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March 30, 2015

The Honorable Mark Mazur
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The Honorable John Koskinen
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Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: **Report on Proposed Regulations Issued under Sections 959 and 961**

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report (the "Report") of the Tax Section of the New York State Bar Association. The Report comments on certain proposed regulations under sections 959 and 961 of the Internal Revenue Code of 1986 that were issued in 2006 (the "Proposed Regulations").

Pursuant to the authority granted by section 959, the Proposed Regulations provide rules for tracing distributions from controlled foreign corporations ("CFCs") to previously taxed earnings and profits ("PTI") when a CFC makes a distribution that would otherwise be treated as a dividend by employing a system of earnings & profits ("E&P") accounts. The Proposed

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Regulations also provide rules for making the basis adjustments required under section 961 to prevent double taxation of PTI in transactions involving dispositions of CFC shares. The guiding principle adopted by the Proposed Regulations is that the purpose of section 959 is to prevent double taxation of amounts that have been previously included in gross income by a United States shareholder (a “US Shareholder”) under section 951(a) and, importantly, to prevent such double taxation at the earliest possible time. A corollary of that guiding principle is that the rules generally treat distributions as coming “first” from the PTI account rather than other earnings.

We support the framework adopted by the Proposed Regulations and our comments are primarily directed towards extending the “PTI first” approach adopted for distributive transactions to dispositions of CFCs.

Our primary recommendations are as follows:

1. We recommend that the final regulations adopt rules that would eliminate the potential disparity under the current Proposed Regulations between the treatment of distributive and dispositive transactions. To achieve this, we recommend that a specific rule be adopted that, upon a disposition of a lower tier CFC, would treat PTI of the lower tier CFC in a manner analogous to the treatment of non-PTI under Section 964(e), which effectively deems the E&P to “tier up” in connection with the disposition to the extent of any gain recognized. Under this approach, basis that arose under section 961(c) (“961(c) Basis”) would only be taken into account in measuring subpart F income of a US Shareholder (not in measuring the gain for E&P purposes), but an appropriate portion of the PTI at the lower tier CFC (equal to the additional E&P arising from ignoring 961(c) Basis for other purposes) would “tier up” to the upper tier CFC.
2. We recommend that in tax-free contribution and distribution transactions otherwise requiring “carry over” of basis that arose under section 961(a) (“961(a) Basis”) or of 961(c) Basis, between upper tier and lower tier CFCs, that 961(a) Basis be converted into 961(c) Basis in contribution situations and vice versa when lower tier CFC shares become upper tier CFC shares.
3. The Proposed Regulations require a “pro rata” allocation of basis that arose under section 961 (“961 Basis”) among the shares of a CFC (or the units of other property through which a CFC is held) but do not provide explicit rules for how to make these allocations. Moreover, they are silent as to how PTI is allocated to specific shares. We recommend that PTI and related basis adjustments be allocated in a consistent manner. Since the regulations under section 1248 already contain a full-fledged set of rules for allocation of non-PTI to shares or blocks of shares and since we do not see a policy reason compelling a different allocation methodology for PTI and non-PTI to shares, we further recommend, in the interest of consistency and efficiency, that the allocation of PTI and basis under sections 959 and 961 follow the principles for allocation of non-PTI applicable to complex cases under section 1248.

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4. The Proposed Regulations contain detailed rules on sharing of PTI among shares (or blocks of shares) owned by a single taxpayer or by members of the same consolidated group. We support inter-share “sharing” of PTI attributes of a particular US Shareholder among different shares, blocks and classes of shares directly owned by such person.
5. We believe further that strong arguments can be made in favor of, and we generally support permitting, sharing of PTI attributes within a consolidated group. Consideration should be given, however, to including the sharing rules for PTI attributes of consolidated return members in a separate regulation under section 1502 rather than including those rules in final regulations under sections 959 and 961.
6. It is unclear whether the Proposed Regulations intend to permit a US Shareholder to share PTI attributes in shares it is deemed to own in a CFC under section 958(a), but actually owns indirectly, with other directly owned shares in the CFC and vice versa. We believe the Internal Revenue Service and Treasury should clarify whether sharing will be permitted in this situation. The Report does not make a recommendation on this point.

We appreciate your consideration of our recommendations.

Respectfully submitted,

David R. Sicular
Chair

Attachment

CCs:
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