foreign personal holding company income and was included in gross income by the section 245A shareholder under section 951(a) but would have been a tiered extraordinary disposition amount by reason of paragraph (d) of this section had paragraph (d) applied to the dividend;

(*iii*) If a prior dividend received by an upper-tier CFC from a lower-tier CFC gives rise to a tiered extraordinary disposition amount with respect to the section 245A shareholder by reason of paragraph (d) of this section, the qualified portion.

(*2*) *Definition of qualified portion*—(*i*) *In general.* The term *qualified portion* means, with respect to a tiered extraordinary disposition amount of a section 245A shareholder and a lower-tier CFC, 200 percent of the portion of the disqualified amount with respect to the tiered extraordinary disposition amount equal to the sum of the amounts included in gross income by each U.S. tax resident under section 951(a) in the taxable year in which the tiered extraordinary disposition amount arose with respect to the lower-tier CFC by reason of paragraph (d) of this section. For purposes of the preceding sentence, the reference to a U.S. tax resident does not include any section 245A shareholder with a tiered extraordinary disposition amount with respect to the lower-tier CFC.

(*ii*) *Determining a qualified portion if multiple section 245A shareholders have tiered extraordinary disposition amounts.* For the purposes of applying paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, if more than one section 245A shareholder has a tiered extraordinary disposition amount with respect to a dividend received by an upper-tier CFC from a lower-tier CFC, then the qualified portion with respect to each section 245A shareholder is equal to the amount described in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, without regard to this paragraph (c)(3)(i)(D)(*2*)(*ii*), multiplied by a fraction, the numerator of which is the section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC and the denominator of which is the sum of the tiered extraordinary disposition amounts with respect to each section 245A shareholder and the lower-tier CFC.

(ii) *Extraordinary disposition*—(A) *In general.* Except as provided in paragraph (c)(3)(ii)(E) of this section, the term *extraordinary disposition* means, with respect to an SFC, any disposition of specified property by the SFC on a date on which it was a CFC and during the SFC's disqualified period to a related party if the disposition occurs outside of the ordinary course of the SFC's activities. An extraordinary disposition also includes a disposition during the disqualified period on a date on which the SFC is not a CFC if there is a plan, agreement, or understanding involving a section 245A shareholder to cause the SFC to recognize gain that would give rise to an extraordinary disposition if the SFC were a CFC.

(B) *Facts and circumstances.* A determination as to whether a disposition is undertaken outside of the ordinary course of an SFC's activities is made on the basis of facts and circumstances, taking into account whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency. In addition, a disposition of specified property by an SFC to a related party may be considered outside of the ordinary course of the SFC's activities notwithstanding that the SFC regularly disposes of property of the same type of, or similar to, the specified property to persons that are not related parties.

(C) *Per se rules.* A disposition is treated as occurring outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or if the disposition is of intangible property, as defined in section 367(d)(4).

(D) *Treatment of dispositions by certain specified entities.* For purposes of paragraph (c)(3)(ii)(A) of this section, an extraordinary disposition with respect to an SFC includes a disposition by a specified entity other than a foreign corporation, provided that immediately before or immediately after the disposition the specified entity is a related party with respect to the SFC, the SFC directly or indirectly (through one or more other specified entities other than foreign corporations) owns an interest in the specified entity, and the disposition would have otherwise qualified as an extraordinary disposition had the specified entity been a foreign corporation.

(E) *De minimis exception to extraordinary disposition.* If the sum of the net gain recognized by an SFC with respect to specified property in all dispositions otherwise described in paragraph (c)(3)(ii)(A) of this section does not exceed the lesser of $50 million or 5 percent of the gross value of all of the SFC's property held immediately before the beginning of its disqualified period, then no disposition of specified property by the SFC is an extraordinary disposition.

(iii) *Disqualified period.* The term *disqualified period* means, with respect to an SFC that is a CFC on any day during the taxable year that includes January 1, 2018, the period beginning on January 1, 2018, and ending as of the close of the taxable year of the SFC, if any, that begins before January 1, 2018, and ends after December 31, 2017.

(iv) *Specified property.* The term *specified property* means any property if gain recognized with respect to such property during the disqualified period is not described in section 951A(c)(2)(A)(i)(I) through (V). If only a portion of the gain recognized with respect to property during the disqualified period is gain that is not described in section 951A(c)(2)(A)(i)(I) through (V), then a portion of the property is treated as specified property in an amount that bears the same ratio to the value of the property as the amount of gain not described in section 951A(c)(2)(A)(i)(I) through (V) bears to the total amount of gain recognized with respect to such property during the disqualified period.

(4) *Successor rules for extraordinary disposition accounts.* This paragraph (c)(4) applies with respect to an extraordinary disposition account upon certain direct or indirect transfers of stock of an SFC by a section 245A shareholder.

(i) *Another section 245A shareholder succeeds to all or portion of account.* Except for a transfer described in § 1.1248–8(a)(1), paragraphs (c)(4)(i)(A) through (C) of this section apply when a section 245A shareholder of an SFC (the *transferor*) transfers directly or indirectly a share of stock (or a portion of a share of stock) of the SFC that it owns directly or indirectly (the share or portion thereof, a *transferred share*).

(A) If immediately after the transfer (taking into account all transactions related to the transfer) another person is a section 245A shareholder of the SFC, then such other person's extraordinary disposition account with respect to the SFC is increased by the person's proportionate share of the amount allocated to the transferred share.

(B) For purposes of paragraph (c)(4)(i)(A) of this section, the amount allocated to a transferred share is equal to the product of—

(*1*) The balance of the transferor's extraordinary disposition account with respect to the SFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(i)(B); and

(*2*) A fraction, the numerator of which is the value of the transferred share and the denominator of which is the value of all of the stock of the SFC that the transferor owns directly or indirectly immediately before the transfer.

(C) For purposes of paragraph (c)(4)(i)(A) of this section, a person's proportionate share of the amount allocated to a transferred share under paragraph (c)(4)(i)(B) of this section is equal to the product of—

(*1*) The amount allocated to the share; and

(*2*) The percentage (expressed as a decimal) of the share (by value) that the person owns directly or indirectly immediately after the transfer (taking into account all transactions related to the transfer).

(D) The transferor's extraordinary disposition account with respect to the SFC is decreased by the amount by which another person's extraordinary disposition account with respect to the SFC is increased pursuant to paragraph (c)(4)(i)(A) of this section.

(E) If a principal purpose of the transfer is to shift, or to avoid, an amount in the transferor's extraordinary disposition account with respect to the SFC to another person, then for purposes of this section, the transfer may be disregarded or other appropriate adjustments may be made.

(ii) *Certain section 381 transactions.* If assets of an SFC (the *acquired corporation*) are acquired by another SFC (the *acquiring corporation*) pursuant to a transaction described in section 381(a) in which the acquired corporation is the transferor corporation for purposes of section 381, then a section 245A shareholder's extraordinary disposition account with respect to the acquiring corporation is increased by the balance of its extraordinary disposition account with respect to the acquired corporation, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(ii).

(iii) *Certain distributions involving section 355 or 356.* If, pursuant to a reorganization described in section 368(a)(1)(D) involving a distribution under section 355 (or so much of section 356 as it relates to section 355) by an SFC (the *distributing corporation*) of stock of another SFC (the *controlled corporation*), earnings and profits of the distributing corporation are allocated between the distributing corporation and the controlled corporation, then a section 245A shareholder's extraordinary disposition account with respect to the distributing corporation is allocated on a similar basis between the distributing corporation and the controlled corporation.

(iv) *Certain transfers of stock of lower-tier CFCs by upper-tier CFCs.* If an upper-tier CFC directly or indirectly transfers stock of a lower-tier CFC and if as a result of the transfer a section 245A shareholder ceases to be a section 245A shareholder with respect to the lower-tier CFC, then the section 245A shareholder's extraordinary disposition account with respect to the upper-tier CFC is increased by the balance of the section 245A shareholder's extraordinary disposition account with respect to the lower-tier CFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and after application of paragraph (c)(4)(i) of this section, if applicable. If a section 245A shareholder ceases to be a section 245A shareholder with respect to a lower-tier CFC by reason of a direct or indirect transfer of stock of the lower-tier CFC by multiple upper-tier CFCs that occur pursuant to a plan (or series of related transactions), then the balance of the section 245A shareholder's extraordinary disposition account is allocated among the upper-tier CFCs. The portion of the balance of the account allocated to each upper-tier CFC is equal to the balance of the account multiplied by a fraction, the numerator of which is the value of the stock of the lower-tier CFC transferred directly or indirectly by the upper-tier CFC, and the denominator of which is the sum of the value of the stock of the lower-tier CFC transferred directly or indirectly by all upper-tier CFCs.

(d) *Limitation of amount eligible for section 954(c)(6) when there is an extraordinary disposition account with respect to a lower-tier CFC*—(1) *In general.* If an upper-tier CFC receives a dividend from a lower-tier CFC, the dividend is eligible for the exception to foreign personal holding company income under section 954(c)(6) only to the extent that the amount that would be eligible for the section 954(c)(6) exception (determined without regard to this paragraph (d)) exceeds the *disqualified amount,* which is 50 percent of the quotient of the following—

(i) The sum of each section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC; and

(ii) The percentage (expressed as a decimal) of stock of the upper-tier CFC (by value) owned, in the aggregate, by U.S. tax residents that include in gross income their pro rata share of the upper-tier CFC's subpart F income under section 951(a) on the last day of the upper-tier CFC's taxable year. If a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder of the upper-tier CFC, the amount of stock owned by the U.S. tax resident for purposes of the preceding sentence is determined under the principles of paragraph (g)(3) of this section.

(2) *Definition of tiered extraordinary disposition amount*—(i) *In general.* The term *tiered extraordinary disposition amount* means, with respect to a dividend received by an upper-tier CFC from a lower-tier CFC and a section 245A shareholder, the portion of the dividend that would be an extraordinary disposition amount if the section 245A shareholder received as a dividend its pro rata share of the dividend from the lower-tier CFC. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC from a lower-tier CFC by reason of section 964(e)(4) (in such case, see paragraphs (b)(1) and (g)(2) of this section).

(ii) *Section 245A shareholder's pro rata share of a dividend received by an upper-tier CFC.* For the purposes of paragraph (d)(2)(i) of this section, a section 245A shareholder's pro rata share of the amount of a dividend received by an upper-tier CFC from a lower-tier CFC equals the amount by which the dividend would increase the section 245A shareholder's pro rata share of the upper-tier CFC's subpart F income under section 951(a)(2) and § 1.951–1(b) and (e) if the dividend were included in the upper-tier CFC's foreign personal holding company income under section 951(a)(1), determined without regard to section 952(c) and as if the upper-tier CFC had no deductions properly allocable to the dividend under section 954(b)(5).

(e) *Extraordinary reduction amount*—(1) *In general.* Except as provided in paragraph (e)(3) of this section, the term *extraordinary reduction amount* means, with respect to a dividend received by a controlling section 245A shareholder from a CFC during a taxable year of the CFC ending after December 31, 2017, in which an extraordinary reduction occurs with respect to the controlling section 245A shareholder's ownership of the CFC, the lesser of the amounts described in paragraph (e)(1)(i) or (ii) of this section. *See* paragraphs (j)(4) through (6) of this section for examples illustrating the application of this paragraph (e).

(i) The amount of the dividend.

(ii) The amount equal to the sum of the controlling section 245A shareholder's pre-reduction pro rata share of the CFC's subpart F income (as defined in section 952(a)) and tested income (as defined in section 951A(c)(2)(A)) for the taxable year, reduced, but not below zero, by the prior extraordinary reduction amount.

(2) *Rules regarding extraordinary reduction amounts*—(i) *Extraordinary reduction*—(A) *In general.* Except as provided in paragraph (e)(2)(i)(C) of this section, an *extraordinary reduction* occurs, with respect to a controlling section 245A shareholder's ownership of a CFC during a taxable year of the CFC, if either of the conditions described in paragraph (e)(2)(i)(A)(*1*) or (*2*) of this section is satisfied. See paragraphs (j)(4) and (5) of this section for examples illustrating an extraordinary reduction.

(*1*) The condition of this paragraph (e)(2)(i)(A)(*1*) requires that during the taxable year, the controlling section 245A shareholder transfers directly or indirectly (other than by reason of a transfer occurring pursuant to an exchange described in section 368(a)(1)(E) or (F)), in the aggregate, more than 10 percent (by value) of the stock of the CFC that the section 245A shareholder owns directly or indirectly as of the beginning of the taxable year of the CFC, provided the stock transferred, in the aggregate, represents at least 5 percent (by value) of the outstanding stock of the CFC as of the beginning of the taxable year of the CFC; or

(*2*) The condition of this paragraph (e)(2)(i)(A)(*2*) requires that, as a result of one or more transactions occurring during the taxable year, the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly as of the close of the last day of the taxable year of the CFC is less than 90 percent of the percentage of stock (by value) that the controlling section 245A shareholder owns directly or indirectly on either of the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section (such percentage, the *initial percentage*), provided the difference between the initial percentage and percentage at the end of the year is at least five percentage points.

(B) *Dates for purposes of the initial percentage.* For purposes of paragraph (e)(2)(i)(A)(*2*) of this section, the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section are—

(*1*) The day of the taxable year on which the controlling section 245A shareholder owns directly or indirectly its highest percentage of stock (by value) of the CFC; and

(*2*) The day immediately before the first day on which stock was transferred directly or indirectly in the preceding taxable year in a transaction (or a series of transactions) occurring pursuant to a plan to reduce the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly.

(C) *Transactions pursuant to which CFC's taxable year ends.* A controlling section 245A shareholder's direct or indirect transfer of stock of a CFC that but for this paragraph (e)(2)(i)(B) would give rise to an extraordinary reduction under paragraph (e)(2)(i)(A) of this section does not give rise to an extraordinary reduction if the taxable year of the CFC ends immediately after the transfer, provided that the controlling section 245A shareholder directly or indirectly owns the stock on the last day of such year. Thus, for example, if a controlling section 245A shareholder exchanges all the stock of a CFC pursuant to a complete liquidation of the CFC, the exchange does not give rise to an extraordinary reduction.

(ii) *Rules for determining pre-reduction pro rata share*—(A) *In general.* Except as provided in paragraph (e)(2)(ii)(B) of this section, the term *pre-reduction pro rata share* means, with respect to a controlling section 245A shareholder and the subpart F income or tested income of a CFC, the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and § 1.951–1(b) and (e) or section 951A(e)(1) and § 1.951A–1(d)(1), respectively, determined based on the controlling section 245A shareholder's direct or indirect ownership of stock of the CFC immediately before the extraordinary reduction (or, if the extraordinary reduction occurs by reason of multiple transactions, immediately before the first transaction) and without regard to section 951(a)(2)(B) and § 1.951–1(b)(1)(ii), but only to the extent that such subpart F income or tested income is not included in the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and § 1.951–1(b) and (e) or section 951A(e)(1) and § 1.951A–1(d)(1), respectively.

(B) *Decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax resident.* A controlling section 245A shareholder's pre-reduction pro rata share of subpart F income or tested income of a CFC for a taxable year is reduced by an amount equal to the sum of the amounts by which each U.S. tax resident's pro rata share of the subpart F income or tested income is increased as a result of a transfer directly or indirectly of stock of the CFC by the controlling section 245A shareholder or an issuance of stock by the CFC (such an amount with respect to a U.S. tax resident, a *specified amount*), in either case, during the taxable year in which the extraordinary reduction occurs. For purposes of this paragraph (e)(2)(ii)(B), if there are extraordinary reductions with respect to more than one controlling section 245A shareholder during the CFC's taxable year, then a U.S. tax resident's specified amount attributable to an acquisition of stock from the CFC is prorated with respect to each controlling section 245A shareholder based on its relative decrease in ownership of the CFC. See paragraph (j)(5) of this section for an example illustrating a decrease in a section 245A shareholder's pre-reduction pro rata share for amounts taken into account by a U.S. tax resident.

(C) *Prior extraordinary reduction amount.* The term *prior extraordinary reduction amount* means, with respect to a CFC and section 245A shareholder and a taxable year of the CFC in which an extraordinary reduction occurs, the sum of the extraordinary reduction amount of each prior dividend received by the section 245A shareholder from the CFC during the taxable year. A section 245A shareholder's prior extraordinary reduction amount also includes—

(*1*) A prior dividend received by the section 245A shareholder from the CFC during the taxable year to the extent the dividend was not eligible for the section 245A deduction by reason of section 245A(e) or the holding period requirement of section 246 not being satisfied but would have been an extraordinary reduction amount had this paragraph (e) applied to the dividend;

(*2*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper tier-CFC, the portion of a prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year of the lower-tier CFC that, by reason of section 245A(e), was included in the upper-tier CFC's foreign personal holding company income and that by reason of section 951(a) was included in income of the section 245A shareholder, and that would have given rise to a tiered extraordinary reduction amount by reason of paragraph (f) of this section had paragraph (f) applied to the dividend of which the section 245A shareholder would have included a pro rata share of the tiered extraordinary reduction amount in income by reason of section 951(a); and

(*3*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper-tier CFC, the sum of the portion of the tiered extraordinary reduction amount of each prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year that is included in income of the section 245A shareholder by reason of section 951(a).

(3) *Exceptions*—(i) *Elective exception to close CFC's taxable year*—(A) *In general.* For a taxable year of a CFC in which an extraordinary reduction occurs with respect to a controlling section 245A shareholder and for which, absent this paragraph (e)(3), there would be an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero, no amount is considered an extraordinary reduction amount or tiered extraordinary reduction amount with respect to the controlling section 245A shareholder if each controlling section 245A shareholder elects, pursuant to this paragraph (e)(3), to close the CFC's taxable year for all purposes of the Internal Revenue Code (and, therefore, as to all shareholders of the CFC) as of the end of the date on which the extraordinary reduction occurs, or, if the extraordinary reduction occurs by reason of multiple transactions, as of the end of each date on which a transaction forming a part of the extraordinary reduction occurs. For purposes of applying this paragraph (e)(3), a controlling section 245A shareholder that has an extraordinary reduction (or a transaction forming a part thereof) with respect to a CFC is treated as owning the same amount of stock it owned in the CFC immediately before the extraordinary reduction (or a transaction forming a part thereof) on the end of the date on which the extraordinary reduction occurs (or such transaction forming a part thereof occurs). To the extent that stock of a CFC is treated as owned by a controlling section 245A shareholder as of the close of the CFC's taxable year pursuant to the preceding sentence, such stock is treated as not being owned by any other person as of the close of the CFC's taxable year. If each controlling section 245A shareholder elects to close the CFC's taxable year, that closing will be treated as a change in accounting period for the purposes of § 1.964–1(c).

(B) *Allocation of foreign taxes.* If an election is made pursuant to this paragraph (e)(3) to close a CFC's taxable year and the CFC's taxable year under foreign law (if any) does not close at the end of the date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to such foreign taxable year are allocated between the period of the foreign taxable year that ends with, and the period of the foreign taxable year that begins after, the date on which the CFC's taxable year closes as a result of the election. If there is more than one date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to the foreign taxable year are allocated to all such periods. The allocation is made based on the respective portions of the taxable income of the CFC (as determined under foreign law) for the foreign taxable year that are attributable under the principles of § 1.1502–76(b) to the periods during the foreign taxable year. Foreign taxes allocated to a period under this paragraph (e)(3)(i)(B) are treated as paid or accrued by the CFC as of the close of that period.

(C) *Time and manner of making election*—(*1*) *General rule.* An election pursuant to this paragraph (e)(3) is made and effective if the statement required by paragraph (e)(3)(iv) of this section is timely filed (including extensions) by each controlling section 245A shareholder making the election with its original U.S. tax return for the taxable year in which the extraordinary reduction occurs. Before the filing of the statement described in paragraph (e)(3)(iv) of this section, each controlling section 245A shareholder and each U.S. tax resident that on the end of the date on which the extraordinary reduction occurs (or, if the extraordinary reduction occurs by reason of multiple transactions, each U.S. tax resident that on the end of each date on which a transaction forming a part of the extraordinary reduction occurs) owns directly or indirectly stock of the CFC and is a United States shareholder with respect to the CFC must enter into a written, binding agreement agreeing that each controlling section 245A shareholder will elect to close the taxable year of the CFC. If a controlling section 245A shareholder is a member of a consolidated group (within the meaning of § 1.1502–1(h)) and participates in the extraordinary reduction, the agent for such group (within the meaning of § 1.1502–77(c)(1)) must file the election described in this paragraph (e)(3) on behalf of such member.

(*2*) *Transition rule.* In the case of an extraordinary reduction occurring before the date these regulations are filed as final regulations in the **Federal**

Register, the statement required by paragraph (e)(3)(iv) of this section is considered timely filed if it is attached by each controlling section 245A shareholder to an original or amended return for the taxable year in which the extraordinary reduction occurs.

(D) *Form and content of statement.* The statement required by paragraph (e)(3)(iii) of this section is to be titled ''Elective Section 245A Year-Closing Statement.'' The statement must—

(*1*) Identify (by name and tax identification number, if any) each controlling section 245A shareholder, each U.S tax resident described in paragraph (e)(3)(iii) of this section, and the CFC;

(*2*) State the date of the extraordinary reduction (or, if the extraordinary reduction includes transactions on more than one date, the dates of all such transactions) to which the election applies;

(*3*) State the filing controlling section 245A shareholder's pro rata share of the subpart F income, tested income, and foreign taxes described in section 960 with respect to the stock of the CFC subject to the extraordinary reduction, and the amount of earnings and profits attributable to such stock within the meaning of section 1248, as of the date of the extraordinary reduction;

(*4*) State that each controlling section 245A shareholder and each U.S. tax resident described in paragraph (e)(3)(iii) of this section have entered into a written, binding agreement to elect to close the CFC's taxable year in accordance with paragraph (e)(3)(iii) of this section; and

(*5*) Be filed in the manner prescribed by forms, publications, or other guidance published in the Internal Revenue Bulletin.

(E) *Consistency requirements.* If multiple extraordinary reductions occur with respect to one or more controlling section 245A shareholders' ownership in a single CFC during one or more taxable years of the CFC, then to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) section may be made only if it is made for all such extraordinary reductions with respect to the CFC. Furthermore, if an extraordinary reduction occurs with respect to a controlling section 245A shareholder's ownership in multiple CFCs, then, to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) may be made only if it is made for all such extraordinary reductions with respect to all of the CFCs that have the same or related (within the meaning of section 267(b) or 707(b)) controlling section 245A shareholders.

(ii) *De minimis subpart F income and tested income.* For a taxable year of a CFC in which an extraordinary reduction occurs, no amount is considered an extraordinary reduction amount with respect to a controlling section 245A shareholder of the CFC if the sum of the CFC's subpart F income and tested income (as defined in section 951A(c)(2)(A)) for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC's total income for the taxable year.

(f) *Limitation of amount eligible for section 954(c)(6) where extraordinary reduction occurs with respect to lower-tier CFCs*—(1) *In general.* If an extraordinary reduction occurs with respect to a lower-tier CFC and an upper-tier CFC receives a dividend from the lower-tier CFC in the taxable year in which the extraordinary reduction occurs, then the amount of the dividend that would otherwise be eligible for the exception to foreign personal holding company income under section 954(c)(6) (determined without regard to this paragraph (f)) is eligible for such exception only to the extent the dividend exceeds the tiered extraordinary reduction amount. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC by reason of section 964(e)(4) (in this case, see paragraphs (b) and (g)(2) of this section). See paragraph (j)(7) of this section for an example illustrating the application of this paragraph (f)(1).

(2) *Definition of tiered extraordinary reduction amount.* The term *tiered extraordinary reduction amount* means, with respect to the portion of a dividend received by an upper-tier CFC from a lower-tier CFC during a taxable year of the lower-tier CFC that would be eligible for the exception to foreign personal holding company income under section 954(c)(6) (determined without regard to this paragraph (f)), the amount of such dividend equal to the excess, if any, of—

(i) The product of—

(A) The sum of the amount of the subpart F income and tested income of the lower-tier CFC for the taxable year; and

(B) The percentage (by value) of stock of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately before the extraordinary reduction (or the first transaction forming a part thereof); over

(ii) The following amounts—

(A) The sum of each U.S. tax resident's pro rata share of the lower-tier CFC's subpart F income and tested income under section 951(a) or 951A(a), respectively, that is attributable to shares of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately prior to the extraordinary reduction (or the first transaction forming a part thereof), computed without the application of this paragraph (f);

(B) The sum of each prior tiered extraordinary reduction amount and sum of each amount included in an upper-tier CFC's subpart F income by reason of section 245A(e) with respect to prior dividends from the lower-tier CFC during the taxable year;

(C) The sum of the prior extraordinary reduction amounts (but, for this purpose, computed without regard to amounts described in paragraphs (e)(2)(ii)(C)(*2*) and (*3*) of this section) of each controlling section 245A shareholder with respect to shares of the lower-tier CFC that were owned by such controlling section 245A shareholder (including indirectly through a specified entity other than a foreign corporation) for a portion of the taxable year but are owned by an upper-tier CFC (including indirectly through a specified entity other than a foreign corporation) at the time of the distribution of the dividend; and

(D) The product of the amount described in paragraph (f)(2)(i)(B) of this section and the sum of the amounts of each U.S. tax resident's pro rata share of subpart F income and tested income for the taxable year under section 951(a) or 951A(a), respectively, attributable to shares of the lower-tier CFC directly or indirectly acquired by the U.S. tax resident from the lower-tier CFC during the taxable year.

(3) *Transition rule for computing tiered extraordinary reduction amount.* Solely for purposes of applying this paragraph (f) in taxable years of a lower-tier CFC beginning on or after January 1, 2018, and ending before June 14, 2019, a tiered extraordinary reduction amount is determined by treating the lower-tier CFC's subpart F income for the taxable year as if it were neither subpart F income nor tested income.

(g) *Special rules.* The following rules apply for purposes of this section.

(1) *Source of dividends.* A dividend received by any person is considered received directly by such person from the foreign corporation whose earnings and profits give rise to the dividend. Therefore, for example, if a section 245A shareholder sells or exchanges stock of an upper-tier CFC and the gain

recognized on the sale or exchange is included in the gross income of the section 245A shareholder as a dividend under section 1248(a), then, to the extent the dividend is attributable under section 1248(c)(2) to the earnings and profits of a lower-tier CFC owned, within the meaning of section 958(a)(2), by the section 245A shareholder through the upper-tier CFC, the dividend is considered received directly by the section 245A shareholder from the lower-tier CFC.

(2) *Certain section 964(e) inclusions treated as dividends.* An amount included in the gross income of a section 245A shareholder under section 951(a)(1)(A) by reason of section 964(e)(4) is considered a dividend received by the section 245A shareholder directly from the foreign corporation whose earnings and profits give rise to the amount described in section 964(e)(1). Therefore, for example, if an upper-tier CFC sells or exchanges stock of a lower-tier CFC, and, as a result of the sale or exchange, a section 245A shareholder with respect to the upper-tier CFC includes an amount in gross income under section 951(a)(1)(A) by reason of section 964(e)(4), then the inclusion is treated as a dividend received directly by the section 245A shareholder from the lower-tier CFC whose earnings and profits give rise to the dividend, and the section 245A shareholder is not allowed a section 245A deduction for the dividend to the extent of the ineligible amount of such dividend.

(3) *Rules regarding stock ownership and stock transfers*—(i) *Determining indirect ownership of stock of an SFC or a CFC.* For purposes of this section, if a person owns an interest in, or stock of, a specified entity, including through a chain of ownership of one or more other specified entities, then the person is considered to own indirectly a pro rata share of stock of an SFC or a CFC owned by the specified entity. To determine a person's pro rata share of stock owned by a specified entity, the principles of section 958(a) apply without regard to whether the specified entity is foreign or domestic.

(ii) *Determining indirect transfers for stock owned indirectly.* If, under paragraph (g)(3)(i) of this section, a person is considered to own indirectly stock of an SFC or CFC that is owned by a specified entity, then the following rules apply in determining if the person transfers stock of the SFC or CFC—

(A) To the extent the specified entity transfers stock that is considered owned indirectly by the person immediately before the transfer, the person is considered to transfer indirectly such stock;

(B) If the person transfers an interest in, or stock of, the specified entity, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the specified entity that is transferred; and

(C) In the case in which the person owns the specified entity through a chain of ownership of one or more other specified entities, if there is a transfer of an interest in, or stock of, another specified entity in the chain of ownership, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the other specified entity transferred.

(iii) *Definition of specified entity.* The term *specified entity* means any partnership, trust, or estate (in each case, domestic or foreign), or any foreign corporation.

(4) *Coordination rules*—(i) *General rule.* A dividend is first subject to section 245A(e). To the extent the dividend is not a hybrid dividend or tiered hybrid dividend under section 245A(e), the dividend is subject to paragraph (e) or (f) of this section, as applicable, and then, to the extent the dividend is not subject to paragraph (e) or (f) of this section, it is subject to paragraph (c) or (d) of this section, as applicable.

(ii) *Coordination rule for paragraphs (c) and (d) and (e) and (f) of this section, respectively.* If an SFC or CFC pays a dividend (or simultaneous dividends), a portion of which may be subject to paragraph (c) or (e) of this section and a portion of which may be subject to paragraph (d) or (f) of this section, the rules of this section apply by treating the portion of the dividend or dividends that may be subject to paragraph (c) or (e) of this section as if it occurred immediately before the portion of the dividend or dividends that may be subject to paragraph (d) or (f) of this section. For example, if a dividend arising under section 964(e)(4) occurs at the same time as a dividend that would be eligible for the exception to foreign personal holding company income under section 954(c)(6) but for the potential application of paragraph (d) this section, then the tiered extraordinary disposition amount with respect to the other dividend is determined as if the dividend arising under section 964(e)(4) occurs immediately prior to the other dividend.

(5) *Ordering rule for multiple dividends made by an SFC or a CFC during a taxable year.* If an SFC or a CFC pays dividends on more than one date during its taxable year or at different times on the same date, this section applies based on the order in which the dividends are paid.

(6) *Partner's distributive share of a domestic partnership's pro rata share of subpart F income.* If a section 245A shareholder or a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder with respect to a CFC and includes in gross income its pro rata share of the CFC's subpart F income under section 951(a), then, solely for purposes of this section, a reference to the section 245A shareholder's or U.S. tax resident's pro rata share of the CFC's subpart F income included in gross income under section 951(a) includes such person's distributive share of the domestic partnership's pro rata share of the CFC's subpart F income. A person is an indirect partner with respect to a domestic partnership if the person indirectly owns the domestic partnership through one or more specified entities (other than a foreign corporation).

(h) *Anti-abuse rule.* The Commissioner may make appropriate adjustments to any amounts determined under this section if a transaction is engaged in with a principal purpose of avoiding the purposes of this section.

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

(1) *Controlled foreign corporation.* The term *controlled foreign corporation* (or *CFC*) has the meaning provided in section 957.

(2) *Controlling section 245A shareholder.* The term *controlling section 245A shareholder* means, with respect to a CFC, any section 245A shareholder that owns directly or indirectly more than 50 percent (by vote or value) of the stock of the CFC. For purposes of determining whether a section 245A shareholder is a controlling section 245A shareholder with respect to a CFC, all stock of the CFC owned by a related party with respect to the section 245A shareholder or by other persons acting in concert with the section 245A shareholder to undertake an extraordinary reduction is considered owned by the section 245A shareholder. If section 964(e)(4) applies to a sale or exchange of a lower-tier CFC with respect to a controlling section 245A shareholder, all United States shareholders of the CFC are considered to act in concert with regard to the sale or exchange. In addition, if all persons selling stock in a CFC, held directly, sell such stock to the same buyer or buyers (or a related party with respect to the buyer or buyers) as part of the same

plan, all sellers will be considered to act in concert with regard to the sale or exchange.

(3) *Disqualified amount.* The term *disqualified amount* has the meaning set forth in paragraph (d)(1) of this section.

(4) *Disqualified period.* The term *disqualified period* has the meaning set forth in paragraph (c)(3)(iii) of this section.

(5) *Extraordinary disposition.* The term *extraordinary disposition* has the meaning set forth in paragraph (c)(3)(ii) of this section.

(6) *Extraordinary disposition account.* The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i) of this section.

(7) *Extraordinary disposition amount.* The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(1) of this section.

(8) *Extraordinary disposition E&P.* The term *extraordinary E&P* has the meaning set forth in paragraph (c)(3)(i)(C) of this section.

(9) *Extraordinary disposition ownership percentage.* The term extraordinary disposition ownership percentage has the meaning set forth in paragraph (c)(3)(i)(B) of this section.

(10) *Extraordinary reduction.* The term *extraordinary reduction* has the meaning set forth in paragraph (e)(2)(i)(A) of this section.

(11) *Extraordinary reduction amount.* The term *extraordinary reduction amount* has the meaning set forth in paragraph (e)(1) of this section.

(12) *Ineligible amount.* The term *ineligible amount* has the meaning set forth in paragraph (b)(2) of this section.

(13) *Lower-tier CFC.* The term *lower-tier CFC* means a CFC whose stock is owned (within the meaning of section 958(a)(2)), in whole or in part, by another CFC.

(14) *Non-extraordinary disposition E&P.* The term *non-extraordinary disposition E&P* has the meaning set forth in paragraph (c)(2)(ii) of this section.

(15) *Pre-reduction pro rata share.* The term *pre-reduction pro rata share* has the meaning set forth in paragraph (e)(2)(ii) of this section.

(16) *Prior extraordinary disposition amount.* The term *prior extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i)(D) of this section.

(17) *Prior extraordinary reduction amount.* The term *prior extraordinary reduction amount* has the meaning set forth in paragraph (e)(2)(ii)(C) of this section.

(18) *Qualified portion.* The term *qualified portion* has the meaning set forth in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section.

(19) *Related party.* The term *related party* means, with respect to a person, another person bearing a relationship described in section 267(b) or 707(b) to the person, in which case such persons are *related.*

(20) *Section 245A deduction.* The term *section 245A deduction* means, with respect to a dividend received by a section 245A shareholder from an SFC, the amount of the deduction allowed to the section 245A shareholder by reason of the dividend.

(21) *Section 245A shareholder.* The term *section 245A shareholder* means a domestic corporation that is a United States shareholder with respect to an SFC that owns directly or indirectly stock of the SFC.

(22) *Specified 10-percent owned foreign corporation (SFC*). The term *specified 10-percent owned foreign corporation* (or *SFC*) has the meaning provided in section 245A(b)(1).

(23) *Specified entity.* The term *specified entity* has the meaning set forth in paragraph (g)(3)(iii) of this section.

(24) *Specified property.* The term *specified property* has the meaning set forth in paragraph (c)(3)(iv) of this section.

(25) *Tiered extraordinary disposition amount.* The term *tiered extraordinary disposition amount* has the meaning set forth in paragraph (d)(2)(i) of this section.

(26) *Tiered extraordinary reduction amount.* The term *tiered extraordinary reduction amount* has the meaning set forth in paragraph (f)(2) of this section.

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

(28) *Upper-tier CFC.* The term *upper-tier CFC* means a CFC that owns (within the meaning of section 958(a)(2)) stock in another CFC.

(29) *U.S. tax resident.* The term *U.S. tax resident* means a United States person described in section 7701(a)(30)(A) or (C).

(j) *Examples.* The application of this section is illustrated by the examples in this paragraph (j).

(1) *Facts.* Except as otherwise stated, the following facts are assumed for purposes of the examples:

(i) US1 and US2 are domestic corporations, each with a calendar taxable year, and are not related parties with respect to each other.

(ii) CFC1 and CFC2 are foreign corporations that are SFCs and CFCs.

(iii) Each entity uses the U.S. dollar as its functional currency.

(iv) Year 2 begins on or after January 1, 2018, and has 365 days.

(v) Absent application of this section, the dividends received by US1 and US2 from CFC1 meet the requirements to qualify for the section 245A deduction.

(vi) The de minimis rules in paragraphs (c)(3)(ii)(E) and (e)(3)(ii) of this section do not apply.

(2) *Example 1. Extraordinary disposition*—(i) *Facts.* US1 and US2 own 60% and 40%, respectively, of the single class of stock of CFC1. CFC1 owns all of the single class of stock of CFC2. CFC1 and CFC2 use the taxable year ending November 30 as their taxable year. On November 1, 2018, CFC1 sells specified property to CFC2 in exchange for $200x of cash (the ''Property Transfer''). The Property Transfer is outside of CFC1's ordinary course of activities. The transferred property has a basis of $100x in the hands of CFC1. CFC1 recognizes $100x of gain as a result of the Property Transfer ($200x − $100x). On December 1, 2018, CFC1 distributes $80x pro rata to US1 ($48x) and US2 ($32x), all of which is a dividend within the meaning of section 316 and treated as a distribution out of earnings described in section 959(c)(3). No other distributions are made by CFC1 to either US1 or US2 in CFC1's taxable year ending November 30, 2019. For its taxable year ending on November 30, 2019, CFC1 has $110x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year.

(ii) *Analysis*—(A) *Identification of extraordinary disposition.* Because CFC1 is a CFC and uses the taxable year ending on November 30, under paragraph (c)(3)(iii) of this section, it has a disqualified period beginning on January 1, 2018, and ending on November 30, 2018. In addition, under paragraph (c)(3)(ii) of this section, the Property Transfer is an extraordinary disposition because it (i) is a disposition of specified property by CFC1 on a date on which it was a CFC and during CFC1's disqualified period, (ii) is to CFC2, a related party with respect to CFC1, (iii) occurs outside of the ordinary course of CFC1's activities, and (iv) is not subject to the de minimis rule in paragraph (c)(3)(ii)(E) of this section.

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts.* Because CFC1 undertook an extraordinary disposition, under paragraph (c)(3)(i) of this section, a portion of CFC1's earnings and profits are extraordinary disposition E&P and, therefore, give rise to an extraordinary disposition account with respect to each of CFC1's section 245A shareholders. Under paragraph (i)(21) of this section, US1 and US2 are both section 245A shareholders with respect to CFC1. The amount of the extraordinary disposition account with respect to US1 is $60x, which is equal to the product of the extraordinary disposition E&P (the amount of the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and the extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US1 on January 1, 2018 (60%)), reduced by the prior extraordinary disposition amount ($0). *See* paragraph (c)(3)(i) of this section. Similarly, the amount of the extraordinary disposition account with respect to US2 is $40x, which is equal to the product of the extraordinary disposition E&P (the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US2 on January 1, 2018 (40%)), reduced by the prior extraordinary disposition amount ($0).

(C) *Determination of extraordinary disposition amount with respect to US1.* The dividend of $48x paid to US1 on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of the extraordinary disposition account with respect to US1. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US1, to the extent thereof. With respect to US1, $6x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $66x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 60%) over $60x (the balance of US1's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $6x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US1. Under paragraph (c)(2)(i)(B) of this section, the remaining $42x of the dividend is next considered paid out of US1's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $42x of the dividend is considered paid out of the extraordinary disposition account with respect to CFC1 and gives rise to $42x of an extraordinary disposition amount. As a result, US1's prior extraordinary disposition amount is increased by $42x under paragraph (c)(3)(i)(D) of this section, and US1's extraordinary disposition account is reduced to $18x ($60 − $42x) under paragraph (c)(3)(i)(A) of this section.

(D) *Determination of extraordinary disposition amount with respect to US2.* The dividend of $32x paid to US2, on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of extraordinary disposition E&P with respect to US2. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US2, to the extent thereof. With respect to US2, $4x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $44x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 40%) over $40x (the balance of US2's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $4x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US2. Under paragraph (c)(2)(i)(B) of this section, the remaining $28x of the dividend is next considered paid out of US2's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $28x of the dividend is considered paid out of the extraordinary disposition account with respect to US2 and gives rise to $28x of an extraordinary disposition amount. As a result, US2's prior extraordinary disposition amount is increased by $28x under paragraph (c)(3)(i)(D) of this section, and US2's extraordinary disposition account is reduced to $12x ($40 − $28x) under paragraph (c)(3)(i)(A) of this section.

(E) *Determination of ineligible amount with respect to US1 and US2.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $48x, the ineligible amount is $21x, the sum of 50 percent of the extraordinary disposition amount ($42x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US1 of $48x, $27x is eligible for a section 245A deduction. With respect to US2 and the dividend of $32x, the ineligible amount is $14x, the sum of 50% of the extraordinary disposition amount ($28x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US2 of $32x, $18x is eligible for a section 245A deduction.

(3) *Example 2. Application of section 954(c)(6) exception with extraordinary disposition account*—(i) *Facts.* The facts are the same as in paragraph (j)(2)(i) of this section (the facts in *Example 1*) except that the Property Transfer is a sale by CFC2 to CFC1 instead of a sale by CFC1 to CFC2, the $80x distribution is by CFC2 to CFC1 in a separate transaction that is unrelated to the Property Transfer, and the description of the earnings and profits of CFC1 is applied to CFC2. Additionally, absent the application of this section, section 954(c)(6) would apply to the distribution by CFC2 to CFC1. Under section 951(a)(2) and § 1.951–1(b) and (e), US1's pro rata share of any subpart F income of CFC1 is 60% and US2's pro rata share of any subpart F income of CFC2 is 40%.

(ii) *Analysis*—(A) *Identification of extraordinary disposition.* The Property Transfer is an extraordinary disposition under the same analysis as provided in paragraph (j)(2)(ii)(A) of this section (the analysis in *Example 1*).

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts.* Both US1 and US2 are section 245A shareholders with respect to CFC2, US1 has an extraordinary disposition account of $60x with respect to CFC2, and US2 has an extraordinary disposition account of $40x with respect to CFC2 under the same analysis as provided in paragraph (j)(2)(ii)(B) of this section (the analysis in *Example 1*).

(C) *Determination of tiered extraordinary disposition amount*—(*1*) *In general.* US1 and US2 each have a tiered extraordinary disposition amount with respect to the $80x dividend paid by CFC2 to CFC1 to the extent that US1 and US2 would have an extraordinary disposition amount if each had received as a dividend its pro rata share of the dividend from CFC2. *See* paragraph (d)(2)(i) of this section. Under paragraph (d)(2)(ii) of this section, US1's pro rata share of the dividend is $48x (60% − $80x), that is, the increase to US1's pro rata share of the subpart F income if the dividend were included in CFC1's foreign personal holding company income, without regard to section 952(c) and the allocation of expenses. Similarly, US2's pro rata share of the dividend is $32x (40% − $80x).

(*2*) *Determination of tiered extraordinary disposition amount with respect to US1.* The extraordinary disposition amount with respect to US1 is $42x, under the same analysis provided in paragraph (j)(2)(ii)(C) of this section (the analysis in *Example 1*). Accordingly, the tiered extraordinary disposition amount with respect to US1 is $42x.

(*3*) *Determination of extraordinary disposition amount with respect to US2.* The extraordinary disposition amount with respect to US2 is $28x, under the same analysis provided in paragraph (j)(2)(ii)(D) of this section (the analysis in *Example 1*). Accordingly, the tiered extraordinary disposition amount with respect to US2 is $28x.

(D) *Limitation of section 954(c)(6) exception.* The sum of US1 and US2's tiered extraordinary disposition amounts is $70x ($42x + $28x). The portion of the stock of CFC1 (by value) owned (within the meaning of section 958(a)) by U.S. tax residents on the last day of CFC1's taxable year is 100%. Under paragraph (d)(1) of this section, the disqualified amount with respect to the dividend is $35x (50% × ($70x/100%)). Accordingly, the portion of the $80x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $45x ($80x − $35x). Under section 951(a)(2) and § 1.951–1(b) and (e), US1 includes $21x (60% × $35x) and US2 includes $14x (60% × $35x) in income under section 951(a).

(E) *Changes in extraordinary disposition account of US1.* Under paragraph (c)(3)(i)(D)(*1*) of this section, US1's prior extraordinary disposition amount with respect to CFC2 is increased by $42x, or 200% of $21x, the amount US1 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US1 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US1's extraordinary disposition account is reduced to $18x ($60x − $42x) under paragraph (c)(3)(i)(A) of this section.

(F) *Changes in extraordinary disposition account of US2.* Under paragraph (c)(3)(i)(D)(*1*) of this section, US2's prior extraordinary disposition amount with respect to CFC2 is increased by $28x, or 200% of $14x, the amount US2 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US2 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US2's extraordinary disposition account is reduced to $12x ($40x − $28x) under paragraph (c)(3)(i)(A) of this section.

(4) *Example 3. Extraordinary reduction*—(i) *Facts.* At the beginning of CFC1's taxable

year ending on December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. Also as of the beginning of Year 2, CFC1 has no earnings and profits described in section 959(c)(1) or (2), and US1 does not have an extraordinary disposition account with respect to CFC1. As of the end of Year 2, CFC1 has $160x of tested income and no other income. CFC1 has $160x of earnings and profits for Year 2. On October 19, Year 2, US1 sells all of its CFC1 stock to US2 for $100x in a transaction (the ''Stock Sale'') in which US1 recognizes $90x of gain. Under section 1248(a), the entire $90x of gain is included in US1's gross income as a dividend and, pursuant to section 1248(j), the $90x is treated as a dividend for purposes of applying section 245A. At the end of Year 2, under section 951A, US2 takes into account $70x of tested income, calculated as $160x (100% of the $160x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $90x, the amount of dividends received by US1 with respect to the transferred stock, and $128x, the amount of tested income attributable to the transferred stock ($160x) multiplied by 292/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of extraordinary reduction amount.* Under paragraph (e)(1) of this section, the entire $90x dividend to US1 is an extraordinary reduction amount with respect to US1 because the dividend is at least equal to US1's pre-reduction pro rata share of CFC1's Year 2 tested income described in paragraph (e)(2)(ii)(A) of this section ($160x), reduced by the amount of tested income taken into account by US2, a U.S. tax resident, under paragraphs (e)(2)(ii)(B) and (i)(29) of this section ($70x).

(C) *Determination of ineligible amount.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $90x, the ineligible amount is $90x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($90x). Therefore, with respect to the dividend received of $90x, no portion is eligible for the dividends received deduction allowed under section 245A(a).

(iii) *Alternative facts—election to close CFC's taxable year.* The facts are the same as in paragraph (j)(4)(i) of this section (the facts of this *Example 3*), except that, pursuant to paragraph (e)(3)(i) of this section, US1 elects to close CFC1's Year 2 taxable year for all purposes of the Internal Revenue Code as of the end of October 19, Year 2, the date on which the Stock Sale occurs; in addition, US1 and US2 enter into a written, binding agreement that US1 will elect to close CFC1's Year 2 taxable year. Accordingly, under section 951A(a), US1 takes into account 100% of CFC1's tested income for the taxable year beginning January 1, Year 2, and ending October 19, Year 2, and US2 takes into account 100% of CFC1's tested income for the taxable year beginning October 20, Year 2, and ending December 31, Year 2. Under paragraph (e)(3)(i)(A) of this section, no amount is considered an extraordinary reduction amount with respect to US1.

(5) *Example 4. Extraordinary reduction; decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax residents*—(i) *Facts.* At the beginning of CFC1's taxable year ending December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. CFC1 generates $120x of subpart F income during its taxable year ending on December 31, Year 2. On October 1, Year 2, CFC1 distributes a $120x dividend to US1. On October 19, Year 2, US1 sells 100% of its stock of CFC1 to PRS, a domestic partnership, in a transaction in which no gain or loss is realized (the ''Stock Sale''). PRS is owned 50% each by A, an individual who is a citizen of the United States, and B, a foreign individual who is not a U.S. tax resident. On December 1, Year 2, US2 and FP, a foreign corporation, contribute property to CFC1; in exchange, each of US2 and FP receives 25% of the stock of CFC1. PRS owns the remaining 50% of the stock of CFC1. US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owns on the first day of Year 2, and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of Year 2 the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the highest percentage of stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of pre-reduction pro rata share.* Before the extraordinary reduction, US1 owned 100% of the stock of CFC1. Thus, under paragraph (e)(2)(ii)(A) of this section, the tentative amount of US1's pre-reduction pro rata share of CFC1's subpart F income is $120x. A and US2 are U.S. tax residents pursuant to paragraph (i)(29) of this section because they are United States persons described in section 7701(a)(30)(A) or (C). Thus, US1's pre-reduction pro rata share amount is subject to the reduction described in paragraph (e)(2)(ii)(B) of this section because U.S. tax residents directly or indirectly acquire stock of CFC1 from US1 or CFC1 during the taxable year in which the extraordinary reduction occurs. With respect to US1's pre-reduction pro rata share of CFC1's subpart F income, the reduction equals the amount of subpart F income of CFC1 taken into account under section 951(a) by these U.S. tax residents.

(C) *Determination of decrease in pre-reduction pro rata share for amounts taken into account by U.S. tax resident.* On December 31, Year 2, both PRS and US2 will be United States shareholders with respect to CFC1 and will include in gross income their pro rata share of CFC1's subpart F income under section 951(a). With respect to US2, this amount will be $30x, which is equal to 25% of CFC1's subpart F income for the taxable year. With respect to PRS, its pro rata share of $60x under section 951(a)(2)(A) (50% of $120x) will be reduced under section 951(a)(2)(B) by $48x. The section 951(a)(2)(B) reduction is equal to the lesser of the $120x dividend paid with respect to those shares to US1 or $48x (50% × $120x × 292/365, the period during the taxable year that PRS did not own CFC1 stock). Thus, PRS includes $12x in gross income pursuant to section 951(a). Of this amount, $6x is allocated to A (as a 50% partner of PRS) and, therefore, treated as taken into account by A under paragraphs (e)(2)(ii)(B) and (g)(6) of this section. Thus, A and US2 take into account a total of $36x of CFC1's subpart F income under section 951(a). This amount reduces US1's pre-reduction pro rata share of CFC1's subpart F income to $84x ($120x − $36x) under paragraph (e)(2)(ii)(B) of this section. CFC1 did not generate tested income during the taxable year and, therefore, no amount is taken into account under section 951A with respect to CFC1, and US1 has no pre-reduction pro rata share with respect to tested income of CFC1.

(D) *Determination of extraordinary reduction amount.* Under paragraph (e)(1) of this section, the extraordinary reduction amount equals $84x, which is the lesser of the amount of the dividend received by US1 from CFC1 during Year 2 ($120x) and the sum of US1's pre-reduction pro rata share of CFC1's subpart F income ($84x) and tested income ($0).

(E) *Determination of ineligible amount.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $120x, the ineligible amount is $84x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($84x). Therefore, with respect to the dividend received by US1 from CFC1, $36x ($120x − $84x) is eligible for a section 245A deduction.

(6) *Example 5. Controlling section 245A shareholder*—(i) *Facts.* US1 and US2 own 30% and 25% of the stock of CFC1, respectively. FP, a foreign corporation that is not a CFC, owns all of the stock of US1 and US2. FP owns the remaining 45% of the stock of CFC1. On September 30, Year 2, US1 sells all of its stock of CFC1 to US3, a domestic corporation that is not a related party with respect to FP, US1, or US2. No person transferred any stock of CFC1 directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1.

(ii) *Analysis.* Under paragraph (i)(21) of this section, US1 is a section 245A shareholder with respect to CFC1, an SFC. Because US1 owns, together with US2 and FP (related persons with respect to US1), more than 50% of the stock of CFC1, US1 is a controlling section 245A shareholder of CFC1. The sale of US1's CFC1 stock results in an extraordinary reduction occurring with respect to US1's ownership of CFC1. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the stock of CFC1 that it owned at the beginning of the year and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 directly or indirectly owns (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 directly or indirectly owned on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (30%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and end of year percentage (30 percentage points) is at least 5 percentage points.

(7) *Example 6. Limitation of section 954(c)(6) exception with respect to an extraordinary reduction.* (i) *Facts.* At the beginning of CFC1 and CFC2's taxable year ending on December 31, Year 2, US1 and A, an individual who is a citizen of the United States, own 80% and 20% of the single class of stock of CFC1, respectively. CFC1 owns 100% of the stock of CFC2. Both US1 and A are United States shareholders with respect to CFC1 and CFC2, and US1 and A are not related parties with respect to each other. No person transferred CFC2 stock directly or indirectly in Year 2 pursuant to a plan to reduce the percentage of stock (by value) of CFC2 owned by US1, and US1 does not have an extraordinary disposition account with respect to CFC2. At the end of Year 2, and without regard to any distributions during Year 2, CFC2 had $150x of tested income and no other income, and CFC1 had no income or expenses. On June 30, Year 2, CFC2 distributed $150x as a dividend to CFC1, which would qualify for the exception from foreign personal holding company income under section 954(c)(6) but for the application of this section. On August 7, Year 2, CFC1 sells all of its CFC2 stock to US2 for $100x in a transaction (the ''Stock Sale'') in which CFC1 realizes no gain or loss. At the end of Year 2, under section 951A, US2 takes into account $60x of tested income, calculated as $150x (100% of the $150x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $150x, the amount of dividends received by CFC1 during Year 2 with respect to the transferred stock, and $90x, the amount of tested income attributable to the transferred stock ($150x) multiplied by 219/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC2, but A is not. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC2. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred indirectly 100% of the CFC2 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC2 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC2 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC2 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC2 stock by value (80%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC2 stock owned by US1, and the difference between the initial percentage and the end of year percentage (80 percentage points) is at least 5 percentage points. Because there is an extraordinary reduction with respect to CFC2 in Year 2 and CFC1 received a dividend from CFC2 in Year 2, under paragraph (f)(1) of this section, it is necessary to determine the limitation on the amount of the dividend eligible for the exception under section 954(c)(6).

(B) *Determination of tiered extraordinary reduction amount.* The limitation on the amount of the dividend eligible for the exception under section 954(c)(6) is based on the tiered extraordinary reduction amount. The sum of the amount of subpart F income and tested income of CFC2 for Year 2 is $150x, and immediately before the extraordinary reduction, CFC1 held 100% of the stock of CFC2. Additionally, US2 is a U.S. tax resident as defined in paragraph (i)(29) of this section because it is a United States person described in section 7701(a)(30)(A) or (C), and US2 has a pro rata share of $60x of tested income under section 951A with respect to CFC2. Accordingly, under paragraph (f)(2) of this section, the tiered extraordinary reduction amount is $90x (($150x × 100%) − $60x).

(C) *Limitation of section 954(c)(6) exception.* Under paragraph (f)(1) of this section, the portion of the $150x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $60x ($150x − $90x). To the extent that the $90x that does not qualify for the exception gives rise to additional subpart F income to CFC1, both US1 and A will take into account their pro rata share of that subpart F income under section 951(a)(2) and § 1.951–1(b) and (e).

(k) *Applicability date.* This section applies to distributions occurring after December 31, 2017.

(l) *Expiration date.* The applicability of this section expires June 14, 2022.

■ **Par. 3.** Section 1.954(c)(6)–1T is added to read as follows:

§ 1.954(c)(6)–1T Certain cases in which section 954(c)(6) exception not available (temporary).

(a) *Cross-references to other rules.* For a non-exclusive list of rules that limit the applicability of the exception to foreign personal holding company income under section 954(c)(6), see—

(1) Section 1.245A–5T(d) (rules regarding the application of section 954(c)(6) to extraordinary disposition amounts);

(2) Section 1.245A–5T(f) (rules regarding the application of section 954(c)(6) to tiered extraordinary reduction amounts)

(3) Section 1.245A(e)–1(c) (rules regarding tiered hybrid dividends);

(4) Section 1.367(b)–4(e)(4) (rules regarding income inclusion and gain recognition in certain exchanges following an inversion transaction);

(5) Section 964(e)(4)(A) (rules regarding certain gain from the sale or exchange of stock that is recharacterized as a dividend); and

(6) Section 1.7701(l)–4(e) (rules regarding recharacterization of certain transactions following an inversion transaction).

(b) *Applicability date.* This section applies on or after June 14, 2019.

(c) *Expiration date.* The applicability of this section expires June 14, 2022.

■ **Par. 4.** Section 1.6038–2T is added to read as follows:

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

(a) through (e) [Reserved].

(f)(1) through (15) [Reserved].

(16) *Dividends for which section 245A deduction or section 954(c)(6) exception is limited*—(i) *General rule.* If for the annual accounting period, the corporation distributes or receives a dividend that gives rise to an ineligible amount (as defined in § 1.245A–5T((i)(12)), a tiered extraordinary disposition amount (as defined in § 1.245A–5T(i)(25)), or a tiered extraordinary reduction amount (as defined in § 1.245A–5T(i)(26)), then Form 5471 (or a successor form) must contain such information about the ineligible amount, tiered extraordinary disposition amount, or tiered extraordinary reduction amount, as applicable, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(ii) *Transition rule.* If the corporation (or predecessor corporation) distributed or received a dividend that gave rise to an ineligible amount, a tiered extraordinary disposition amount, or a tiered extraordinary reduction amount in an annual accounting period for which the Form 5471 (or successor form) has been filed before the date of publication of these Temporary regulations, the corporation must provide the information described in paragraph (f)(16)(i) of this section on the first Form 5471 (or successor form) filed by the corporation after the issuance of guidance setting forth the form and manner of reporting such information.

(g) through (l) [Reserved].

(m)(1) [Reserved].

(2) *Special rule for paragraph (f)(16).* Paragraph (f)(16) of this section applies with respect to information for annual accounting periods in which a dividend subject to § 1.245A–5T is paid.

(n) *Expiration date.* The applicability of paragraphs (f)(16) and (m) of this section expires June 14, 2022.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

Approved: June 4, 2019.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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