

RELEARNING CORPORATE TRANSACTIONS

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NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON SECTION 965

February 6, 2018

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NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON THE GILTI PROVISIONS OF THE CODE

May 4, 2018

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Guidance under Section 965

Notice 2018-07

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) intend to issue regulations for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code (“Code”) as amended by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), which was enacted on December 22, 2017. Section 2 of this notice provides background on section 965. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue. Section 4 of this notice describes the effective dates of those regulations. Section 5 of this notice requests comments and provides contact information.

SECTION 2. BACKGROUND

.01 Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation (“DFIC”) that begins before January 1, 2018 (such year of the DFIC, the “inclusion year”), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017

(each such date, a “measurement date,” and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the “section 965(a) earnings amount”). Furthermore, under section 965(b)(1), the section 965(a) earnings amount which would otherwise be taken into account under section 951(a)(1) by a United States shareholder with respect to a DFIC is reduced by the amount of such United States shareholder’s aggregate foreign E&P deficit which is allocated to such DFIC under section 965(b)(2). The section 965(a) earnings amount reduced as described in the preceding sentence is referred to in this notice as the “section 965(a) inclusion amount.” Neither the section 965(a) earnings amount nor the section 965(a) inclusion amount is subject to the rules or limitations in section 952 or limited by the accumulated earnings and profits of the DFIC on the date of the inclusion.

.02 Application of the Participation Exemption

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

Section 965(c)(3)(A) provides that the term “aggregate foreign cash position” means, with respect to any United States shareholder, the greater of (i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the inclusion year, or (ii) one half

of the sum of (I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation that ends before November 2, 2017, plus (II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I). Each date referred to in the preceding sentence is referred to in this notice as a “cash measurement date.”

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

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

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

.03 Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under Chapter 1 (“effectively connected income”), or (B) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed income”). Section 965(d)(2).

Section 965(d)(2) further provides that, to the extent provided in regulations or other guidance prescribed by the Secretary, in the case of any CFC that has shareholders that are not United States shareholders, accumulated post-1986 deferred foreign income shall be appropriately reduced by amounts which would be previously taxed income if such shareholders were United States shareholders.

Section 965(d)(3) provides that the term “post-1986 earnings and profits” means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by only taking into account periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (A) as of the measurement date that is applicable with respect to such foreign

corporation, and (B) without diminution by reason of dividends distributed during the inclusion year other than dividends distributed to another specified foreign corporation. Accordingly, under section 965(d)(3)(B), dividends paid by a specified foreign corporation in the inclusion year before a measurement date generally reduce the post-1986 earnings and profits of the corporation as determined on such measurement date, except for dividends paid to a person other than a specified foreign corporation (for example, a United States shareholder).

.04 Specified Foreign Corporation

Section 965(e)(1) provides that the term “specified foreign corporation” means (A) any CFC, and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (10-percent corporation). For purposes of sections 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a). Section 965(e)(2). However, if a passive foreign investment company (as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

.05 Determinations of Pro Rata Share

Section 965(f)(1) provides that the determination of any United States shareholder’s pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a CFC).

.06 Regulations or Other Guidance

Section 965(o) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 965, including regulations or other guidance to provide appropriate basis adjustments, and

regulations or other guidance to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.

SECTION 3. REGULATIONS TO BE ISSUED ADDRESSING THE APPLICATION OF SECTION 965

.01 Determination of Aggregate Foreign Cash Position

(a) Allocation Between Multiple Inclusion Years

The Treasury Department and the IRS are aware that in cases where specified foreign corporations have inclusion years that end in or with different taxable years of the same United States shareholder, section 965 could result in double-counting such shareholder's aggregate foreign cash position for purposes of determining the shareholder's deduction under section 965(c). For example, assume USP, a calendar year taxpayer, wholly owns CFC1, which has an inclusion year ending December 31, 2017, and CFC2, which has an inclusion year ending November 30, 2018. In addition, assume that USP's pro rata share of the cash position of each of CFC1 and CFC2 on all relevant cash measurement dates is \$100, with the result that USP's aggregate foreign cash position is \$200. Under section 965(c), the amount allowed as a deduction in the taxable year of a United States shareholder for which the United States shareholder takes a section 965(a) inclusion amount into gross income is based on the aggregate foreign cash position of the United States shareholder. One interpretation of section 965(c) could result in the 15.5 percent rate equivalent percentage applying to as much as \$400 of the aggregate section 965(a) inclusion amounts of CFC1 and CFC2 taken into account by USP, because USP's aggregate foreign cash position for its 2017 taxable year (in which CFC1's section 965(a) inclusion amount is taken into account) is \$200 and its aggregate foreign cash

position for its 2018 taxable year (in which CFC2's section 965(a) inclusion amount is taken into account) is also \$200.

The Treasury Department and the IRS intend to issue regulations providing that in the case of a United States shareholder that has a section 965(a) inclusion amount in more than one taxable year, the aggregate foreign cash position taken into account in the first taxable year will equal the lesser of the United States shareholder's aggregate foreign cash position or the aggregate of the section 965(a) inclusion amounts taken into account by the United States shareholder in that taxable year. Furthermore, the amount of the United States shareholder's aggregate foreign cash position taken into account in any succeeding taxable year will be its aggregate foreign cash position reduced by the amount of its aggregate foreign cash position taken into account in any preceding taxable year.

Example. (i) Facts. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP is a calendar year taxpayer. CFC1's inclusion year ends December 31, 2017, and CFC2's inclusion year ends November 30, 2018. The cash position of each of CFC1 and CFC2 on all relevant cash measurement dates is \$200, with the result that USP has an aggregate foreign cash position of \$400. For its 2017 taxable year, USP takes into account CFC1's section 965(a) inclusion amount of \$300, and for its 2018 taxable year, USP takes into account CFC2's section 965(a) inclusion amount of \$300.

(ii) Analysis. USP's aggregate foreign cash position taken into account in 2017 is \$300, the lesser of USP's aggregate foreign cash position (\$400) or the section 965(a) inclusion amount (\$300) that USP takes into account in 2017. The amount of USP's aggregate foreign cash position taken into account in 2018 is \$100, USP's aggregate foreign cash position (\$400) reduced by the amount of its aggregate foreign cash position taken into account in 2017 (\$300).

In addition, in cases in which, for example, a calendar year United States shareholder owns specified foreign corporations with inclusion years that end in or with different taxable years of the United States shareholder, at least one specified foreign corporation of such United States shareholder will have a final cash measurement date in 2017 (for example, December 31, 2017) and at least one other such specified foreign corporation will have a final cash

measurement date in 2018 (for example, November 30, 2018). The Treasury Department and the IRS are aware that a United States shareholder in this situation may not be able to determine its aggregate foreign cash position for purposes of calculating its deduction under section 965(c) for its 2017 taxable year by the date that its return for such taxable year must be filed (including extensions).

For purposes of determining the aggregate foreign cash position of a United States shareholder for a taxable year in which it takes into account a section 965(a) inclusion amount, future regulations will provide that the United States shareholder can assume that its pro rata share of the cash position of any specified foreign corporation with an inclusion year ending after the date the return for such taxable year of such United States shareholder is timely filed (including extensions, if any) will be zero as of the cash measurement date with which the inclusion year ends. If a United States shareholder's pro rata share of the cash position of a specified foreign corporation was treated as zero pursuant to the preceding sentence, and the amount described in section 965(c)(3)(A)(i) in fact exceeds the amount described in section 965(c)(3)(A)(ii) with respect to such United States shareholder, the United States shareholder must make appropriate adjustments to reflect that the 15.5 percent rate equivalent percentage applies to a greater amount of the aggregate section 965(a) inclusion amounts taken into account. The Treasury Department and the IRS expect to issue future guidance regarding the appropriate method for making such an adjustment.

Example. (i) Facts. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP is a calendar year taxpayer. CFC1's inclusion year ends December 31, 2017, and CFC2's inclusion year ends November 30, 2018. The cash position of CFC1 on each of December 31, 2015, December 31, 2016, and December 31, 2017, is \$100. The cash position of CFC2 on each of November 30, 2015, and November 30, 2016, is \$200. CFC1 has a section 965(a) inclusion amount.

(ii) Analysis. In determining its aggregate foreign cash position for its 2017 taxable year, USP may assume that its pro rata share of the cash position of CFC2 will be zero as of November 30, 2018, for purposes of filing its U.S. federal income tax return due on April 15, 2018 (or due on October 15, 2018, with extension). Therefore, USP's aggregate foreign cash position is treated as \$300, which is the greater of (a) \$300, 50% of the sum of USP's pro rata shares of the cash position of CFC1 as of December 31, 2015, and December 31, 2016, and of the cash position of CFC2 as of November 30, 2015, and November 30, 2016, and (b) \$100, USP's pro rata share of the cash position of CFC1 as of December 31, 2017. If USP's pro rata share of the cash position of CFC2 as of November 30, 2018, in fact exceeds \$200, which would result in USP's aggregate foreign cash position being greater than \$300, USP must make appropriate adjustments to reflect a higher aggregate foreign cash position, under future guidance to be issued by the Treasury Department and the IRS.

(b) Treatment of Related-Party Transactions for Purposes of Determination of Cash Position

Net accounts receivables and short-term obligations between related specified foreign corporations may inflate the aggregate foreign cash position of a United States shareholder relative to the actual aggregate amount of liquid assets (other than the intercompany receivables) owned by the specified foreign corporations of the United States shareholder. For example, if a United States shareholder wholly owns two specified foreign corporations and one specified foreign corporation makes a short-term loan to the other specified foreign corporation, the borrowing corporation may invest the proceeds of such financing in illiquid assets or may spend the cash on operating expenses. The resulting intercompany receivable would be included in the United States shareholder's aggregate foreign cash position, notwithstanding that, if the specified foreign corporations were treated as a single corporation, the liquid assets of the specified foreign corporations would have been reduced by the amount of the borrowed proceeds.

Accordingly, for purposes of determining the cash position of a specified foreign corporation with respect to net accounts receivable and short-term obligations, the Treasury Department and the IRS intend to issue regulations providing that, with respect to a United States shareholder, any receivable or payable of a specified foreign corporation from or to a

related specified foreign corporation will be disregarded to the extent of the common ownership of such specified foreign corporations by the United States shareholder. For this purpose, a specified foreign corporation will be treated as related to another specified foreign corporation to the extent that the specified foreign corporations are related persons within the meaning of section 954(d)(3), substituting the term “specified foreign corporation” for “controlled foreign corporation” in each place that it appears.

(c) Treatment of Derivative Financial Instruments and Hedging Transactions for Purposes of Determination of Cash Position

Under section 965(c)(3)(B)(iii)(V), the Secretary may identify any asset as being economically equivalent to any asset described in section 965(c)(3)(B). The Treasury Department and the IRS intend to issue regulations that address the treatment of derivative financial instruments for purposes of measuring the cash position of a specified foreign corporation. Derivative financial instruments include notional principal contracts, options contracts, forward contracts, futures contracts, short positions in securities and commodities, and any similar financial instruments. These regulations will provide that the cash position of any specified foreign corporation will include the fair market value of each derivative financial instrument held by the specified foreign corporation that is not a “bona fide hedging transaction” (as defined in this section 3.01(c)). The Treasury Department and the IRS are considering whether future guidance should exclude derivative financial instruments that are not actively traded or that do not reference an asset described in section 965(c)(3)(B) (a “cash-equivalent asset”) from the definition of cash position. The value of each derivative financial instrument that must be taken into account in determining the cash position of a specified foreign corporation may be positive or negative; however, the aggregate amount taken into account for all derivative financial instruments (excluding bona fide hedging transactions) of a specified

foreign corporation cannot be less than zero. Furthermore, derivative financial instruments between related specified foreign corporations will be disregarded on the same terms as receivables and payables described in section 3.01(b) of this notice.

For purposes of this section 3.01(c), a bona fide hedging transaction means a hedging transaction that meets the requirements of a bona fide hedging transaction described in §1.954-2(a)(4)(ii) and that is properly identified as such in accordance with the requirements of that subparagraph. Consistent with the definition of a bona fide hedging transaction in §1.954-2(a)(4)(ii), in the case of an asset hedging transaction, the risk being hedged may be with respect to ordinary property, section 1231 property, or a section 988 transaction. Because the identification requirements of §1.954-2(a)(4)(ii) are generally relevant only to CFCs whereas section 965 applies to all specified foreign corporations, the Treasury Department and the IRS will provide guidance in the future on identifying bona fide hedging transactions of specified foreign corporations that are not CFCs.

If a derivative financial transaction is a bona fide hedging transaction that is used to hedge a cash-equivalent asset, the value of the cash-equivalent asset identified on the taxpayer's books and records as the asset being hedged must be adjusted by the fair market value of the bona fide hedging transaction that is used to hedge such cash-equivalent asset (such hedging transaction, a "cash-equivalent asset hedging transaction"). The value of a cash-equivalent asset hedging transaction must be taken into account in determining the cash position of a specified foreign corporation whether the cash-equivalent asset hedging transaction has positive or negative value, but only to the extent that the cash-equivalent asset hedging transaction (or transactions) does not reduce the fair market value of the asset being hedged below zero.

Finally, a bona fide hedging transaction with respect to an asset that is not a cash-equivalent asset or with respect to a liability (as described in §1.1221-2(b)(2)) is not included in a specified foreign corporation's cash position for purposes of section 965(c)(3)(B).

.02 Determination of Accumulated Post-1986 Deferred Foreign Income

(a) Adjustments to Post-1986 Earnings and Profits to Account for Certain Amounts Paid or Incurred Between Specified Foreign Corporations Between Measurement Dates

Certain transactions between specified foreign corporations may result in earnings and profits of a specified foreign corporation being taken into account more than once or not at all by a United States shareholder under section 965(a). In this regard, the Conference Report accompanying the Act states:

In order to avoid double-counting and double non-counting of earnings, the Secretary may provide guidance to adjust the amount of post-1986 earnings and profits of a specified foreign corporation to ensure that a single item of a specified foreign corporation is taken into account only once in determining the income of a United States shareholder subject to this provision. Such an adjustment may be necessary, for example, when there is a deductible payment (e.g., interest or royalties) from one specified foreign corporation to another specified foreign corporation between measurement dates.

H.R. Rep. No. 115-466, at 619 (2017). Consistent with congressional intent, the Treasury Department and the IRS intend to issue regulations to address the possibility of double-counting or double non-counting in the computation of post-1986 earnings and profits arising from amounts paid or incurred (including certain dividends) between related specified foreign corporations of a United States shareholder that occur between measurement dates and that would otherwise reduce the post-1986 earnings and profits as of December 31, 2017, of the specified foreign corporation that paid or incurred such amounts. For purposes of this section 3.02(a), the term "related" has the same meaning as given in section 3.01(b) of this notice.

The following examples illustrate fact patterns involving double-counting or double non-counting that will be addressed by future regulations.

Example 1. (i) Facts. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 have calendar year taxable years. On November 2, 2017, each of CFC1 and CFC2 has post-1986 earnings and profits of 100u. Neither CFC1 nor CFC2 has previously taxed income or effectively connected income for any taxable year, and therefore each of CFC1's and CFC2's accumulated post-1986 deferred foreign income is equal to such corporation's post-1986 earnings and profits. On November 3, 2017, CFC2 makes a deductible payment of 10u to CFC1. The payment does not constitute subpart F income. CFC1 and CFC2 have no other items of income or deduction.

(ii) Analysis. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 110u (100u plus 10u income from the deductible payment), and CFC2 has post-1986 earnings and profits of 90u (100u minus 10u deductible expense). The section 965(a) earnings amount with respect to CFC1 would be 110u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 110u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 90u accumulated post-1986 deferred foreign income on December 31, 2017. Disregarding the intercompany deductible payment, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u. However, taking the deductible payment into account, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 210u, because the 10u of income from the deductible payment would increase the post-1986 earnings and profits of CFC1 as of December 31, 2017, but the 10u of deductible expense would not decrease the post-1986 earnings and profits of CFC2 as of November 2, 2017. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u.

Example 2. (i) Facts. Assume the same facts as in Example 1, except instead of a deductible payment to CFC1, CFC2 makes a 10u distribution on November 3, 2017. The distribution increases CFC1's post-1986 earnings and profits as of December 31, 2017, by 10u and reduces CFC2's post-1986 earnings and profits as of December 31, 2017, by the same amount under section 965(d)(3)(B).

(ii) Analysis. Similar to the analysis in Example 1, the section 965(a) earnings amount with respect to CFC1 would be 110u, and the section 965(a) earnings amount with respect to CFC2 would be 100u, resulting in aggregate section 965(a) earnings amounts of 210u. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u. For an additional rule relating to dividends paid by one specified foreign corporation to another specified foreign corporation, see section 3.02(b) of this notice.

Example 3. (i) Facts. Assume the same facts as in Example 1, except that CFC2 does not make a deductible payment to CFC1, and, between measurement dates, CFC2 accrues gross income of 20u from a person that is not related to CFC2, and CFC1 incurs a deductible expense of 20u to a person that is not related to CFC1.

(ii) Analysis. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 80u (100u minus 20u deductible expense), and CFC2 has post-1986 earnings and profits of 120u (100u plus 20u gross income). The section 965(a) earnings amount with respect to CFC1 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 80u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 120u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 120u accumulated post-1986 deferred foreign income on December 31, 2017. CFC1 and CFC2 have, in the aggregate, section 965(a) earnings amounts of 220u. The section 965(a) earnings amounts, in the aggregate, are 20u greater than in Example 1, notwithstanding that CFC1 and CFC2 have, in the aggregate, earned no additional income. However, the additional 20u of section 965(a) earnings amount does not arise from an amount paid or incurred between specified foreign corporations that are related. The regulations to be issued by the Treasury Department and the IRS will not adjust the aggregate section 965(a) earnings amounts of CFC1 and CFC2.

Example 4. (i) Facts. Assume the same facts as in Example 3, except that CFC2 also makes a deductible payment of 10u to CFC1 on November 3, 2017.

(ii) Analysis. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 90u (100u minus 20u deductible expense plus 10u intercompany income from the deductible payment), and CFC2 has post-1986 earnings and profits of 110u (100u plus 20u gross income minus 10u intercompany deductible expense). The section 965(a) earnings amount with respect to CFC1 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 90u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 110u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 110u accumulated post-1986 deferred foreign income on December 31, 2017. Taking the intercompany deductible payment into account, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 210u, because the 10u of income from the deductible payment would not increase the post-1986 earnings and profits of CFC1 as of November 2, 2017, but the 10u of deductible expense would decrease the post-1986 earnings and profits of CFC2 as of December 31, 2017. However, disregarding the intercompany deductible payment, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 220u. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 220u.

(b) Determination of Amount of Diminution by Reason of Distributions to Specified Foreign Corporations

The post-1986 earnings and profits of a specified foreign corporation are reduced to reflect dividends distributed during the corporation's inclusion year to another specified foreign corporation ("the dividend reduction rule"). Section 965(d)(3)(B). As a result, a dividend paid by

a specified foreign corporation to another specified foreign corporation (whether in an inclusion year or a prior taxable year, including a prior taxable year that includes a measurement date) generally reduces the corporation's post-1986 earnings and profits with respect to any measurement date that such dividend precedes.

The dividend reduction rule is intended to address the potential double-counting of the earnings and profits of the distributing specified foreign corporation in calculating the section 965(a) inclusion amounts taken into account by a United States shareholder with respect to the distributing specified foreign corporation and the distributee specified foreign corporation. (See Example 2 in section 3.02(a) of this notice illustrating double-counting arising from dividends paid between measurement dates notwithstanding the application of the dividend reduction rule.) To the extent that a portion of a distribution reduces the post-1986 earnings and profits of a distributing specified foreign corporation (for example, by reason of a reduction pursuant to section 312(a)(3)) in an amount in excess of the increase in the post-1986 earnings and profits of the distributee specified foreign corporation, such reduction would not relieve double-counting and thus would be inconsistent with the purpose of the rule.

Accordingly, the Treasury Department and the IRS intend to issue regulations to clarify that the amount by which the post-1986 earnings and profits of a specified foreign corporation is reduced under section 965(d)(3)(B) as a result of a distribution made to a specified foreign corporation in the inclusion year may not exceed the amount by which the post-1986 earnings and profits of the distributee corporation is increased as a result of the distribution.

(c) Determination of Accumulated Post-1986 Deferred Foreign Income in the Case of a Controlled Foreign Corporation with Non-United States Shareholders

In the case of a CFC that has shareholders that are not United States shareholders on a measurement date, the Treasury Department and the IRS intend to issue regulations providing

that the accumulated post-1986 deferred foreign income of the CFC on such measurement date will be reduced by amounts that would be described in section 965(d)(2)(B) if such shareholders were United States shareholders. In such cases, the regulations will follow the principles of Revenue Ruling 82-16, 1982-1 C.B. 106, in order to determine the amounts by which accumulated post-1986 deferred foreign income is reduced.

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

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

(d) Coordination Between Sections 959 and 965 in the Inclusion Year

The accumulated post-1986 deferred foreign income of a specified foreign corporation that is a CFC excludes earnings to the extent that they would, if distributed, be excluded from the gross income of a United States shareholder under section 959 (that is, previously taxed income). Section 965(d)(2)(B). Post-1986 earnings and profits of a specified foreign corporation are determined without diminution by reason of dividends distributed during the inclusion year, other than dividends distributed to another specified foreign corporation. Section 965(d)(3)(B).

In general, earnings and profits of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) are not again included in the gross income of such United States shareholder when distributed (or when they would but for section 959(a) be included under section 951(a)(1)(B)). Section 959(a). For purposes of applying section 959(a), a distribution from a foreign corporation is treated as attributable first to earnings and profits included in gross income under section 951(a)(1)(B), then to earnings and profits included in gross income under section 951(a)(1)(A), and then to other earnings and profits. Section 959(c). A distribution excluded from gross income under section 959(a) is treated, for purposes of Chapter 1, as a distribution which is not a dividend, except that such distributions immediately reduce earnings and profits. Section 959(d). Actual distributions are taken into account before amounts that would be included under section 951(a)(1)(B). Section 959(f)(2).

The Treasury Department and the IRS intend to issue regulations to clarify the interaction between the rules under sections 959 and 965 in the inclusion year of a DFIC and the taxable year of a United States shareholder of the DFIC in which or with which such inclusion year ends. Such regulations will describe the following steps for determining the section 965(a) inclusion amount of a DFIC, the treatment of distributions under section 959, and the amount of an inclusion under sections 951(a)(1)(B) and 956 with respect to a DFIC:

- (1) First, the subpart F income of the DFIC is determined without regard to section 965(a), and the United States shareholder's inclusion under section 951(a)(1)(A) by reason of such amount is taken into account.
- (2) Second, the treatment of a distribution from the DFIC to another specified foreign corporation that is made before January 1, 2018, is determined under section 959.

- (3) Third, the section 965(a) inclusion amount of the DFIC is determined, and the United States shareholder's inclusion under section 951(a)(1)(A) by reason of such amount is taken into account.
- (4) Fourth, the treatment of all distributions from the DFIC other than those described in step 2 is determined under section 959.
- (5) Fifth, an amount is determined under section 956 with respect to the DFIC and the United States shareholder, and the United States shareholder's inclusion under section 951(a)(1)(B) is taken into account.

Example. (i) Facts. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 all have taxable years ending December 31, 2017. As of January 1, 2017, CFC1 has no earnings and profits, and CFC2 has 100u of earnings and profits described in section 959(c)(3) that were accumulated in taxable years beginning after December 31, 1986, while CFC2 was a specified foreign corporation. On March 1, 2017, CFC1 earns 30u of subpart F income (as defined in section 952), and CFC2 earns 20u of subpart F income. On July 1, 2017, CFC2 distributes 40u to CFC1, and the exception described in section 954(c)(6)(A) applies to such distribution. On November 1, 2017, CFC1 distributes 60u to USP.

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

(B) Distributions between specified foreign corporations before January 1, 2018. The distribution of 40u from CFC2 to CFC1 is treated as a distribution of 20u out of earnings and profits described in section 959(c)(2) (attributable to inclusions under section 951(a)(1)(A) that are not by reason of section 965(a)) and 20u out of earnings and profits described in section 959(c)(3).

(C) Section 965(a) inclusion amount. USP determines CFC1's and CFC2's section 965(a) inclusion amounts. Because there are no aggregate foreign E&P deficits to be allocated to CFC1 and CFC2, the section 965(a) inclusion amount of CFC1 and CFC2 equals the section 965(a) earnings amount with respect to CFC1 and CFC2, respectively.

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

(2) CFC2 section 965(a) earnings amount. The section 965(a) earnings amount with respect to CFC2 is 80u, the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, which is equal to the amount of CFC2's post-1986 earnings and profits of 80u. For purposes of calculating CFC2's accumulated post-1986 deferred foreign income, CFC2 has no previously taxed income and therefore no adjustment is made under section 965(d)(2)(B). CFC2's 80u of post-1986 earnings and profits consists of 120u of earnings and profits that it earned, reduced by the 40u distribution to CFC1 under section 965(d)(3)(B). The amount of the reduction to the post-1986 earnings and profits of CFC2 for the 40u distribution is not limited by the rules described in section 3.02(b) of this notice because CFC1's post-1986 earnings and profits are increased by 40u as a result of the distribution. Furthermore, because the 40u distribution was made on July 1, 2017, which is prior to any measurement date, section 3.02(a) of this notice is not relevant.

(3) Effect on previously taxed income. CFC1 and CFC2 increase their previously taxed income described in section 959(c)(2) by their section 965(a) inclusion amounts taken into account by USP, 20u and 80u, respectively, and reduce their earnings and profits described in section 959(c)(3) by an equivalent amount.

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

.03 Application of Section 961 to Amounts Treated as Subpart F Income Under Section 965

Section 965(o) authorizes the Treasury Department and the IRS to issue regulations or other guidance to provide appropriate basis adjustments in order to carry out the provisions of section 965. In order to provide certainty regarding the application of the rules described in section 961 with respect to amounts included under section 965, the Treasury Department and the IRS intend to issue regulations providing that if a United States shareholder receives distributions from a DFIC during the inclusion year that are attributable to previously taxed

income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized by the United States shareholder with respect to the stock of the DFIC under section 961(b)(2) will be reduced (but not below zero) by the section 965(a) inclusion amount.

.04 Treatment of Affiliated Group Making a Consolidated Return For Purposes of Section 965

Pursuant to the Secretary's authority under sections 965(o) and 1502, the Treasury Department and the IRS intend to issue regulations providing that, solely with respect to the calculation of the amount included in gross income by a consolidated group (as defined in §1.1502-1(h)) under section 951(a)(1) by reason of section 965(a), all of the members of a consolidated group that are United States shareholders of one or more specified foreign corporations will be treated as a single United States shareholder. Thus, for example, all members of a consolidated group that are United States shareholders will be treated as a single United States shareholder for purposes of determining the aggregate foreign cash position of the consolidated group and for purposes of taking such aggregate foreign cash position into account under section 965(c)(1).

These regulations will provide that, consistent with the consolidated return regulations (and notwithstanding the calculation of the amount described in the prior paragraph), appropriate adjustments, for example, adjustments under §1.1502-32 to the basis of the stock of each member that is a United States shareholder, will be made to reflect the impact of amounts included in gross income under section 951(a)(1) by reason of section 965(a), and the impact of other attributes of each member on this calculation, such as the ownership of E&P deficit foreign corporations by particular members and the cash position of specified foreign corporations held by particular members. These regulations will also provide that taxpayers must make appropriate adjustments reflecting minority ownership interests in a member of the consolidated group that are owned by a person that is not a member of the consolidated group.

.05 Determination of Foreign Currency Gain or Loss under Section 986(c)

The Treasury Department and the IRS intend to issue regulations providing that any gain or loss recognized under section 986(c) with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965(a) will be diminished proportionately to the diminution of the taxable income resulting from section 965(a) by reason of the deduction allowed under section 965(c). See H.R. Rep. No. 115-466, at 620.

The adjustments with respect to section 986(c) must be made so as to apply solely with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965(a). Accordingly, future regulations will also provide ordering rules for determining the portion of a distribution that will be treated as previously taxed income described in section 959(c)(2) by reason of section 965(a).

SECTION 4. EFFECTIVE DATES

Section 965 is effective for the last taxable years of foreign corporations that begin before January 1, 2018, and with respect to United States shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end. The Treasury Department and the IRS intend to provide that the regulations described in section 3 of this notice are effective beginning the first taxable year of a foreign corporation (and with respect to United States shareholders, the taxable years in which or with which such taxable years of the foreign corporations end) to which section 965 applies. Before the issuance of the regulations described in this notice, taxpayers may rely on the rules described in section 3.

SECTION 5. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. In addition, the Treasury Department and the IRS expect to issue additional guidance

under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR-4549, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to Notice.comments@irsounsel.treas.gov. Comments will be available for public inspection and copying.

The principal author of this notice is Ms. Perkins of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Perkins at (202) 317-6934 (not a toll free call).

Additional Guidance Under Section 965 and Guidance Under Sections 863 and 6038 in Connection with the Repeal of Section 958(b)(4)

Notice 2018-13

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) intend to issue regulations for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code (“Code”) as amended by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), which was enacted on December 22, 2017. See Notice 2018-07, 2018-4 I.R.B. 317, for prior guidance issued under section 965. In addition, this notice provides guidance in connection with the repeal of section 958(b)(4) by the Act.

Section 2 of this notice provides background on section 965 and the repeal of section 958(b)(4) by the Act. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue with respect to section 965. Section 4 of this notice describes a modification that the Treasury Department and the IRS intend to make with respect to regulations under section 965 that were described in section 3.03 of Notice 2018-07. Section 5 of this notice provides guidance under section 863 in connection with the repeal of section 958(b)(4) by the Act and announces the IRS’s

intention to update the Instructions for Form 5471 as a result of such repeal. Section 6 of this notice describes the effective dates of the regulations and other guidance described in this notice. Section 7 of this notice requests comments and provides contact information.

SECTION 2. BACKGROUND

.01 Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation (“DFIC”) that begins before January 1, 2018 (such year of the DFIC, the “inclusion year”), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, a “measurement date,” and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the “section 965(a) earnings amount”).

The section 965(a) earnings amount is not subject to the rules or limitations in section 952 and is not limited by the accumulated earnings and profits of the DFIC as of the close of the inclusion year.

.02 Determination of United States Shareholder's Section 951(a)(1) Inclusion By Reason of Section 965

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

.03 Allocation of Aggregate Foreign E&P Deficit and Definition of E&P Deficit Foreign Corporation

The aggregate foreign E&P deficit of any United States shareholder is allocated to each DFIC of the United States shareholder in an amount that bears the same proportion to such aggregate as (A) such United States shareholder's pro rata share of the section 965(a) earnings amount of each such DFIC bears to (B) the aggregate of

¹ In contrast to Notice 2018-07, this notice uses the term "section 965(a) inclusion amount" to refer to an amount included in the gross income of the United States shareholder with respect to a DFIC, rather than an amount of the DFIC.

such United States shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such United States shareholder. Section 965(b)(2). The term "aggregate foreign E&P deficit" means, with respect to any United States shareholder, the lesser of (I) the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder or (II) the aggregate of such shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such shareholder. Section 965(b)(3)(A)(i).

The term "E&P deficit foreign corporation" means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if, as of November 2, 2017, (i) such specified foreign corporation has a deficit in post-1986 earnings and profits, (ii) such corporation was a specified foreign corporation, and (iii) such taxpayer was a United States shareholder of such corporation. Section 965(b)(3)(B). The term "specified E&P deficit" means, with respect to an E&P deficit foreign corporation, the amount of such corporation's deficit in post-1986 earnings and profits as of November 2, 2017. See section 965(b)(3)(C). A specified foreign corporation that is a DFIC cannot also be an E&P deficit foreign corporation. See H.R. Rep. No. 115-466, at 618 (2017) (Conf. Rep.) ("Deferred earnings of a U.S. shareholder are reduced (but not below zero) by the shareholder's

share of deficits as of November 2, 2017, from a specified foreign corporation that is not a [DFIC] . . .”).

.04 Application of the Participation Exemption

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

Section 965(c)(3)(A) provides that the term “aggregate foreign cash position” means, with respect to any United States shareholder, the greater of (i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the inclusion year, or (ii) one half of the sum of (I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign

corporation that ends before November 2, 2017, plus (II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I). Each date referred to in the preceding sentence is referred to in this notice as a “cash measurement date.”

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

.05 Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1 (“effectively connected income”), or (B) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed income”). Section 965(d)(2).

Section 965(d)(3) provides that the term “post-1986 earnings and profits” means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by only taking into account periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (A) as of the measurement date that is applicable with respect to such foreign corporation, and (B) without diminution by reason of dividends distributed during the inclusion year other than dividends distributed to another specified foreign corporation.

.06 Specified Foreign Corporation

Section 965(e)(1) provides that the term “specified foreign corporation” means (A) any CFC and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (10-percent corporation). For purposes of sections 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a). Section 965(e)(2). However, if a passive foreign investment company (as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

.07 Determination of Pro Rata Share

Section 965(f)(1) provides that the determination of any United States shareholder’s pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a CFC).

.08 Repeal of Section 958(b)(4)

Section 958 provides rules for determining stock ownership of a foreign corporation for purposes of sections 951 through 965. Section 958(b) provides, in relevant part, that section 318(a) (relating to the constructive ownership of stock)

applies, subject to certain modifications, to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b) or to treat a foreign corporation as a CFC under section 957. Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, the Act repeals section 958(b)(4). As in effect prior to repeal, section 958(b)(4) provided that subparagraphs (A), (B), and (C) of section 318(a)(3) were not to be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person. The subparagraphs of section 318(a)(3) generally attribute stock owned by a person to a partnership, estate, trust, or corporation in which such person has an interest (so-called “downward attribution”). For example, stock of a corporation owned by a person that owns 50 percent or more in value of the stock of another corporation is treated as owned by such other corporation. See section 318(a)(3)(C).

SECTION 3. REGULATIONS TO BE ISSUED ADDRESSING THE APPLICATION OF SECTION 965

.01 Determination of Status of a Specified Foreign Corporation as a DFIC or an E&P Deficit Foreign Corporation

The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining the status of a specified foreign corporation as a DFIC or an E&P deficit foreign corporation, it must first be determined whether the specified foreign corporation is a DFIC. If the specified foreign corporation meets the definition of a DFIC, it is classified solely as a DFIC and not also as an E&P deficit foreign corporation, even if such specified foreign corporation otherwise satisfies the requirements of section 965(b)(3)(B). If a specified foreign corporation does not meet the definition of a DFIC, the United States shareholder must then determine whether it is an E&P deficit foreign corporation. In some cases, as illustrated in Example 2, a specified foreign corporation may be classified as neither a DFIC nor an E&P deficit foreign corporation, despite having post-1986 earnings and profits greater than zero or a deficit in accumulated post-1986 deferred foreign income.

Example 1. (i) Facts. USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of November 2, 2017, FS has a deficit in post-1986 earnings and profits of 150u. As of December 31, 2017, FS has 200u of post-1986 earnings and profits. FS does not have previously taxed income or effectively connected income for any taxable year.

(ii) Analysis. Because FS, a specified foreign corporation, does not have previously taxed income or effectively connected income for any taxable year, FS's accumulated post-1986 deferred foreign income is equal to its post-1986 earnings and profits. Because FS has accumulated post-1986 deferred foreign income as of December 31, 2017, FS is a DFIC. See section 965(d)(1). Accordingly, FS is not an E&P deficit foreign corporation.

Example 2. (i) Facts. USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of both November 2, 2017, and December 31, 2017, FS has 100u of previously taxed income described in section 959(c)(2) and a deficit of 90u in earnings and profits described in section 959(c)(3), all of which were accumulated in taxable years beginning after December 31, 1986, while FS was a specified foreign corporation. Accordingly, as of both November 2, 2017, and December 31, 2017, FS has 10u of post-1986 earnings and profits.

(ii) Analysis. (A) Determination of status as a DFIC. For purposes of determining whether FS is a DFIC, a determination must be made whether FS has accumulated post-1986 deferred foreign income greater than zero as of either November 2, 2017, or December 31, 2017. Under section 965(d)(2), FS's accumulated post-1986 deferred foreign income is its post-1986 earnings and profits, except to the extent such earnings are effectively connected income or previously taxed income. Disregarding FS's 100u of previously taxed income, FS has a 90u deficit in accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017. Accordingly, FS does not have accumulated post-1986 deferred foreign income greater than zero as of either measurement date and therefore FS is not a DFIC.

(B) Determination of status as an E&P deficit foreign corporation. For purposes of determining whether FS is an E&P deficit foreign corporation, a determination must be made whether FS has a deficit in post-1986 earnings and profits as of November 2, 2017. As described in paragraph (i) of this Example 2, FS has 10u of post-1986 earnings and profits as of both November 2, 2017, and December 31, 2017. As a result, FS does not have a deficit in post-1986 earnings and profits as of November 2, 2017, and therefore FS is not an E&P deficit foreign corporation. Accordingly, FS is neither a DFIC nor an E&P deficit foreign corporation.

.02 Alternative Method for Calculating Post-1986 Earnings and Profits

The Act provides that the earnings and profits of a specified foreign corporation must be determined as of two measurement dates and “in accordance with sections 964(a) and 986.” See section 965(a) and (d)(3). Consistent with this requirement, the Treasury Department and the IRS have determined that, for purposes of measuring the

post-1986 earnings and profits of a specified foreign corporation as of a measurement date, the extent to which an item of income, deduction, gain, or loss is taken into account as of such measurement date must generally be determined under principles applicable to the calculation of earnings and profits, including the application of sections 312 and 964.

For purposes of determining whether a specified foreign corporation is a DFIC and for purposes of determining a DFIC's section 965(a) earnings amount, the actual post-1986 earnings and profits of the specified foreign corporation must be determined as of the close of both November 2, 2017, and December 31, 2017. In addition, for purposes of determining whether a specified foreign corporation is an E&P deficit foreign corporation and for purposes of determining the amount of the specified E&P deficit of an E&P deficit foreign corporation, the actual post-1986 earnings and profits (including a deficit) of the specified foreign corporation must be determined as the close of November 2, 2017.

However, the Treasury Department and the IRS recognize that it may be impractical for taxpayers to determine the post-1986 earnings and profits of a specified foreign corporation as of a measurement date that does not fall on the last day of a month. Therefore, the Treasury Department and the IRS intend to issue regulations providing that an election may be made to determine a specified foreign corporation's

post-1986 earnings and profits as of a measurement date based on the amount of post-1986 earnings and profits (including a deficit) as of another date as provided in this section 3.02 (the “alternative method”). If an election to use the alternative method is made, the amount of the post-1986 earnings and profits (including a deficit) of a specified foreign corporation (other than a specified foreign corporation with a 52-53-week taxable year described in §1.441-2(a)(1)) as of November 2, 2017, will equal the sum of (1) the corporation’s post-1986 earnings and profits as of October 31, 2017, and (2) the corporation’s annualized earnings and profits amount. For this purpose, the term “annualized earnings and profits amount” means, with respect to a specified foreign corporation, the amount equal to the product of two (the number of days after October 31, 2017, and on or before the measurement date on November 2, 2017) multiplied by the daily earnings amount of the specified foreign corporation. The term “daily earnings amount” means, with respect to a specified foreign corporation, the post-1986 earnings and profits (including a deficit) of the specified foreign corporation as of the close of October 31, 2017, that were earned (or incurred) during the specified foreign corporation’s taxable year that includes October 31, 2017, divided by the number of days that have elapsed in such taxable year as of the close of October 31, 2017. A specified foreign corporation that does not have a 52-53-week taxable year described in

§1.441-2(a)(1) may not determine its post-1986 earnings and profits under the alternative method with respect to the measurement date on December 31, 2017.

In the case of a specified foreign corporation that has a 52-53-week taxable year described in §1.441-2(a)(1), an election may be made to use the alternative method to determine its post-1986 earnings and profits as of both measurement dates based on the amount of post-1986 earnings and profits (including a deficit) as of the closest end of a fiscal month to each measurement date consistent with the principles of the preceding paragraph. For example, if the closest end of a fiscal month of a specified foreign corporation that has a 52-53-week taxable year occurs after an applicable measurement date, the annualized earnings amount will be subtracted from (rather than added to) the post-1986 earnings and profits of the specific foreign corporation as of such fiscal month end. For a specified foreign corporation with a 52-53-week taxable year, in order to use the alternative method for any measurement date, the election must be made for both measurement dates.

The IRS intends to issue forms, publications, regulations, or other guidance that will specify the manner and timing of an election to use the alternative method.

Example. (i) Facts. FS, a foreign corporation, has a calendar year taxable year and as of October 31, 2017, FS has post-1986 earnings and profits of 10,000u, 3,040u of which were earned during the taxable year that includes October 31, 2017. An election is made for FS to determine its post-1986 earnings and profits under the alternative method.

(ii) Analysis. As of the close of October 31, 2017, 304 days have elapsed in the taxable year of FS that includes October 31, 2017. Therefore, FS's daily earnings amount is 10u (3,040u divided by 304), and FS's annualized earnings and profits amount is 20u (10u multiplied by 2). Accordingly, FS's post-1986 earnings and profits as of November 2, 2017, are 10,020u (its post-1986 earnings and profits as of October 31, 2017 (10,000u), plus its annualized earnings and profits amount (20u)).

.03 Treatment of Deficits

(a) Allocation of Deficits to Different Classes of Stock

For purposes of determining the amount of a United States shareholder's aggregate foreign E&P deficit, the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder must be determined. Section 965(f)(1) provides that, in determining a United States shareholder's pro rata share of "any amount with respect to any specified foreign corporation," rules similar to section 951(a)(2) shall be applied. Section 1.951-1(e) provides guidance with respect to allocating subpart F income among multiple classes of stock but does not address deficits.

The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a United States shareholder's pro rata share of the specified E&P deficit of an E&P deficit foreign corporation that has multiple classes of stock outstanding, the specified E&P deficit is allocated first among the shareholders of

the corporation's common stock and in proportion to the value of the common stock held by such shareholders.

(b) Treatment of Hovering Deficits

The Conference Report accompanying the Act provides that “the amount of post-1986 earnings and profits of a specified foreign corporation is the amount of positive earnings and profits accumulated as of the measurement date reduced by any deficit in earnings and profits of the specified foreign corporation as of the measurement date, without regard to the limitation category of the earnings or deficit.” H.R. Rep. No. 115-466, at 618. The Conference Report clarifies that, for this purpose, the term “deficit” includes a hovering deficit (as defined in §1.367(b)-7(d)(2)(i)), with the following example:

For example, assume that a foreign corporation organized after December 31, 1986 has \$100 of accumulated earnings and profits as of November 2, 2017, and December 31, 2017 . . . which consist of \$120 general limitation earnings and profits and a \$20 passive limitation deficit, the foreign corporation's post-1986 earnings and profits would be \$100, even if the \$20 passive limitation deficit was a hovering deficit.

Id. at 619. Consistent with the Conference Report, the Treasury Department and the IRS intend to issue regulations clarifying that all deficits related to post-1986 earnings and profits, including hovering deficits, are taken into account for purposes of determining the post-1986 earnings and profits (including a deficit) of a specified foreign corporation.

.04 Determination of Aggregate Foreign Cash Position

(a) Definitions for Determining Net Accounts Receivable

Section 965(c)(3)(C) does not define the term “accounts receivable” for purposes of the term “net accounts receivable.” The Treasury Department and the IRS intend to issue regulations providing that, for purposes of section 965(c)(3)(C), the term “accounts receivable” means receivables described in section 1221(a)(4), and the term “accounts payable” means payables arising from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers. Receivables that are treated as accounts receivable within the meaning of section 965(c)(3)(C)(i) will not also be treated as short-term obligations.

(b) Treatment of Demand Obligations

Section 965(c)(3)(B) provides that the “cash position” of a specified foreign corporation includes the fair market value of any short-term obligation. The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a specified foreign corporation’s cash position, a loan that must be repaid on the demand of the lender (or that must be repaid within one year of such demand) will be treated as a short-term obligation, regardless of the stated term of the instrument.

.05 Translation Rules

(a) Comparison of Accumulated Post-1986 Deferred Foreign Income as of the Measurement Dates

Generally, determinations made under subtitle A of the Code must be made in a taxpayer's functional currency. See section 985(a). For purposes of determining the tax under subtitle A of the Code of any shareholder of a foreign corporation, the earnings and profits of such corporation must be determined in the corporation's functional currency. See section 986(b)(1). Accordingly, the Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining the section 965(a) earnings amount of a specified foreign corporation, the accumulated post-1986 deferred foreign income of the specified foreign corporation as of each of the measurement dates must be compared in the functional currency of the specified foreign corporation. If the functional currency of a specified foreign corporation changes between the two measurement dates, the comparison must be made in the functional currency of the specified foreign corporation as of December 31, 2017, by translating the specified foreign corporation's earnings and profits as of November 2, 2017, into the new functional currency using the spot rate on November 2, 2017. For purposes of this notice, the term "spot rate" has the meaning described in §1.988-1(d).

(b) Determination of the Amount of Inclusion Under Section 951(a)(1) by Reason of Section 965

In the case of any United States person, the earnings and profits determined under section 986(b)(1) when distributed, deemed distributed, or otherwise taken into account are translated into U.S. dollars using the appropriate exchange rate for purposes of determining the tax on such earnings under subtitle A of the Code. See section 986(b)(2). Generally, except as provided in regulations, section 989(b) sets forth the appropriate exchange rate. In the case of an actual distribution of earnings and profits or an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the appropriate exchange rate is the spot rate on the date such distribution or deemed dividend is included into income. Section 989(b)(1) and (2). In the case of subpart F income included in income by a United States shareholder under section 951(a)(1)(A), the appropriate exchange rate is the average exchange rate for the taxable year of the foreign corporation. Section 989(b)(3). Any amounts included in income under section 951(a)(1)(B) (inclusions under section 956) are treated for this purpose as distributions made on the last day of the taxable year for which such amounts were so included, and accordingly translated at the spot rate on the last day of such taxable year. Section 989(b).

In order to calculate the section 965(a) inclusion amount of a United States shareholder with respect to a DFIC, the United States shareholder's pro rata shares of the section 965(a) earnings amounts of its DFICs and the specified E&P deficits of its

E&P deficit foreign corporations must be translated into U.S. dollars. The Treasury Department and the IRS have determined that the spot rate on December 31, 2017, is the appropriate exchange rate for purposes of translating these amounts, regardless of a specified foreign corporation's taxable year or the applicable measurement date, because it is the date on which a specified foreign corporation's post-1986 earnings and profits becomes fixed and immediately precedes the transition to the participation exemption under section 245A. Furthermore, a single spot rate on December 31, 2017, is more administrable for the IRS and less burdensome for taxpayers than the yearly average approach of section 989(b)(3) because under the yearly average approach, certain amounts required for the determination of the section 965(a) inclusion amount of a United States shareholder (for example, the United States shareholder's aggregate foreign E&P deficit) would not be determinable until the last closing of an inclusion year of a specified foreign corporation of the United States shareholder.

Accordingly, the Treasury Department and the IRS intend to issue regulations providing that the appropriate exchange rate under section 989(b) for translating the section 965(a) earnings amount will be the spot rate on December 31, 2017. The regulations will also provide that the spot rate on December 31, 2017, will apply for purposes of translating other amounts necessary for the application of section 965(b), including (1) translating a section 965(a) earnings amount into U.S. dollars in computing

amounts described in section 965(b)(2)(A) and (B), (2) translating a specified E&P deficit into U.S. dollars in order to determine a United States shareholder's aggregate foreign E&P deficit under section 965(b)(3)(A), (3) translating a section 965(a) inclusion amount with respect to a DFIC (if such amount was reduced by an aggregate foreign E&P deficit under section 965(b)(1)) back into the functional currency of the DFIC for purposes of determining the previously taxed income of the DFIC, and (4) translating the portion of the U.S. dollar-denominated aggregate foreign E&P deficit allocated to a DFIC under section 965(b)(2) into the functional currency of the DFIC for purposes of determining its previously taxed income under section 965(b)(4)(A).

The regulations will also provide that, for purposes of section 986(c), foreign currency gain or loss with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965 will be determined based on movements in the exchange rate between December 31, 2017, and the date on which such previously taxed earnings and profits are actually distributed.

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

(ii) Analysis. (A) For purposes of applying section 965(b), the section 965(a) earnings amount of each of CFC3 and CFC4 translated into U.S. dollars at the spot rate on December 31, 2017, is \$100 (50y at .50y=\$1) and \$300 (75z at .25z=\$1), respectively. Furthermore, USP's pro rata share of the section 965(a) earnings amounts, as translated, is \$100 and \$300, respectively, or 100% of each section 965(a) earnings amount.

(B) For purposes of applying section 965(b), the specified E&P deficit of each of CFC1 and CFC2 translated into U.S. dollars at the spot rate on December 31, 2017, is \$100 (100u at 1u=\$1) and \$160 (120v at .75v=\$1), respectively. Furthermore USP's pro rata share of each specified E&P deficit, as translated, is \$100 and \$160, respectively, or 100% of each specified E&P deficit. Therefore, USP's aggregate foreign E&P deficit is \$260.

(C) For purposes of applying section 965(b), USP's aggregate foreign E&P deficit of \$260 is allocated \$65 to reduce the amount that USP would otherwise take into account under section 951(a)(1) by reason of section 965 with respect to CFC3 (\$260 x (\$100/\$400)) and allocated \$195 to reduce the amount that USP would otherwise take into account under section 951(a)(1) by reason of section 965 with respect to CFC4 (\$260 x (\$300/400)). After reduction under section 965(b)(1), the section 965(a) inclusion amount of USP with respect to CFC3 is \$35 (\$100 – \$65) and the section 965(a) inclusion amount of USP with respect to CFC4 is \$105 (\$300 – \$195). The previously taxed income of CFC3 and CFC4 resulting from the section 965(a) inclusion amounts included in gross income by USP, translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are 17.5y (\$35 at .50y=\$1) and 26.25z (\$105 at .25z=\$1), respectively.

(D) For purposes of determining the previously taxed income of each of CFC3 and CFC4 under section 965(b)(4)(A) as a result of the reduction to USP's section 965(a) inclusion amounts with respect to CFC3 and CFC4, the amounts of the aggregate foreign E&P deficit of USP are allocated to each of CFC3 and CFC4 under section 965(b)(2), which translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are 32.5y (\$65 at .50y=\$1) and 48.75z (\$195 at .25z=\$1), respectively.

(c) Determination of Cash Positions as of Cash Measurement Dates

The Treasury Department and the IRS intend to issue regulations providing that the cash position of a specified foreign corporation with respect to any cash measurement date must be expressed in U.S. dollars. Therefore, the amount of a United States shareholder's aggregate foreign cash position will be the greater of the U.S. dollar-denominated aggregate amounts on each cash measurement date described in section 965(c)(3)(A).

In determining the cash position attributable to net accounts receivable, the amount of accounts receivables and accounts payables (in each case, if not otherwise denominated in U.S. dollars) must be translated into U.S. dollars at the spot rate on the relevant cash measurement date. The fair market value of assets described in section 965(c)(3)(B)(iii) must also be determined in U.S. dollars on the relevant cash measurement date. For example, in the case of foreign currency, the fair market value will equal the currency amount translated at the spot rate on the relevant cash measurement date.

SECTION 4. MODIFICATION TO RULE DESCRIBED IN SECTION 3.03 OF NOTICE 2018-07 RELATING TO DISTRIBUTIONS OF PREVIOUSLY TAXED INCOME

Section 3.03 of Notice 2018-07 announced that the Treasury Department and the IRS intend to issue regulations providing that if a United States shareholder receives distributions from a DFIC during the inclusion year that are attributable to previously

taxed income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized by the United States shareholder with respect to the stock of the DFIC under section 961(b)(2) will be reduced (but not below zero) by the section 965(a) inclusion amount (the “gain-reduction rule”). Notice 2018-07 does not expressly apply the gain-reduction rule to distributions to a United States shareholder from an entity (an “upper-tier entity”) that is not a DFIC (for instance, an E&P deficit foreign corporation) that has received distributions from a DFIC (a “lower-tier DFIC”) attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a). Moreover, Notice 2018-07 could be interpreted to provide that even when the upper-tier entity is a DFIC, the amount of gain recognized by the United States shareholder that is reduced by reason of the gain-reduction rule is limited solely to the section 965(a) inclusion amount of the United States shareholder with respect to the upper-tier entity, rather than also including the section 965(a) inclusion amount with respect to the lower-tier DFIC from which such upper-tier entity has received distributions attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a).

The Treasury Department and the IRS intend to issue regulations that provide that the gain-reduction rule also applies to distributions received from a DFIC through a chain of ownership described in section 958(a). Specifically, regulations will provide that if a United States shareholder receives distributions through a chain of ownership

described under section 958(a) from a DFIC during the inclusion year that are attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized under section 961(b)(2) by the United States shareholder with respect to the stock or property of any entity in the ownership chain described in section 958(a) through which the distribution is made will be reduced (but not below zero) by the section 965(a) inclusion amount of the United States shareholder with respect to such DFIC. The gain-reduction rule will apply similarly to reduce the amount of gain that would otherwise be recognized under section 961(c) by any controlled foreign corporation in the ownership chain described in section 958(a) through which the distribution is made to a United States shareholder for purposes of determining the amount included under section 951(a)(1) in the gross income of the United States shareholder.

Example. (i) Facts. USP, a domestic corporation, owns all of the stock of CFC1, a specified foreign corporation that has no post-1986 earnings and profits (or deficit), and CFC1 owns all the stock of CFC2, a DFIC. USP is a calendar year taxpayer. CFC1 and CFC2 have inclusion years that end on November 30, 2018. The functional currency of CFC1 and CFC2 is the U.S. dollar. USP's adjusted basis in the stock of CFC1 is zero, and CFC1's adjusted basis in the stock of CFC2 is zero. On January 1, 2018, CFC2 distributes \$100 to CFC1, and CFC1 distributes \$100 to USP. USP has a section 965(a) inclusion amount of \$100 with respect to CFC2. CFC2 has no other earnings and profits described in section 959(c)(1) or (2), other than earnings and profits described in section 959(c)(2) by reason of section 965(a).

(ii) Analysis. USP receives a distribution from CFC2, a lower-tier DFIC, through a chain of ownership described in section 958(a) during the inclusion year of CFC2 that

is attributable to \$100 of previously taxed income described in section 959(c)(2) by reason of section 965(a). The amount of gain that USP would otherwise recognize with respect to the stock of CFC1 under section 961(b)(2) and the amount of gain that CFC1 would otherwise recognize with respect to the stock of CFC2 under section 961(c) for purposes of determining CFC1's subpart F income is reduced (but not below zero) in each case by \$100, USP's section 965(a) inclusion amount with respect to CFC2.

SECTION 5. GUIDANCE IN CONNECTION WITH THE REPEAL OF SECTION 958(b)(4)

.01 Application of Section 863

Section 863 and the regulations thereunder provide special rules for determining the source of certain items of gross income, including gross income from space and ocean activities and international communications income. Section 863(d) provides that, except as provided in regulations, any income derived from a space or ocean activity ("space and ocean income") by a United States person is sourced in the United States (such income, "U.S. source income") and that any space and ocean income derived by a foreign person is sourced outside the United States (such income, "foreign source income"). Regulations under section 863(d) include an exception from the statutory provision regarding space and ocean income derived by a foreign person if the foreign person is a CFC. Specifically, space and ocean income derived by a CFC is treated as U.S. source income, except to the extent that the income, based on all the facts and circumstances, is attributable to functions performed, resources employed, or risks assumed in a foreign country. See §1.863-8(b)(2)(ii).

In the case of any United States person, 50 percent of any international communications income (as defined in section 863(e)(2)) is treated as U.S. source income and 50 percent of such income is treated as foreign source income. Section 863(e)(1)(A). Subject to certain exceptions, including exceptions set forth in regulations, international communications income derived by a foreign person is treated as foreign source income. Regulations under section 863(e) provide that international communications income derived by a CFC is treated as one-half U.S. source and one-half foreign source. See §1.863-9(b)(2)(ii).

As a result of the repeal of section 958(b)(4) by the Act, stock of a foreign corporation owned by a foreign person can be attributed to a United States person under section 318(a)(3) for purposes of determining whether such United States person is a United States shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, as a result of the repeal of section 958(b)(4), section 958(b) now provides for “downward attribution” from a foreign person to a United States person in circumstances in which section 958(b), before the Act, did not so provide. As a result, foreign corporations that were not previously treated as CFCs may be treated as CFCs.

The Treasury Department and the IRS have determined that, in light of the change to the constructive ownership rules in section 958(b), further study is necessary

to determine whether it is appropriate for the source of income described in section 863(d) and (e) to be determined by reference to the status of the recipient as a CFC. Accordingly, for purposes of applying §§1.863-8 and 1.863-9, taxpayers may determine whether a foreign corporation is a CFC without regard to the repeal of section 958(b)(4) pending further guidance (which will be prospective, as described in section 6 of this notice).

.02 Elimination of Form 5471 Filing Obligation for Certain Constructive Owners

Pursuant to section 6038(a)(4), the IRS may require any United States person treated as a United States shareholder of a CFC to file an information return on Form 5471, "Information Return of U.S. Persons with Respect to Certain Foreign Corporations," with respect to its ownership in such CFC. For this purpose, a United States shareholder is defined in section 951(b), and the United States shareholder's ownership in a CFC is determined based on direct and indirect ownership under section 958(a) and constructive ownership under section 958(b). Under the Instructions for Form 5471 (Rev. Dec. 2017), a United States shareholder who owns stock in a CFC for an uninterrupted period of 30 or more days during the CFC's tax year and owned the stock on the last day of that year is a Category 5 Filer and must file Form 5471.

As discussed in section 5.01 of this notice, as a result of the Act, section 958(b) now provides for "downward attribution" from a foreign person under section 318(a)(3)

to a United States person in circumstances in which section 958(b), before the Act, did not so provide. A United States shareholder's pro rata share of a CFC's subpart F income and the amount determined under section 956 that a United States shareholder is required to include in gross income, however, continue to be determined based on direct and indirect ownership of the CFC under section 958(a), which does not take into account such downward attribution.

The IRS intends to amend the Instructions for Form 5471 to provide an exception from Category 5 filing for a United States person that is a United States shareholder with respect to a CFC if no United States shareholder (including such United States person) owns, within the meaning of section 958(a), stock in such CFC, and the foreign corporation is a CFC solely because such United States person is considered to own the stock of the CFC owned by a foreign person under section 318(a)(3).

SECTION 6. EFFECTIVE DATES

Section 965 is effective for the last taxable years of foreign corporations that begin before January 1, 2018, and with respect to United States shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end. The Treasury Department and the IRS intend to provide that the regulations described in sections 3 and 4 of this notice are effective beginning the first taxable year of a foreign corporation (and with respect to United States shareholders, the taxable years in

which or with which such taxable years of the foreign corporations end) to which section 965 applies. Before the issuance of the regulations described in this notice, taxpayers may rely on the rules described in sections 3 and 4 of this notice.

The repeal of section 958(b)(4) is effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end. Taxpayers may rely on section 5.01 of this notice with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance (the application of which will be prospective). Before the change to instructions described in section 5.02 of this notice, taxpayers may also rely on the exception described in section 5.02 of this notice for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SECTION 7. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. The Treasury Department and the IRS expect to issue additional

guidance under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965. In addition, comments are requested as to whether, in light of the repeal of section 958(b)(4), it would be appropriate for the Treasury Department and the IRS to reconsider the provisions of any form, publication, regulation, or other guidance that reference CFCs, and if so, what revisions may be appropriate.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR-4549, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to Notice.comments@irs.counsel.treas.gov. Comments will be available for public inspection and copying.

The principal author of this notice is Ms. Perkins of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Perkins at (202) 317-6934 (not a toll free call).

Additional Guidance Under Section 965; Guidance Under Sections 62, 962, and 6081 in Connection With Section 965; and Penalty Relief Under Sections 6654 and 6655 in Connection with Section 965 and Repeal of Section 958(b)(4)

Notice 2018-26

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) intend to issue regulations in connection with section 965 of the Internal Revenue Code (“Code”) as amended by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), which was enacted on December 22, 2017. For prior guidance issued under section 965, see Notice 2018-07, 2018-4 I.R.B. 317; Notice 2018-13, 2018-6 I.R.B. 341; and Rev. Proc. 2018-17, 2018-9 I.R.B. 384. In addition, this notice announces relief from estimated tax penalties in connection with the amendment of section 965 and the repeal of section 958(b)(4) by the Act.

Section 2 of this notice provides background on section 965 and other relevant provisions of the Code. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue in connection with section 965 and announces the IRS’s intent to modify certain form instructions as a result of section 965. Section 4 of this notice describes a modification that the Treasury Department and the IRS intend

to make with respect to regulations under section 965 that were described in section 3.04(a) of Notice 2018-13. Section 5 of this notice provides guidance under section 962 in connection with section 965. Section 6 of this notice provides guidance concerning the application of the estimated tax rules in sections 6654 and 6655 and a waiver from the penalty imposed under those sections with respect to estimated taxes in connection with section 965 and the repeal of section 958(b)(4). Section 7 of this notice describes the effective dates of the regulations and other guidance described in this notice, as well as a clarification to the effective date provided in section 6 of Notice 2018-13 for the rule described in section 5.01 of Notice 2018-13. Section 8 of this notice requests comments and provides contact information.

SECTION 2. BACKGROUND

.01 Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation (“DFIC”) that begins before January 1, 2018 (such year of the DFIC, the “inclusion year”), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, a “measurement date,” and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the “section 965(a) earnings amount”). The section 965(a) earnings amount is not subject to the rules or limitations in section 952

and is not limited by the accumulated earnings and profits of the DFIC as of the close of the inclusion year.

.02 Determination of United States Shareholder's Section 951(a)(1) Inclusion by Reason of Section 965

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

.03 Allocation of Aggregate Foreign E&P Deficit and Definition of E&P Deficit Foreign Corporation

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

aggregate of such shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such shareholder. Section 965(b)(3)(A)(i).

The term "E&P deficit foreign corporation" means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if, as of November 2, 2017, (i) such specified foreign corporation has a deficit in post-1986 earnings and profits, (ii) such corporation was a specified foreign corporation, and (iii) such taxpayer was a United States shareholder of such corporation. Section 965(b)(3)(B). The term "specified E&P deficit" means, with respect to an E&P deficit foreign corporation, the amount of such corporation's deficit in post-1986 earnings and profits as of November 2, 2017. See section 965(b)(3)(C).

.04 Application of the Participation Exemption

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

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

The cash position of any specified foreign corporation is the sum of (i) cash held by such corporation, (ii) the net accounts receivable of such corporation, and (iii) the fair market value of the following assets held by such corporation (each asset, a “cash equivalent asset”): (I) personal property which is of a type that is actively traded and for which there is an established financial market; (II) commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign

¹ Notice 2018-07 and Notice 2018-13 referred to the year that includes the final cash measurement date as the “inclusion year” of such specified foreign corporation. However, only a DFIC can have an inclusion year, and therefore the final cash measurement date of a specified foreign corporation, which can be a DFIC, an E&P deficit foreign corporation, or neither, will not necessarily be the close of an inclusion year. The regulations described in Notice 2018-07 and Notice 2018-13 will describe the final cash measurement date consistently with section 965(c)(3)(A) and this notice. Any reference to an “inclusion year” for a specified foreign corporation that is not a DFIC will describe the last year of the specified foreign corporation that begins before January 1, 2018.

government; (III) any foreign currency; (IV) any obligation with a term of less than one year (“short-term obligation”); and (V) any asset which the Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B). Section 965(c)(3)(B). For purposes of determining the aggregate foreign cash position of a United States shareholder, the term “net accounts receivable” means, with respect to any specified foreign corporation, the excess (if any) of (i) such corporation’s accounts receivable, over (ii) such corporation’s accounts payable (determined consistent with the rules of section 461). Section 965(c)(3)(C).

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

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

.05 Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign

corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1 (“effectively connected income”), or (B) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed income”). Section 965(d)(2).

Section 965(d)(3) provides that the term “post-1986 earnings and profits” means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by taking into account only periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (A) as of the measurement date that is applicable with respect to such foreign corporation, and (B) without diminution by reason of dividends distributed during the inclusion year other than dividends distributed to another specified foreign corporation.

.06 Specified Foreign Corporation

Section 965(e)(1) provides that the term “specified foreign corporation” means (A) any CFC and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder. For purposes of sections 951 and 961, a specified foreign corporation described in section 965(e)(1)(B) is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a) (and for purposes of determining a United States shareholder’s pro rata share of any amount with respect to a specified foreign corporation under section 965(f)). Section 965(e)(2). However, if a passive foreign investment company

(as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

.07 Determination of Pro Rata Share

Section 965(f)(1) provides that the determination of any United States shareholder's pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a CFC).

.08 Election Under Section 965(h) Concerning Payment of Net Tax Liability Under Section 965

Section 965(h)(1) provides that in the case of a United States shareholder of a DFIC, such United States shareholder may elect to pay the net tax liability under section 965 in eight installments. Section 965(h)(5) provides that any election under section 965(h)(1) must be made not later than the due date for the return of tax for the year of the United States shareholder in which or with which the inclusion year of the DFIC ends and must be made in such manner as the Secretary provides.

If an election is made under section 965(h)(1), the first installment must be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the year of the United States shareholder in which or with which the inclusion year of the DFIC ends, and each succeeding installment must be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the taxable year following the taxable year with respect to which the preceding installment was made. Section 965(h)(2).

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

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

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

Under section 965(i)(1), any net tax liability, payment of which is deferred under section 965(i)(1), will be assessed on the return of tax as an addition to tax in the shareholder's taxable year which includes the triggering event with respect to such liability. As defined in section 965(i)(2), in the case of any shareholder's net tax liability under section 965 with respect to any S corporation, the triggering event with respect to such liability is whichever of the following occurs first: (i) such corporation ceases to be an S corporation (determined as of the first day of the first taxable year that such corporation is not an S corporation); (ii) a liquidation or sale of substantially all the

assets of such S corporation (including in a title 11 or similar case), a cessation of business by such S corporation, such S corporation ceases to exist, or any similar circumstance; or (iii) a transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise). In the case of a transfer of less than all of the taxpayer's shares of stock in the S corporation, such transfer shall only be a triggering event with respect to so much of the taxpayer's net tax liability under section 965 with respect to such S corporation as is properly allocable to such stock. Section 965(i)(2)(B).

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

.10 Election Under Section 965(m) Concerning Inclusions of Amounts Under Section 965

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

.11 Election Under Section 965(n) Not to Apply Net Operating Loss Deduction

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

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

.12 Regulations or Other Guidance Under Section 965

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

.13 Definition of United States Shareholder

For taxable years of foreign corporations beginning before January 1, 2018, under section 951(b), a United States shareholder is a United States person (within the meaning of section 957(c)) that owns within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the stock of a foreign corporation. Under section 957(c), a United States person generally

has the meaning assigned to it by section 7701(a)(30), which includes a domestic partnership or domestic trust. But see Notice 2010-41, 2010-22 I.R.B. 715 (announcing that the Treasury Department and the IRS intend to issue regulations treating certain domestic partnerships as foreign partnerships for purposes of identifying which United States shareholders are required to include amounts in gross income under section 951(a)). Moreover, an S corporation is treated as a partnership for purposes of sections 951 through 965. See section 1373(a).

.14 Attribution Rules in Section 958(b) and Section 318(a)

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

Section 318 provides rules that attribute the ownership of stock to certain family members, between certain entities and their owners, and to holders of options to acquire stock. Section 318(a)(1) provides rules attributing stock ownership among members of a family. Section 318(a)(2) provides rules attributing stock ownership “upward” from partnerships, estates, trusts, and corporations to partners, beneficiaries, owners, and shareholders. In addition, section 318(a)(3) provides specific rules that attribute the ownership of stock “downward” from partners, beneficiaries, owners, and

shareholders to partnerships, estates, trusts, and corporations. In particular, section 318(a)(3)(A) provides that stock owned, directly or indirectly, by or for a partner in a partnership or a beneficiary of an estate is considered as owned by the partnership or estate. This provision applies to all partners and beneficiaries without regard to the size of their interest in the partnership or estate. Section 318(a)(3)(B) similarly provides, subject to certain exceptions, that stock owned, directly or indirectly, by or for a beneficiary of a trust (or a person who is considered an owner of a trust) is considered owned by the trust. In comparison, section 318(a)(3)(C) provides that stock owned, directly or indirectly, by or for a shareholder in a corporation is considered owned by the corporation only if 50 percent or more in value of the stock in the corporation is owned, directly or indirectly, by such person.

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

.15 Estimated Taxes Under Sections 6654 and 6655

Taxpayers who fail to make sufficient and timely payments of estimated taxes are liable for additions to tax under sections 6654(a), for individuals, and 6655(a), for corporations. Generally, the addition to tax is calculated by applying the underpayment

interest rate under section 6621 to the unpaid portion of any required installment for the period that portion goes unpaid.

.16 Miscellaneous Itemized Deductions

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

.17 Election Under Section 962 for Individual to be Subject to Tax at Corporate Rates

As amended by the Act, section 962 provides that an individual who is a United States shareholder may elect to have the tax imposed under chapter 1 on amounts that are included in the individual’s gross income under section 951(a) be an amount equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. In addition, if such election is made, the amounts included in the individual’s gross income under section 951(a) are treated as if they were received by a domestic corporation for purposes of applying section 960 (relating to foreign tax

credits). See §1.962-1(a). However, the taxable income determined for purposes of applying section 11 is not reduced by any deduction of the United States shareholder. See §1.962-1(b)(1)(i). An election under section 962 does not affect tax imposed under other chapters, including under chapter 2A.

.18 Extensions of Time for Filing Income Tax Returns and Paying Tax for Certain Citizens and Residents Abroad

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

SECTION 3. REGULATIONS TO BE ISSUED ADDRESSING THE APPLICATION OF SECTION 965

.01 Application of Section 318(a)(3)(A) to Treat a Foreign Corporation as a Specified Foreign Corporation

As a result of the application of the constructive ownership rule in section 318(a)(3)(A) (providing for downward attribution of stock from a partner to a partnership), it may be difficult to determine if a foreign corporation is a specified foreign corporation under certain circumstances. Assume, for example, that a person, A, owns 100 percent of the stock of a domestic corporation, DC, and 1 percent of the interests in a partnership, PS. Assume further that a United States citizen, USI, owns 10 percent of the interests in PS and 10 percent by vote and value of the stock of a foreign

corporation, FC. The remaining 90 percent by vote and value of the stock of FC is owned by non-U.S. persons that are unrelated to A, USI, DC, and PS. Absent the application of sections 958(b), 318(a)(3)(A), and 318(a)(3)(C), FC would not be a specified foreign corporation, because FC is not a CFC and there would be no domestic corporation that is a United States shareholder of FC.

Under sections 958(b) and 318(a)(3)(A), PS would be treated as owning 100 percent of the stock of DC and 10 percent of the stock of FC. As a result, under sections 958(b), 318(a)(5)(A), and 318(a)(3)(C), DC would be treated as owning the stock of FC treated as owned by PS, and thus DC would be a United States shareholder with respect to FC, causing FC to be a specified foreign corporation within the meaning of section 965(e)(1)(B). USI is a United States shareholder with respect to FC and thus, absent an exception, would be required to include amounts in gross income under section 951(a)(1) by reason of section 965 with respect to FC. The results are the same whether A or PS or both are domestic or foreign persons.

The Treasury Department and the IRS have determined that it would pose compliance difficulties for taxpayers and administrative difficulties for the IRS to require a United States person to determine whether a foreign corporation with respect to which it is a United States shareholder is a specified foreign corporation if such foreign corporation may be a specified foreign corporation solely by reason of downward attribution under section 318(a)(3)(A) of stock from a partner to a partnership when such partner has only a de minimis interest in such partnership. Accordingly, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that, solely for purposes of determining whether a

foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B), stock owned, directly or indirectly, by or for a partner (tested partner) will not be considered as being owned by a partnership under sections 958(b) and 318(a)(3)(A) if such partner owns less than five percent of the interests in the partnership's capital and profits. For purposes of the preceding sentence, an interest in the partnership owned by another partner will be considered as being owned by the tested partner under the principles of sections 958(b) and 318, as modified by this notice, as if the interest in the partnership were stock.

Thus, for example, assume the same facts as in the example above, except that A is a corporation wholly owned by B, and B directly owns 4 percent of the interests in PS. For purposes of the rule in this section 3.01, applying the principles of sections 958(b) and 318, as modified by this notice, as if the interest in PS were stock, A is treated as owning the interests in PS owned by B (in addition to the 1 percent interest in PS that A owns directly), and thus A is not treated as owning less than five percent of the interests in PS's capital and profits. Accordingly, the rule in this section 3.01 does not apply, and PS is treated as owning A's stock in DC for purposes of determining whether FC is a specified foreign corporation within the meaning of section 965(e)(1)(B).

.02 Determination of Cash Measurement Dates of a Specified Foreign Corporation with Respect to a United States Shareholder

In certain cases, a specified foreign corporation may not be owned by a particular United States shareholder on all of the cash measurement dates, whether because the specified foreign corporation goes out of existence before the final cash measurement date or because its stock is acquired or disposed of between cash measurement dates.

The Treasury Department and the IRS understand that section 965(c)(3)(A)(i) could be interpreted to treat the close of the final taxable year of a specified foreign corporation that ceased to exist before November 2, 2017, as the final cash measurement date of such specified foreign corporation. Additionally, if a United States shareholder acquires or disposes of stock of a specified foreign corporation between cash measurement dates of the specified foreign corporation, questions have been raised as to whether the United States shareholder's pro rata share of the cash position of such specified foreign corporation as of an earlier or subsequent cash measurement date should be taken into account for purposes of determining the United States shareholder's aggregate foreign cash position.

The Treasury Department and the IRS intend to issue regulations providing that (i) the final cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any; (ii) the second cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any; (iii) the first cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any; and (iv) a United States shareholder takes into account its pro rata share of the cash position of a specified foreign corporation as of any cash measurement date of the specified foreign corporation on which such United States shareholder is a United States shareholder of such specified foreign corporation, regardless of whether such United States shareholder is a United States

shareholder of such specified foreign corporation as of any other cash measurement date, including the final cash measurement date of such specified foreign corporation. For purposes of applying this paragraph, a 52-53-week taxable year is deemed to begin on the first day of the calendar month nearest to the first day of the 52-53-week taxable year, and is deemed to end or close on the last day of the calendar month nearest to the last day of the 52-53-week taxable year, as the case may be. See §1.441-2(c).

Example. (i) Facts. Except as otherwise provided, for all relevant periods, USP, a domestic corporation, has owned directly at least 10 percent of the stock of CFC1, CFC2, CFC3, and CFC4, each a foreign corporation. CFC1 and CFC2 have calendar year U.S. taxable years. CFC3 and CFC4 have U.S. taxable years that end on November 30. No entity has a short taxable year, except as a result of the transactions described below.

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

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

(ii) Analysis. Each of CFC1, CFC2, CFC3, and CFC4 is a specified foreign corporation. Taking into account the regulations described in this section 3.02, the cash measurement dates of the specified foreign corporations to be taken into account by USP in determining its aggregate foreign cash position are summarized in the following table:

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

.03 Treatment of Certain Accrued Foreign Income Taxes for Purposes of Determining Post-1986 Earnings and Profits

Post-1986 earnings and profits are defined, in relevant part, as the earnings and profits of a specified foreign corporation determined as of each of the two measurement

dates described in section 965(a) and “computed in accordance with sections 964(a) and 986.” Section 965(d)(3). In general, section 964(a) provides that, under regulations prescribed by the Secretary, the earnings and profits of any foreign corporation, and the deficit in earnings and profits of any foreign corporation, for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations. As described in section 3.02 of Notice 2018-13, for purposes of measuring the post-1986 earnings and profits of a specified foreign corporation as of a measurement date, the extent to which an item of income, deduction, gain, or loss is taken into account as of such measurement date must be determined under principles generally applicable to the calculation of the earnings and profits of a domestic corporation. Section 3.02(a) of Notice 2018-13 provided a limited exception to this general rule in order to reduce taxpayer compliance burdens. Section 3.02(a) of Notice 2018-07 also announced the intention to issue regulations that may provide exceptions to this general rule in limited cases that are contemplated by section 965 or the legislative history to the Act, such as to address double counting or double non-counting.

The Treasury Department and the IRS have determined that an additional limited exception to the general rule is appropriate for certain foreign income taxes that accrue between measurement dates. Accordingly, the Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a specified foreign corporation’s post-1986 earnings and profits as of the measurement date on November 2, 2017, any foreign income tax (as defined in section 901(m)(5)) that accrues (i) within the specified foreign corporation’s U.S. taxable year that includes

November 2, 2017, and (ii) after November 2, 2017, but on or before December 31, 2017, will be allocated between the respective portions of the foreign tax base on which the accrued foreign taxes are determined that are attributable to the part of the U.S. taxable year ending on November 2, 2017, and the part of the U.S. taxable year beginning after November 2, 2017.

The Treasury Department and the IRS have determined that it is appropriate to limit the scope of the regulations to foreign income taxes that accrue on or before December 31, 2017, in order to allow for the section 965(a) earnings amounts of each specified foreign corporation to be determined as of the final measurement date, December 31, 2017.

The regulations announced in this section 3.03 are relevant solely for purposes of determining a specified foreign corporation's post-1986 earnings and profits (including a deficit) within the meaning of section 965(d)(3). Therefore, the regulations to be issued will not affect, for example, the computation of credits for taxes deemed paid under sections 902 and 960.

.04 Prevention of the Reduction of the Section 965 Tax Liability of a United States Shareholder

(a) Anti-Avoidance Rule

(i) Transactions Undertaken with a Principal Purpose of Reducing Section 965 Tax Liability

The Treasury Department and the IRS intend to issue regulations under sections 965(c)(3)(F) and 965(o) providing that a transaction will be disregarded for purposes of determining a United States shareholder's section 965 tax liability if each of the following conditions is satisfied: (i) such transaction occurs, in whole or in part, on or after November 2, 2017 (the "specified date"); (ii) such transaction is undertaken with a

principal purpose of reducing the section 965 tax liability of such United States shareholder; and (iii) such transaction would, without regard to this sentence, reduce the section 965 tax liability of such United States shareholder (the “anti-avoidance rule”).

For purposes of this section 3.04(a) and section 3.04(b) of this notice, a transaction (or change in method of accounting or election described in section 3.04(b) of this notice) reduces the section 965 tax liability of a United States shareholder if such transaction (i) reduces a section 965(a) inclusion amount of such United States shareholder with respect to any specified foreign corporation, (ii) reduces the aggregate foreign cash position of such United States shareholder, or (iii) increases the amount of foreign income taxes of any specified foreign corporation deemed paid by such United States shareholder under section 960 as a result of an inclusion under section 951(a) by reason of section 965. Also for purposes of this section 3.04(a) and section 3.04(b) of this notice, in the case of a United States shareholder that is a domestic pass-through entity, a domestic pass-through owner of such domestic pass-through entity is also treated as a United States shareholder. For the definition of domestic pass-through entity and domestic pass-through owner, see section 3.05(b) of this notice.

Under section 3.04(a)(ii) through (iv) of this notice, certain transactions are presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. The presumption described in the preceding sentence may be rebutted only if facts and circumstances clearly establish that the transaction was not undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. The

regulations will provide that a taxpayer that takes the position that the presumption is rebutted must attach a statement to its income tax return for its taxable year in which or with which the relevant taxable year of the relevant specified foreign corporation ends disclosing that it has rebutted the presumption. In the case of a transaction described in section 3.04(a)(ii) and (iii), if the presumption does not apply because such transaction occurs in the ordinary course of business, whether such transaction was undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder must be determined under all the facts and circumstances. Under section 3.04(a)(ii) through (iv) of this notice, certain transactions are also treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. Further, under section 3.04(a)(ii), certain distributions are treated per se as not being undertaken with a principal purpose of reducing the section 965 tax liability of such United States shareholder and therefore are not subject to the anti-avoidance rule.

For purposes of the rules described in section 3.04(a)(ii) through (iv) of this notice, a person is treated as related to a United States shareholder if (i) the person bears a relationship to the United States shareholder described in section 267(b) or section 707(b) and (ii) the relationship described in clause (i) of this sentence is satisfied either immediately before or immediately after the transaction. Furthermore, for purposes of the rules described in section 3.04(a)(ii) and (iv) of this notice, the term “transfer” includes any disposition, exchange, contribution, distribution, issuance, redemption, recapitalization, or loan, and includes an indirect transfer (for example, a transfer of an interest in a partnership is a transfer of the assets of such partnership).

No inference is intended as to the treatment, under general tax law, of transactions that occurred before the specified date. The IRS may, where appropriate, challenge such transactions under the Code, regulations, or judicial doctrines such as the step transaction doctrine or the economic substance doctrine.

(ii) Application of the Anti-Avoidance Rule to Cash Reduction Transactions

For purposes of applying the anti-avoidance rule, a cash reduction transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “cash reduction transaction” means (i) a transfer of cash, accounts receivable, or cash equivalent assets by a specified foreign corporation to a United States shareholder of such specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation, or (ii) an assumption by a specified foreign corporation of an accounts payable of a United States shareholder of such specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation, if such transfer or assumption would, without regard to the anti-avoidance rule, reduce the aggregate foreign cash position of such United States shareholder. The presumption described in this paragraph does not apply to a cash reduction transaction that occurs in the ordinary course of business.

Notwithstanding the presumption described in the preceding paragraph, except in the case of a specified distribution, a cash reduction transaction that is a distribution by a specified foreign corporation to a United States shareholder of such specified foreign corporation will be treated per se as not being undertaken with a principal purpose of reducing the section 965 tax liability of such United States shareholder for purposes of the anti-avoidance rule. A specified distribution will be treated per se as being

undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. For purposes of this section 3.04(a)(ii), the term “specified distribution” means a cash reduction transaction that is a distribution by a specified foreign corporation of a United States shareholder if (i) at the time of the distribution, there was a plan or intention for the distributee to transfer, directly or indirectly, cash, accounts receivable, or cash equivalent assets to any specified foreign corporation of such United States shareholder, or (ii) the distribution is a non pro rata distribution to a foreign person that is related to such United States shareholder. For purpose of clause (i) of the preceding sentence, an indirect transfer includes, for example, a transfer of cash to a partnership if a specified foreign corporation of such United States shareholder is a partner.

(iii) Application of the Anti-Avoidance Rule to E&P Reduction Transactions

For purposes of applying the anti-avoidance rule, an E&P reduction transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “E&P reduction transaction” means a transaction between a specified foreign corporation and any of (i) a United States shareholder of such specified foreign corporation, (ii) another specified foreign corporation of a United States shareholder of such specified foreign corporation, or (iii) any person related to a United States shareholder of such specified foreign corporation, if such transaction would, without regard to the anti-avoidance rule, reduce the accumulated post-1986 deferred foreign income or the post-1986 undistributed earnings (as defined in section 902(c)(1) as in effect before the date of the enactment of the Act) of such specified foreign corporation or another specified foreign corporation of any United States shareholder of such specified foreign corporation. The

presumption described in this paragraph does not apply to an E&P reduction transaction that occurs in the ordinary course of business.

Notwithstanding the presumption described in the preceding paragraph, a specified transaction will be treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. For purposes of the preceding sentence, the term “specified transaction” means an E&P reduction transaction that involves one or more of the following: (i) a complete liquidation of a specified foreign corporation to which section 331 applies; (ii) a sale or other disposition of stock by a specified foreign corporation, or (iii) a distribution by a specified foreign corporation that reduces the earnings and profits of such specified foreign corporation pursuant to section 312(a)(3).

(iv) Application of the Anti-Avoidance Rule to Pro Rata Share Transactions

For purposes of applying the anti-avoidance rule, a pro rata share transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “pro rata share transaction” means a transfer of the stock of a specified foreign corporation to a United States shareholder of the specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation if such transfer would, without regard to the anti-avoidance rule, (i) reduce such United States shareholder’s pro rata share of the section 965(a) earnings amount of such specified foreign corporation if it is a DFIC; (ii) increase such United States shareholder’s pro rata share of the specified E&P deficit of such specified foreign corporation if it is an E&P deficit foreign corporation; or (iii) reduce such United States shareholder’s pro rata share of the cash position of such specified foreign corporation.

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

Example. (i) Facts. FP, a foreign corporation, owns all of the stock of USP, a domestic corporation. USP owns all of the stock of FS, a foreign corporation. USP has held the stock of FS for more than one year. USP has a calendar year taxable year; FS’s taxable year ends November 30. On January 2, 2018, USP transfers all of the stock of FS to FP in exchange for cash. On January 3, 2018, FS makes a distribution with respect to the stock transferred to FP. USP treats the transaction as a taxable sale of the FS stock and claims a dividends received deduction under section 245A with respect to its deemed dividend under section 1248(j) as a result of the sale. FS has post-1986 earnings and profits as of December 31, 2017, and no previously taxed income or effectively connected income for any previous taxable year.

(ii) Analysis. The transfer of the stock of FS is a pro rata share transaction because such transfer is to a person related to USP, and the transfer would, without regard to the anti-avoidance rule, reduce USP's pro rata share of FS's section 965(a) earnings amount. Because USP and FP are also members of an affiliated group within the meaning of this section 3.04(a)(iv), the transfer of the stock of FS is also an internal group transaction and is treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of USP. Accordingly, the transfer will be disregarded for purposes of determining USP's section 965 tax liability with the result that, among other things, USP's pro rata share of FS's section 965(a) earnings amount is determined as if USP owned (within the meaning of section 958(a)) 100 percent of the stock of FS on the last day of FS's inclusion year and no other person received a distribution with respect to such stock during such year. See section 951(a)(2)(A) and (B).

(b) Disregard of Certain Changes in Method of Accounting and Entity Classification Elections

The Treasury Department and the IRS also intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that any change in method of accounting made for a taxable year of a specified foreign corporation that ends in 2017 or 2018 will be disregarded for purposes of determining the section 965 tax liability of a United States shareholder if such change in method of accounting would otherwise reduce the section 965 tax liability of such United States shareholder. The rule described in this section 3.04(b) will apply whether or not such change in method of accounting was made in accordance with the procedures described in Rev. Proc. 2015-13, 2015-5 I.R.B. 419 (or successor), and whether or not such change in method of accounting was properly made. These regulations will not apply to a change in method of accounting for which the original and/or duplicate copy of any Form 3115, Application for Change in Accounting Method, requesting the change was filed before the specified date, November 2, 2017.

The regulations will also provide that any entity classification election under §301.7701-3 that is filed on or after the specified date will be disregarded for purposes

of determining the section 965 tax liability of such United States shareholder if such entity classification election would otherwise reduce the section 965 tax liability of any United States shareholder. An entity classification election filed on or after the specified date will be subject to these regulations even if such entity classification election was effective on a date before the specified date.

The regulations described in this section 3.04(b) will apply regardless of whether such change in method of accounting or change of entity classification election is made with a principal purpose of reducing the section 965 tax liability of a United States shareholder.

.05 Rules Related to Elections, Reporting, and Payment

(a) Documentation of Cash Position

Section 965(c)(3)(D) provides that net accounts receivable, actively traded property, and short-term obligations shall not be taken into account by a United States shareholder in determining its aggregate foreign cash position to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation. The IRS intends to issue forms, publications, regulations, or other guidance that will specify the documentation that a United States shareholder must maintain or provide, and the time and manner for providing any such documentation, in order to make the required demonstration to the Secretary.

(b) United States Persons Eligible to Make Elections Under Section 965 in the Case of a United States Shareholder that is a Domestic Pass-Through Entity

Section 965 increases the amount included in the gross income of a United States shareholder under section 951(a)(1) only if such United States shareholder owns

(within the meaning of section 958(a)) stock in one or more specified foreign corporations. See section 951(a)(2)(A). For purposes of this notice, the term “section 958(a) stock” means, with respect to a United States shareholder of a DFIC, the stock of the DFIC owned by the United States shareholder within the meaning of section 958(a).

The Treasury Department and IRS have determined that if a domestic pass-through entity is a United States shareholder of a DFIC and owns section 958(a) stock in such DFIC, the section 965(a) inclusion amount with respect to such section 958(a) stock and the section 965(c) deduction with respect to such amount should be determined at the level of the domestic pass-through entity. However, the domestic pass-through owners of the domestic pass-through entity are subject to federal income tax on their share of the section 965(a) inclusion amount with respect to the section 958(a) stock of the domestic pass-through entity. Accordingly, in the case of a domestic pass-through entity that is a United States shareholder, the regulations will provide that each domestic pass-through owner takes into account its share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of the domestic pass-through entity and the section 965(c) deduction with respect to such amount, regardless of whether such domestic pass-through owner is also a United States shareholder with respect to such DFIC. In this case, the section 965(a) inclusion amount and the related section 965(c) deduction must be allocated in the same proportion. For example, if a domestic pass-through owner is allocated 50 percent of the section 965(a) inclusion amount with respect to section 958(a) stock of a domestic pass-through entity, such domestic pass-through owner must be allocated 50 percent of the related section 965(c)

deduction. If the domestic pass-through owner is also a United States shareholder with respect to such DFIC that owns section 958(a) stock of such DFIC, regulations will provide that the section 965(a) inclusion amount with respect to such section 958(a) stock of such domestic pass-through owner and the section 965(c) deduction with respect to such amount are determined separately from its share of the section 965(a) inclusion amount and section 965(c) deduction of the domestic pass-through entity.

For purposes of this notice, the term “domestic pass-through entity” means a pass-through entity that is a United States person (as defined in section 7701(a)(30)). Also for purposes of this notice, a “pass-through entity” means a partnership, S corporation, or any other person to the extent that the income or deductions of such person are included in the income of one or more direct or indirect owners or beneficiaries of the person. Accordingly, if, for example, a domestic trust is subject to federal income tax on a portion of its section 965(a) inclusion amount and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion. Also for purposes of this notice, the term “domestic pass-through owner” means a United States person that is a partner, shareholder, beneficiary, grantor, or owner, as the case may be, in a domestic pass-through entity, except that, in the case of tiered pass-through entities, the term does not include a partner, shareholder, beneficiary, or owner that is itself a domestic pass-through entity. In the case of tiered pass-through entities, a reference in this notice to a domestic pass-through owner includes a United States person that is an indirect partner, shareholder, beneficiary, or owner through one or more other pass-through entities, and a reference to a domestic pass-through owner’s

share of the section 965(a) inclusion amount and section 965(c) deduction of a domestic pass-through entity includes such domestic pass-through owner's share of the section 965(a) inclusion amount and section 965(c) deduction of a domestic pass-through entity owned indirectly by such domestic pass-through owner through one or more other pass-through entities.

The elections under section 965(h), (m), and (n) ("specified elections") are described in section 965 as available to a United States shareholder of a DFIC. However, because a domestic pass-through owner includes in income a share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of a domestic pass-through entity, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of regulatory authority under section 965(o), allowing such domestic pass-through owner to make a specified election that applies to its share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of the domestic pass-through entity. Such a domestic pass-through owner will be permitted to make a specified election regardless of whether the domestic pass-through owner is itself a United States shareholder of the DFIC. If a domestic pass-through owner makes a specified election for its taxable year, such election will be applicable to all section 965(a) inclusion amounts included in the gross income of such domestic pass-through owner for such taxable year (other than amounts with respect to which elections under section 965(i) are effective), whether included directly by reason of owning section 958(a) stock in a DFIC or indirectly by reason of being a domestic pass-through owner.

If an S corporation is, directly or indirectly, a partner, beneficiary, or owner of a domestic pass-through entity and takes into account a share of the section 965(a) inclusion amount of a domestic pass-through entity with respect to a DFIC, and the S corporation is a United States shareholder of the DFIC, the regulations will provide that shareholders of the S corporation will be permitted to make an election under section 965(i) to defer the shareholder's net tax liability under section 965 with respect to the S corporation. However, in such a case, if the S corporation is not itself a United States shareholder of a DFIC, the net tax liability under section 965 of a shareholder with respect to the S corporation for purposes of the election under section 965(i) will not include the shareholder's share of the domestic pass-through entity's section 965(a) inclusion amount with respect to the DFIC or section 965(c) deduction with respect to such amount.

(c) Determination of Amount of Net Tax Liability Under Section 965 for Purposes of Section 965(h)

As discussed in section 3.05(b) of this notice, if a domestic pass-through entity is a United States shareholder that has a section 965(a) inclusion amount with respect to section 958(a) stock in a DFIC, a United States person that is a domestic pass-through owner, directly or indirectly, in such domestic pass-through entity is subject to net income tax on its share of the section 965(a) inclusion amount. Accordingly, the Treasury Department and the IRS intend to issue regulations providing that for purposes of determining the net tax liability under section 965 of a domestic pass-through owner, the domestic pass-through owner will be treated as a United States shareholder. See, however, section 5 of this notice, which provides that a domestic

pass-through owner that is not itself a United States shareholder is not permitted to make an election under section 962.

Furthermore, the regulations will provide that, in the case of a taxpayer that has made one or more elections under section 965(i) for a taxable year, the taxpayer's net tax liability under section 965 for purposes of section 965(h) is the taxpayer's net tax liability under section 965 as determined under section 965(h)(6) (taking into account the rules in this section 3.05(c)) reduced by the aggregate amount of the taxpayer's net tax liabilities under section 965 as determined under section 965(i)(3) (taking into account the rule provided in section 3.05(b) of this notice) with respect to which elections under section 965(i) are effective.

(d) Application of Section 965(n) to Losses Arising in the Year in Which the Inclusion Year of a DFIC Ends

A United States shareholder of a DFIC may elect the application of section 965(n) for the taxable year of the United States shareholder in which, or with which, the inclusion year of the DFIC ends. If such an election is made, the United States shareholder does not take into account the amount described in section 965(n)(2) in determining the amount of the net operating loss deduction under section 172 of such shareholder for such taxable year or in determining the amount of taxable income for such taxable year which may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172.

Questions have arisen regarding the scope of the election under section 965(n) due to the use of the term "deduction" in section 965(n)(1)(A). A net operating loss "deduction" for a taxable year generally refers to the amount of a net operating loss carried to such taxable year from a prior or subsequent year rather than the net

operating loss arising from such year. Compare section 172(a) and (c). However, interpreting “deduction” in section 965(n)(1)(A) to refer to carryovers or carrybacks (and not to the net operating loss for the taxable year) would cause that paragraph to be duplicative of section 965(n)(1)(B), which already provides that amounts described in section 965(n)(2) are disregarded for purposes of applying net operating loss carryovers or carrybacks to such taxable year under section 172. The Treasury Department and the IRS have determined that section 965(n)(1)(A) was intended to apply to a different set of losses than those to which section 965(n)(1)(B) applies. Therefore, the Treasury Department and the IRS intend to issue regulations providing that, if an election under section 965(n) is made with respect to a taxable year in which or with which the inclusion year of a DFIC ends, the amount of a net operating loss for such taxable year will be determined without taking into account as gross income the amount described in section 965(n)(2). The regulations will also clarify that an election made under section 965(n) will be treated as made with respect to both the amount of a net operating loss for such taxable year and the net operating loss carryovers or carrybacks for such taxable year.

(e) Filing and Payment Due Date for Specified Individuals

A specified individual (as defined in section 2.18 of this notice) who does not make the election under section 965(h)(1) or (i)(1) is considered to have timely filed such person’s return and paid the net tax liability under section 965 if the filing and payment are made on or before the fifteenth day of the sixth month following the close of the taxable year, and the specified individual attaches a statement to the return showing that the person for whom the return is made is a person described in §1.6081-5(a). See §1.6081-5(a)(5)-(6), and (b). For a specified individual who makes the

election under section 965(h)(1), section 965(h)(2) provides that the installments must be paid on the due dates for the relevant returns (determined without regard to any extension of time for filing the return).

The question has arisen whether the disregarding of extensions of time to file in section 965(h)(2) applies to negate the extension of time to pay that is otherwise available under §1.6081-5 for a specified individual that does not make the election under section 965(h)(1). The Treasury Department and the IRS intend to issue regulations providing that, if a specified individual receives an extension of time to file and pay under §1.6081-5(a)(5) or (6), then the individual's due date for an installment payment under section 965(h) is also the fifteenth day of the sixth month following the close of a taxable year.

.06 Treatment of Section 965(c) Deduction for Purposes of Sections 62(a) and 63(d)

Questions have arisen as to whether the section 965(c) deduction is a miscellaneous itemized deduction as defined in section 67(b). The Treasury Department and the IRS have determined that an individual's section 965(c) deduction was not intended to be subject to the 2-percent floor under section 67 or the deduction disallowance under the AMT, or, in the case of a taxable year beginning after December 31, 2017, the deduction disallowance under section 67 as modified by the Act. Therefore, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that a section 965(c) deduction will not be treated as an itemized deduction, including for purposes of sections 56 and 67.

SECTION 4. MODIFICATION OF RULE DESCRIBED IN SECTION 3.04(a) OF NOTICE 2018-13

Section 3.04(a) of Notice 2018-13 announced that the Treasury Department and the IRS intend to issue regulations providing that, for purposes of calculating the net accounts receivable of a specified foreign corporation, the term “accounts receivable” means receivables described in section 1221(a)(4), and the term “accounts payable” means payables arising from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers. The Treasury Department and the IRS have determined that it is appropriate to exclude any receivable or payable with an initial term of one year or more for purposes of calculating a specified foreign corporation’s net accounts receivable. Cf. section 965(c)(3)(B)(iii)(IV) (short-term obligations). Accordingly, the Treasury Department and the IRS intend to issue regulations providing that the terms “accounts receivable” and “accounts payable” will include only receivables or payables with a term of less than one year.

SECTION 5. REGULATIONS TO BE ISSUED ADDRESSING ELECTIONS UNDER SECTION 962

As discussed in section 3.05(b) of this notice, if a domestic pass-through entity is a United States shareholder that has a section 965(a) inclusion amount with respect to section 958(a) stock in a DFIC, a domestic pass-through owner of such entity is subject to net income tax on its share of the section 965(a) inclusion amount. The Treasury Department and the IRS intend to issue regulations clarifying that a domestic pass-through owner who is an individual (including, as provided in §1.962-2(a), a trust or estate) and a United States shareholder with respect to a DFIC may make an election under section 962 with respect to the individual’s share of the section 965(a) inclusion

amount of a domestic pass-through entity with respect to such DFIC. However, an individual who is not a United States shareholder of a DFIC is not permitted to make an election under section 962 with respect to the individual's share of a section 965(a) inclusion amount of a domestic pass-through entity with respect to such DFIC notwithstanding the rules in section 3.05(b) and (c) of this notice. See section 962(b). The regulations will clarify that the same principles apply to inclusions under section 951(a) other than by reason of section 965.

If an individual elects to have the provisions of section 962 apply for a taxable year, the tax imposed on amounts included in the individual's gross income under section 951(a) (directly by reason of owning section 958(a) stock or indirectly by reason of being a domestic pass-through owner), including by reason of section 965, is an amount equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. In addition, §1.962-1(b)(1)(i) provides that a deduction of a United States shareholder does not reduce the amount included in gross income under section 951(a) for purposes of computing the amount of tax that would be imposed under section 11.

The Treasury Department and the IRS have determined that in the case of a taxpayer making an election under section 962, Congress intended for the section 965(c) deduction (which is generally available to United States shareholders of DFICs, including individuals) to be allowed with respect to the tax imposed under section 11 rather than under section 1. See H.R. Rep. No. 115-466, at 620 (2017) (Conf. Rep.). Pursuant to the grant of authority under section 965(o), the Treasury Department and the IRS intend to modify §1.962-1(b)(1)(i) to provide that, in computing the amount of

tax due as a result of a section 962 election, the section 965(c) deduction may be taken into account. Specifically, the regulations will provide that “taxable income” as used in section 11 shall be reduced by the section 965(c) deduction. These regulations will not apply to any other deductions, and therefore existing §1.962-1(b)(1)(i) will continue to provide that “taxable income” as used in section 11 shall not be reduced by any other deductions. Any section 965(c) deduction allowed in determining “taxable income” as used in section 11 for purposes of computing the tax due as a result of a section 962 election will not also be allowed for purposes of determining an individual’s actual taxable income.

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

(ii) Analysis. USI’s “taxable income” described in §1.962-1(b)(1)(i) equals \$100 (USI’s distributive share of USPRS’s section 965(a) inclusion amount) minus \$70 (USI’s distributive share of USPRS’s allowable section 965(c) deduction), or \$30. No other deductions are allowed in determining this amount. USI’s tax on such amount will be equal to the tax imposed under section 11 as if \$30 were received by a domestic corporation. USI cannot deduct \$70 for purposes of determining USI’s taxable income that is subject to tax under section 1.

SECTION 6. PENALTY RELIEF UNDER SECTIONS 6654 AND 6655 IN CONNECTION WITH THE AMENDMENT OF SECTION 965 AND THE REPEAL OF SECTION 958(B)(4)

.01 Penalty Waiver with Respect to Section 965

A United States shareholder that has a net tax liability under section 965 generally includes the amount of the net tax liability on its return for the year in which or with which the inclusion year of the DFIC ends.

Section 965(h)(1) provides that a United States shareholder of a DFIC may elect to pay the net tax liability under section 965 in eight annual installments, the first of which is due on the due date (without regard to any extension of time to file) of the return for the shareholder's taxable year in which or with which the inclusion year of the DFIC ends. Each successive installment is due on the due date (without regard to any extension of time to file) of the return for the taxable year following the taxable year the prior installment was made. Section 965(h)(2). The timely payment of an installment does not incur underpayment interest. See H.R. Rep. No. 115-466, at 611 (2017) (Conf. Rep.). Section 965(h), therefore, demonstrates Congress's intent to permit a taxpayer to pay its net tax liability under section 965 without incurring additional liability, including additions to tax. Consistent with this intent, and in the interest of sound tax administration, the IRS will waive underpayment penalties under sections 6654 and 6655 with respect to a taxpayer's net tax liability under section 965 for those taxpayers that make an election under section 965(h). In addition, the IRS will waive underpayment penalties under sections 6654 and 6655 with respect to a taxpayer's net tax liability under section 965 for those taxpayers who do not elect to pay their net tax liability under section 965 in installments. Accordingly, a taxpayer's required installments of estimated tax need not include amounts attributable to its net tax liability under section 965 to prevent the imposition of penalties under sections 6654(a) and 6655(a). If a taxpayer fails to timely pay its net tax liability under section 965 when due, other sections of the Code may apply; for example, additions to tax could result under section 6651, and installment payments could be accelerated under section 965(h)(3).

The instructions to estimated tax forms will be modified, as necessary, to clarify that no underpayment penalty will be imposed under section 6654 or section 6655 with respect to a taxpayer's net tax liability under section 965 and that the taxpayer may exclude such amounts when calculating the amount of its required installment.

.02 Penalty Waiver for 2017 with Respect to Amendments to Sections 965 and 958(b) by the Act

In addition, because the amendment to section 965 and the repeal of section 958(b)(4) could also affect tax liability (other than by way of the imposition of the net tax liability under section 965) for periods that end before or shortly after the enactment of the Act, the IRS has determined that additional penalty relief is appropriate. Therefore, the IRS has determined that if the amendment to section 965 or the amendment to section 958(b) by the Act causes an underpayment related to a required installment of estimated tax due on or before January 15, 2018, the estimated tax penalty under section 6654 or section 6655 will not apply to that underpayment.

SECTION 7. EFFECTIVE DATES

Section 965 is effective for the last taxable years of foreign corporations that begin before January 1, 2018, and with respect to United States shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end. The Treasury Department and the IRS intend to provide that the regulations and instructions described in sections 3, 4, 5, and 6 of this notice are effective beginning for the first taxable year of a foreign corporation (and with respect to United States shareholders, the taxable years in which or with which such taxable years of the foreign corporations end) to which section 965 applies. Before the issuance of the regulations

and instructions described in this notice, taxpayers may rely on the rules described in sections 3, 4, 5, and 6 of this notice.

This notice also clarifies one of the effective dates described in section 6 of Notice 2018-13, which provided that taxpayers could rely on the rules described in section 5.01 of Notice 2018-13 with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance. Taxpayers may rely on section 5.01 of Notice 2018-13 with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance (the application of which will be prospective).

SECTION 8. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. The Treasury Department and the IRS expect to issue additional guidance under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR-4579, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to Notice.comments@irsounsel.treas.gov. Comments will be available for public inspection and copying.

The principal author of this notice is Ms. Perkins of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Perkins at (202) 317-6934 (not a toll free call).

