

August 10, 2022

Report on the Application of Section 382 to Foreign Corporations New York State Bar Association Tax Section – Under 10

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Application of Section 382 to CFCs

AGENDA

- ▶ Overview of Relevant Law
- ▶ Summary of Recommendations
- ▶ Highlights of Certain Recommendations
- ▶ Tying Together: Should Section 382 Apply to CFCs?

Application of Section 382 to CFCs

OVERVIEW

- ▶ NYSBA Tax Section – Report on the Application of Section 382 to Foreign Corporations (Report No. 1457) (the “**Report**”):
 - Section 382 may seem to have little to do with foreign corporations, apart from a foreign corporation that has a loss-making U.S. branch.
 - However, in a world with GILTI, there may be opportunities for Inclusion Shareholders (as defined herein) to use attributes of a CFC to reduce its income tax.

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (LEGISLATIVE HISTORY)

► Legislative History

- Section 382 was originally enacted in 1954 to address abusive transfers of loss corporation stock.
 - Before that time, the primary weapon against loss trafficking was Section 269, which denies an NOL deduction or other tax benefit if control of a corporation is acquired and **the** principal purpose of such acquisition is evasion or avoidance of U.S. federal income tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy.
 - The IRS had a string of losses in establishing “**the** principal purpose” standard in litigation, particularly where courts found a business purpose for entering the transaction (see e.g., *Commodores Point Terminal Corp.*, 11 T.C. 411 (1948), *Alcorn Wholesale Co.*, 16 T.C. 75 (1951)).
- Section 382 provided the IRS a set of mechanical rules to supplement the subjective standards of Section 269.
 - The Tax Reform Act of 1986 changed Section 382 again where Congress clarified the primary purposes behind the provision:
 - To restrict the function of carryforwards as a device for transferring tax benefits (“**Anti-Trafficking Policy**”) and to preserve the integrity of the carryover provisions by using an averaging system (the “**Averaging Policy**”).
 - Prevent the loss corporation from obtaining a greater benefit from its losses attributable to the pre-change period than it would have obtained had the change not occurred (the “**Neutrality Principle**”).

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (MECHANICS)

- ▶ Section 382 limits the amount of income a loss corporation that has undergone an ownership change may offset using its pre-ownership change NOLs and certain other tax attributes.
 - The Section 382 limitation is generally the product of (1) the FMV of the corporation's stock at the time of the ownership change, **multiplied** by (2) the long-term tax-exempt rate (2.54% for August 2022).
 - Ex. OLC is valued at \$100 right before an ownership change. The annual Section 382 limitation will be \$2.54.
 - A “**loss corporation**” is a corporation entitled to use an NOL carryover (or, among other things, with a net unrealized built-in loss (“**NUBIL**”), or business interest expense carryforward under Section 163(j)).
 - The same definition of loss corporations applies to CFCs, however, CFCs are not entitled to attributes a U.S. corporation can use.

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (MECHANICS) (CONT'D)

- ▶ An “**ownership change**” occurs if, within a three-year testing period, the ownership of one or more 5% shareholders increases by more than 50 percentage points (over the lowest percentage ownership during the testing period).
 - Ex. SH owns 12% of the stock of LC and, two years later, increases her ownership to 62%. An ownership change has **not** occurred because SH increased her ownership by 50 percentage points during the testing period.
 - The increase is measured by comparing the lowest percentage ownership during the testing period.
 - Ex. In Y1, SH owns 60% of LC. In Y2, SH owns 25% of LC. In Y3, SH owns 55%. The shareholder’s percentage ownership is considered to have increased 30 percentage points (i.e., 55% - 25%).

- ▶ “**Owner shift**”: Transaction that causes a change in a 5% shareholder’s (direct or indirect) ownership in the loss corporation.
 - Only changes in ownership of 5% shareholders are taken into account in determining an ownership change.

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (MECHANICS) (CONT'D)

► 5% Shareholders

- A 5% shareholder generally includes:
 - An individual owning 5% (or more) of stock,
 - Public shareholders (i.e., group of direct shareholders each owning less than 5%),
 - Less than 5% owners of an entity that owns 5% (or more) of stock, or
 - Segregated groups (i.e., groups resulting from certain transaction events like mergers, redemptions, etc.).
- Each 5% shareholder's percentage is determined by reference to the value of the shares in the loss corporation.
- Transfers among the public group are disregarded in determining if there was an ownership change.

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (MECHANICS) (CONT'D)

► Built-in-gains/losses at the time of the ownership change

- If a loss corporation has a NUBIL (i.e., basis > FMV), and, within 5 years of the ownership change (or recognition period), sells an asset with a built-in-loss at the time of the ownership change, the loss recognized (to the extent it does not exceed the loss at the time of the change, or “**RBIL**”) on the sale will be subject to the Section 382 limitation as if the RBIL was an NOL from a pre-change period.
 - Section 382(h)(2)(B) specifies that any depreciation, amortization, or depletion is treated as a RBIL to the extent attributable to a built-in loss at the time of the ownership change.
 - Ex. LC owns depreciable property that it received from OLC in OLC’s merger into LC. The depreciable property’s value was \$80 and basis was \$120. Therefore, the \$40 of built-in-loss is subject to the Section 382 limitation.
- Alternatively, if a loss corporation has a NUBIG (i.e., FMV > basis), then the loss corporation can utilize its pre-change NOLs and other tax attributes to offset such gain when the loss corporation recognizes such gain (or “**RBIG**”).
- If a NUBIG or NUBIL is below a de minimis amount, the NUBIG or NUBIL is \$0.

Application of Section 382 to CFCs

BACKGROUND: SECTION 382 (CFC GUIDANCE)

▶ Section 382 guidance on CFCs:

- In the case of a foreign corporation, Section 382(e)(3) provides that “[e]xcept as otherwise provided in regulations, in determining the value of any old loss corporation which is a foreign corporation, there shall be taken into account only items treated as connected with the conduct of a trade or business in the United States.”
 - This rule appears designed to ensure the Section 382 limitation is calculated by reference to only the assets and liabilities of the foreign corporation’s U.S. branch.
 - The rule also does not explicitly address what happens to the residual non-ECI portion.
- Legislative history
 - “The bill also clarifies that if the old loss corporation is a foreign corporation, except as provided in the regulations its value shall be determined taking into account only assets and liabilities treated as connected with the conduct of a trade or business in the United States.”
 - There is no other explanation and Treasury has not issued regulations under Section 382(e)(3).

Application of Section 382 to CFCs

BACKGROUND: TAXATION OF FOREIGN CORPORATIONS

► Taxation of CFCs not engaged in a trade or business

- CFCs are generally not taxed directly.
- 10% United States shareholders that directly or indirectly own CFCs (“**Inclusion Shareholders**”) include, if it holds CFC stock on the last day of the CFC’s tax year on which it is a CFC, the following:
 - Its pro rata share of Subpart F income for the year, and
 - Its GILTI inclusions (i.e., net CFC tested income **less** “net deemed tangible income return”).
 - Net CFC tested income: Aggregate pro rata shares of CFC tested income minus aggregate pro rata shares of CFC tested loss.
 - The net deemed tangible income return is 10% of such shareholder’s aggregate pro rata shares of CFC tangible depreciable asset basis (“**QBAI**”) **less** certain interest expense.
 - A U.S. corporation, under Section 250, is entitled to deduct 50% of its GILTI inclusion, subject to limitations.
 - Tax rate is currently 10.5% (ignoring non-U.S. taxes); and the deduction is reduced from 50% to 27.5% in 2026 (i.e., 15.225% tax rate).
- CFCs have no NOLs except to the extent it arises in the conduct of a U.S. trade or business (see 1.367(b)-3(e), Rev. Rul. 72-421).
- Inclusion Shareholders cannot carryover tested losses to future years (see 1.951A-2(c)(1), 1.952-2(c)(5)).
- Business interest expense under Section 163(j) can be carried forward (see 1.163(j)-7(b)).
 - Regulations also permit an election to be made for group CFCs to have a combined limitation.

Application of Section 382 to CFCs

SUMMARY OF RECOMMENDATIONS

► Recommendations from the Report

- **Owner shifts of a CFC should be recognized to the extent an Inclusion Shareholder increases its ownership percentage.**
- **An owner shift of a CFC should include acquisitions of its Inclusion Shareholder(s)** (i.e., no special rule preventing an owner shift where the Inclusion Shareholder owns 100% of the CFC before and after).
- The ownership percentage point threshold should remain at 50 percentage points.
- **Individual Inclusion Shareholders and corporate Inclusion Shareholders should be treated similarly.**
- **Subsequent transfers within 5 years of an original transaction by a non-Inclusion Shareholder to an Inclusion Shareholder should be taken into account as an owner shift** (even if such transfer would not be an owner shift under normal Section 382 rules).
 - NUBIG would be measured at the beginning of the RBIG/RBIL recognition period and the owner shift would occur at the time of the subsequent transfer.
- Owner shifts during the testing period of a non-CFC that subsequently becomes a CFC should be taken into account in determining whether there was an ownership change of a CFC.
- **Treasury should issue regulations under Section 382(m) permitting a CFC to carryforward disallowed RBILs** (even if unrelated to a U.S. trade or business).
- **Treasury should issue regulations under Section 382(e)(3) permitting a CFC to include the value of non-ECI items.**

Application of Section 382 to CFCs

SUMMARY OF RECOMMENDATIONS (CONT'D)

► Recommendations from the Report

- **Treasury should adopt an aggregate approach under which a Section 382 limitation would be determined and allocated between GILTI and Subpart F income**, rather than a segregated approach under which a separate Section 382 limitation would be determined for GILTI and Subpart F assets.
- **Section 382 should not apply to tax attributes other than interest carryforwards, built-in-losses, and the pre-change portion of current year losses.**
- The current framework for treating “controlled groups” should continue and, if there is an ownership change of a corporate Inclusion Shareholder, taxpayers should be able to elect which entity (corporate Inclusion Shareholder or the CFC) benefits from the value of the CFC stock in calculating the Section 382 limitation under Treasury Regulations Section 1.382-8.
- Section 382 should apply directly to the CFC, as opposed to the CFC’s attributes being considered attributes of a corporate Inclusion Shareholder.
- **When stock of multiple CFCs is acquired from a single seller, the Section 382 limitation (and NUBIG/NUBIL) should be calculated on an aggregate basis by referencing a “CFC Group”** (i.e., CFCs acquired from a single seller where 80% vote and value of each CFC is owned by the acquiror after the acquisition).
- **While an imperfect system, Section 382 should apply in the CFC context.**
 - SRLY and Section 384 would not adequately protect loss trafficking.

Application of Section 382 to CFCs

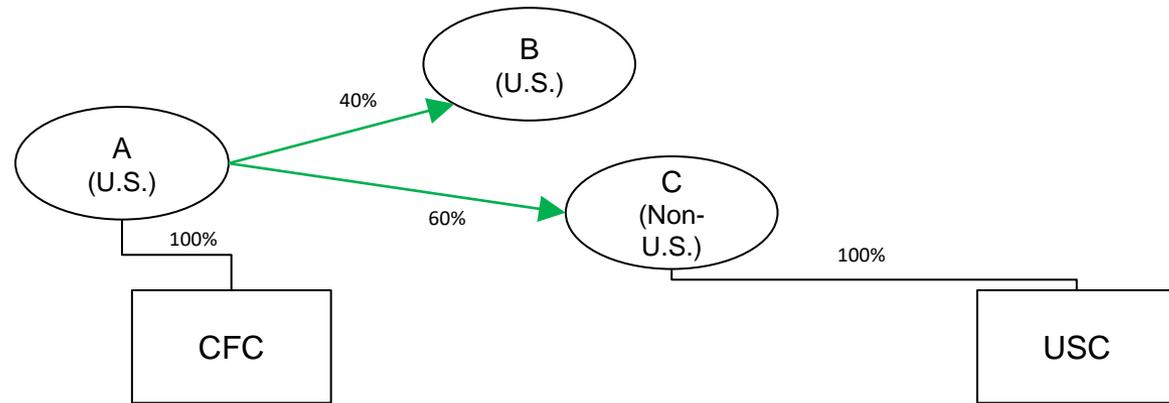
HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS

- ▶ **Should owner shifts be limited to Inclusion Shareholders or, as in the domestic context, track all owner shifts?**
 - A CFC's taxable income is only included by an Inclusion Shareholder and generally only an Inclusion Shareholder can benefit from a CFC's tax attributes.
 - If a CFC is not owned by Inclusion Shareholders, then its attributes cannot be used to offset U.S. income (and thus none of the Section 382 policies are implicated).
 - Rules should be aimed at circumstances where abuses are most likely to occur, be objective, and protect the policies of Section 382 without causing undue burden to taxpayers.
 - The Report generally recommended to consider owner shifts of a CFC only to the extent an Inclusion Shareholder (i.e., individual or a public group that indirectly owns the CFC through ownership of an Inclusion Shareholder) increases its ownership percentage of CFC stock.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS

- ▶ Example 1: A (U.S. person) sells 40% of CFC, a non-U.S. corporation, to B (U.S. person) and 60% to C (non-U.S. person).



- B could benefit from acquiring CFC's attributes, so its acquisition would be recognized as an owner shift.
- C cannot use any of CFC's attributes, so its acquisition of CFC should not be recognized as an owner shift.

Application of Section 382 to CFCs

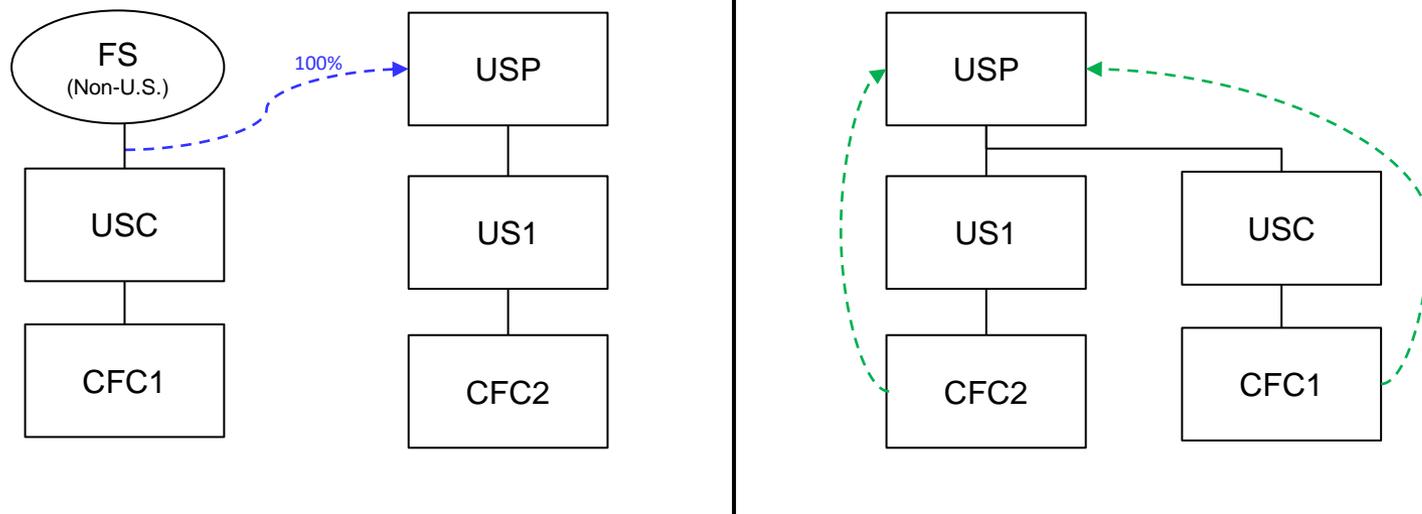
HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS (CONT'D)

- ▶ **Should indirect acquisitions of CFC stock through an Inclusion Shareholder be recognized as an owner shift?**
 - Owner shifts are changes in ownership affecting the percentage of stock owned by any 5% shareholder.
 - If only owner shifts by Inclusion Shareholders are taken into account (per the prior recommendation), what happens when stock of the Inclusion Shareholder is acquired?
 - Historic relationship is retained.
 - Although, as illustrated in Example 2, the Anti-Trafficking Policy could be implicated.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS (CONT'D)

- ▶ Example 2: FS (non-U.S. person) owns 100% of USC, a U.S. corporation, which owns 100% of CFC1. FS sells 100% of USC to USP (U.S. person/parent of consolidated group).



- When USC joins USP's consolidated group, the attributes of CFC1 can be used to offset items of CFC2 owned by USP's consolidated group (since GILTI is determined by aggregating items of CFCs owned by all members of the consolidated group).
- This implicates Section 382 policies because USP is benefitting from CFC1's pre-change tax attributes to offset income from the USP group's other CFCs.
- Therefore, the Report recommended taking into account indirect owner shifts.

Application of Section 382 to CFCs

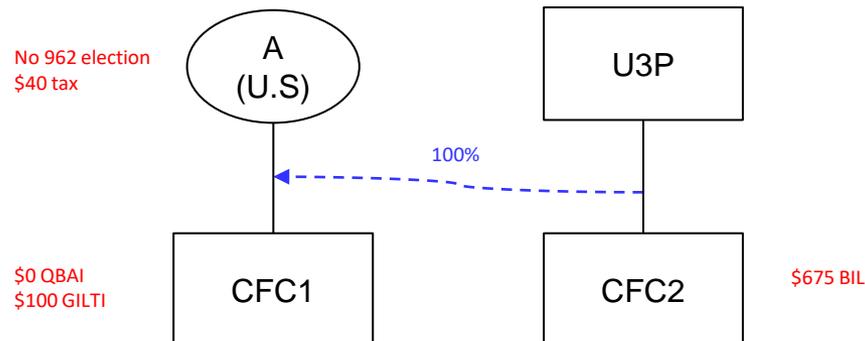
HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS (CONT'D)

- ▶ **If a CFC is acquired by an Inclusion Shareholder, should it make a difference if such shareholder is an individual or a U.S. corporation?**
 - Individuals are generally ineligible for (i) the Section 250 deduction under GILTI, (ii) the Section 245A deduction for the foreign-sourced portion of a dividend out of untaxed E&P, and (iii) deemed paid FTCs under Section 960(d).
 - While an individual can make an election under Section 962 to access the Section 960 FTCs and be taxed on Subpart F and GILTI inclusions like a U.S. corporation, there are limitations on these benefits (e.g., repatriation of earnings from CFCs to individuals only benefits from the PTEP regime to a limited extent).
 - Given these detriments, U.S. individuals that are already Inclusion Shareholders may be incentivized to acquire a CFC with favorable tax attributes.
 - Arguably, Section 382 is concerned with trafficking in attributes reducing corporate income tax returns.
 - While ownership changes are tested by referencing ownership by individuals, the actual tax returns impacted are those of the loss corporation.
 - If Section 382 only impacts corporate tax returns, an individual's GILTI should not be impacted.
 - However, the Report recommended recognizing owner shifts involving individual Inclusion Shareholders.
 - Complex – corporate Inclusion Shareholders, not individuals, are affected by a Section 382 limitation.
 - Recent guidance implies Section 382 can affect what is on an individual return (i.e., S corporation interest carryforwards are subject to Section 382).
 - Similar to consolidated parent acquiring a U.S. target.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS (CONT'D)

- ▶ Example 3: Individual A (U.S. person) owns 100% of CFC1, which has no QBAI and generates \$100 of tested income annually. A makes no Section 962 election and pays \$40 of tax annually. At the beginning of Y2, A acquires CFC2 from an unrelated seller for \$50. CFC2 has a built-in loss asset with a basis of \$675 that can be amortized over 15 years (i.e., \$45/year).



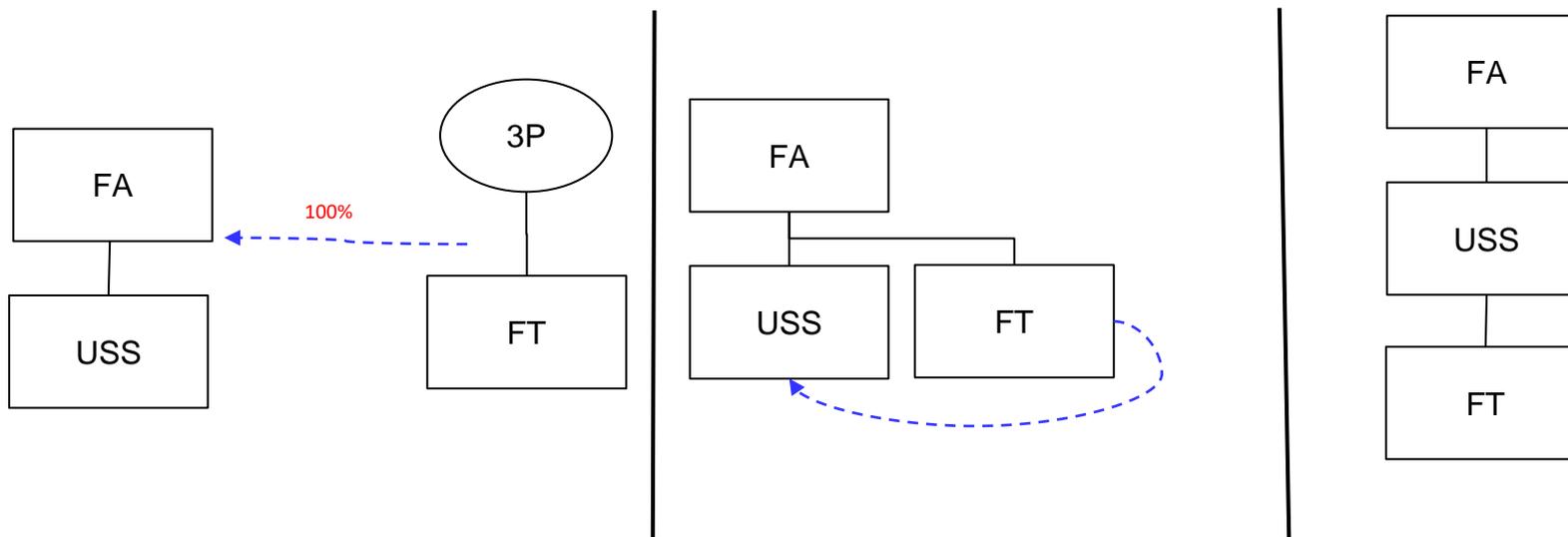
- If Section 382 did not apply, A could reduce its GILTI from \$100 to \$55 (an \$18 benefit/year) and recover its \$50 investment in under 3 years. This enhanced benefit suggests that Section 382 should take into account owner shifts by individuals that are Inclusion Shareholders.
- Therefore, the Report recommended recognizing owner shifts involving individual Inclusion Shareholders, and that a Section 382 ownership change should impact the individual's share of CFC items.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: RELEVANT OWNER SHIFTS AND MECHANICS (CONT'D)

► Are special rules needed where an acquired CFC is subsequently transferred to an Inclusion Shareholder?

- If only owner shifts increasing ownership by Inclusion Shareholders are recognized, taxpayers could abuse the rules through multiple transfers.
 - Ex. FA, a foreign corporation, owns 100% of USS, a U.S. corporation. FA acquires 100% of FT, a foreign loss corporation from an unrelated third party. Thereafter, FA contributes FT to USS.



– Absent an additional rule, there's no ownership change in this transaction. FA's acquisition of FT is not an owner shift because FA is not an Inclusion Shareholder. FA's transfer of FT to USS is not an owner shift because the ultimate beneficial owners remain the same (FA).

- Therefore, the Report recommended a rule that subsequent transfers to an Inclusion Shareholder should be a cognizable owner shift under Section 382 (even if there's no change in the ultimate beneficial owner).

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: APPLICATION TO DIFFERENT TYPES OF INCOME

► Should the disallowed portion of a CFC's RBIL be subject to a carryforward rule?

- For CFCs without a U.S. branch, RBILs are the primary attribute to which Section 382 could apply.
 - Under the GILTI regime, CFCs cannot carryforward tested losses or excess FTCs, so the use of carryforwards is limited to NOLs of a U.S. branch and qualified deficits with respect to Subpart F income.
- If CFCs could not carryforward the disallowed portion of an RBIL, it would result in a permanent disallowance wherever a CFC has a NUBIL and the RBIL cannot be allowed in the year of recognition.
- This is inconsistent with the purpose of Section 382, which is generally not to permanently disallow the use of a loss corporation's attributes, but to use those attributes over a longer period of time.
 - In the GILTI context, a tested loss becomes a shareholder-level attribute which can offset tested income realized from another CFC in such year.
 - By contrast, disallowed RBILs cannot be used in the taxable year in which recognized and would always expire absent a rule to the contrary.
- Allowing CFCs to carryforward RBILs would be similar to the rules permitting CFCs to carry forward their Section 163(j) excess business interest expense.
- Therefore, the Report recommended Treasury exercise its grant of regulatory authority under Section 382(m) to clarify that CFCs can carryforward all disallowed RBILs.
 - No Congressional legislation should be required because, under Section 382(h)(4), disallowed RBILs can be carried forward “under rules **similar to** the rules for the carrying forward of net operating losses.”

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: APPLICATION TO DIFFERENT TYPES OF INCOME (CONT'D)

► How should the equity value of a foreign loss corporation be calculated?

- A loss corporation that undergoes an ownership change must generally calculate its Section 382 limitation for a post-change year according to the formula in Section 382(b)(1) (i.e., the old loss corporation value * long-term tax-exempt rate).
- However, under Section 382(e)(3), an old loss corporation that is a foreign corporation only takes into account items connected with a U.S. trade or business to determine equity value.
 - In the GILTI/Subpart F context, this could lead to nonsensical results (e.g., CFCs not engaged in a U.S. trade or business will always have a Section 382 limitation of \$0).
- Section 382(e)(3) provides the Secretary with a grant of regulatory authority to issue regulations permitting foreign corporations to include other items in determining equity value.
 - Although no regulations have been issued to date, many taxpayers take the position a CFC may include the value of foreign items because, under Treasury Regulations Section 1.952-2(a), a CFC's gross income is determined as if a CFC were a U.S. corporation.
- Therefore, the Report recommended Treasury issue regulations under Section 382(e)(3) permitting a CFC to include the value of non-ECI items.
 - A CFC's U.S. branch would be segregated from its foreign operations.
 - Separate equity values would be computed for each as if they were held by distinct corporations.

Application of Section 382 to CFCs

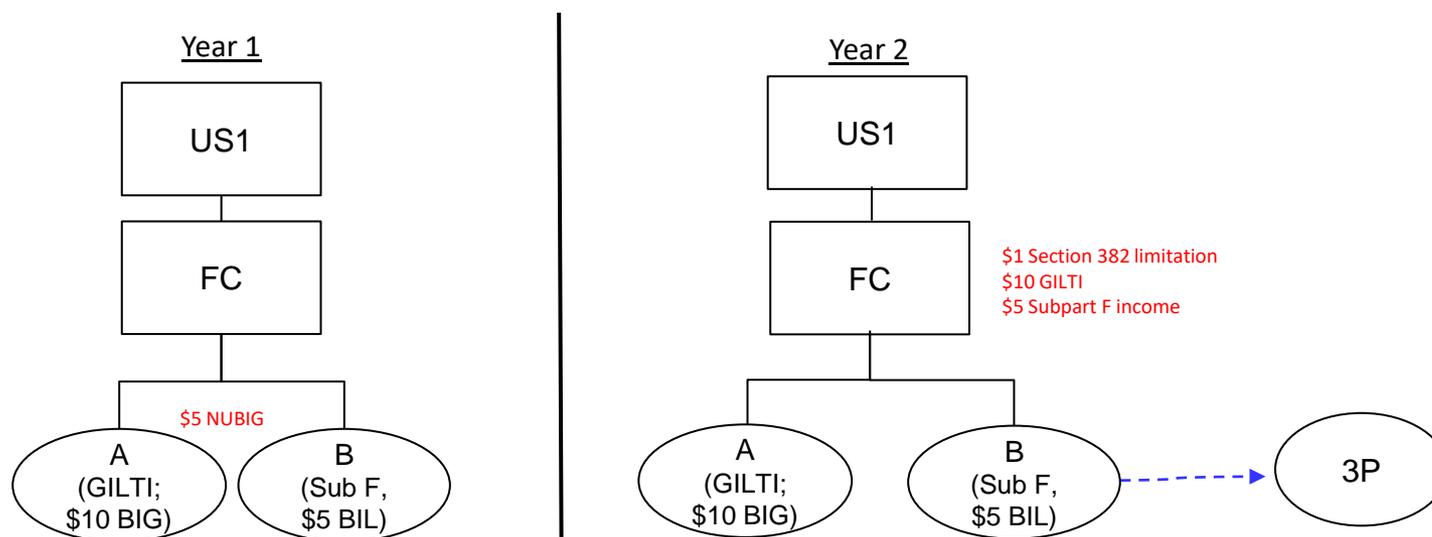
HIGHLIGHT OF RECOMMENDATIONS: APPLICATION TO DIFFERENT TYPES OF INCOME (CONT'D)

- ▶ **Should CFCs earning different categories of income (e.g., Subpart F, GILTI) calculate a single Section 382 limitation and an aggregate NUBIG/NUBIL?**
 - U.S. corporations pay a tax at a single 21% rate, whereas Inclusion Shareholders are subject to tax at varying rates (i.e., 10.5%, 21%, or 37% for individuals).
 - Therefore, the manner in which the Section 382 limitation is allocated against different types of income could have a material impact.
 - Commentators proposed two alternative approaches:
 - *Aggregated Approach*: Calculate a single Section 382 limitation, equity value and NUBIG/NUBIL amounts and then apply existing allocation and apportionment rules with respect to its U.S. branch and foreign operations.
 - *Segregated Approach*: Calculate a separate Section 382 limitation, equity value, and NUBIG/NUBIL amounts for different categories of income.
 - The Report recommended adopting the Aggregated Approach, as the Segregated Approach would be difficult to administer.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: APPLICATION TO DIFFERENT TYPES OF INCOME (CONT'D)

- ▶ Example 4A: FC, a foreign corporation with no U.S. branch, has a single inclusion shareholder, US1, that owns 100% of its stock. In Y1, FC undergoes an ownership change at which time it owns (1) Asset A, which generates GILTI and has a \$10 BIG, and (2) Asset B, which earns foreign base company sales income and has a \$5 BIL. FC has a \$1 Section 382 limitation. In Y2, FC has \$10 of tested income, \$5 of Subpart F income and then sells Asset B (recognizing the \$5 pre-change BIL).

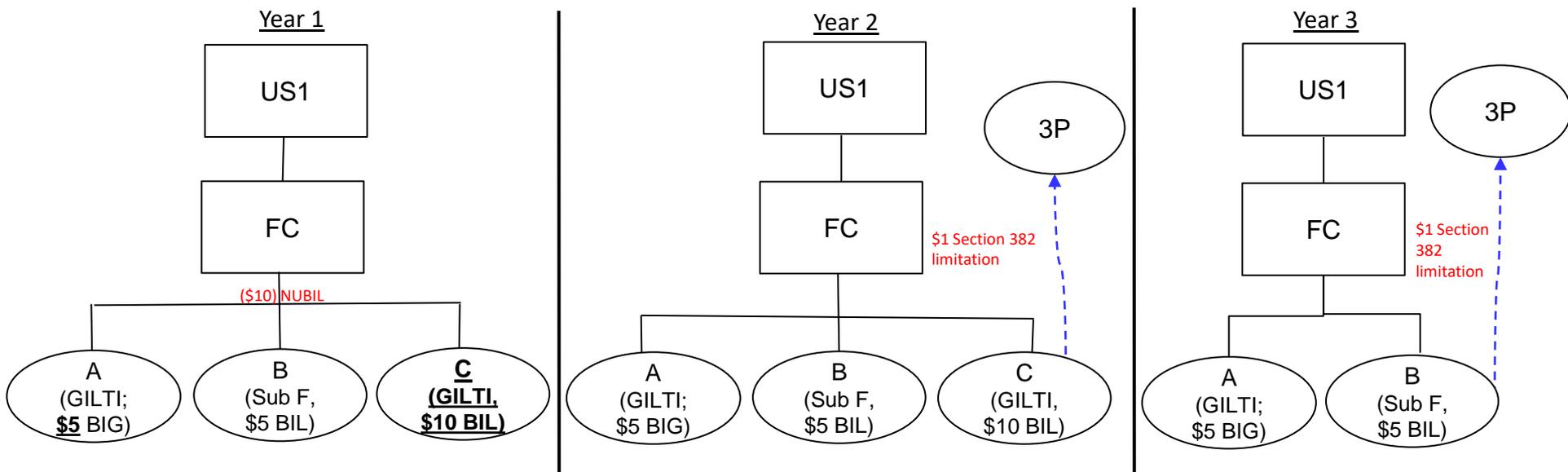


- **Aggregated Approach:** FC has a \$5 NUBIG at the time of the ownership change, so utilizing the \$5 BIL is not subject to the \$1 limitation. Therefore, US1 has \$10 of tested income and \$0 Subpart F income (i.e., \$5 - \$5) with respect to FC.
- **Segregated Approach:** FC would have separate Section 382 limitations and NUBIG/NUBIL amounts with respect to GILTI and Subpart F income and, in Y2, the sale of Asset B would be a \$5 RBIL whose use is subject to FC's Section 382 limitation of \$1.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: APPLICATION TO DIFFERENT TYPES OF INCOME (CONT'D)

- ▶ Example 4B: Same as Example 4A, except that (i) Asset A has a \$5 BIG and (ii) FC owns Asset C which generates GILTI and has a \$10 BIL. In Y2, FC sells Asset C and recognizes the \$10 pre-change BIL. In Y3, FC sells Asset B, recognizing the \$5 pre-change BIL.



- **Aggregated Approach:** FC has a NUBIL of \$10 at the time of the ownership change, so the \$10 RBIL in Y2 is subject to the \$1 Section 382 limitation (and, if NYSBA's recommendation is adopted, would be carried forward). However, Asset C has fully absorbed FC's NUBIL, so when FC sells Asset B in Y3, it can fully utilize the \$5 loss.
 - Risk is taxpayers elect to soak up RBILs with cheap losses (GILTI) freeing up more valuable losses (Subpart F).
- **Segregated Approach:** FC would have separate Section 382 limitations and NUBIG/NUBIL amounts with respect to GILTI and Subpart F income and, in Y3, the sale of Asset B would be an RBIL whose use is subject to FC's Section 382 limitation of \$1.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: OTHER RELEVANT CFC ATTRIBUTES

► To which attributes of a CFC should Section 382 apply?

- CFC attributes include interest carryforwards, built-in-losses, QBAI, FTCs, and the pre-change portion of current year losses.
 - QBAI
 - Not a loss, deduction or credit that should be considered a “pre-change loss,” but rather is a category of income (i.e., a deemed tangible income return) that Congress determined should not be subject to GILTI.
 - Incongruous to impose the Section 382 limitation, which is determined by reference to enterprise value, to QBAI, which is determined by reference to the tax basis of the corporation’s tangible assets.
 - FTCs
 - Subject to numerous and complex limitations on use that are determined at the shareholder level (e.g., excess FTCs in the GILTI basket cannot be carried forward, Section 383, Section 904).
 - Less justification after repeal of the deemed-paid credits under Section 902.
- Therefore, the Report recommended that, to avoid duplicative and conflicting FTC limitations, Section 382 should be limited to interest carryforwards, built-in-losses, and the pre-change portion of current year losses (in the case of mid-year acquisitions of a corporate Inclusion Shareholder).

Application of Section 382 to CFCs

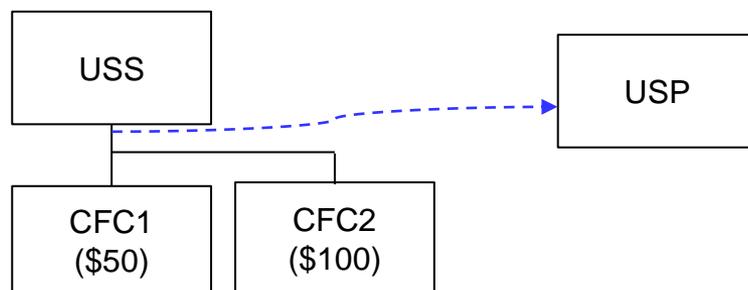
HIGHLIGHT OF RECOMMENDATIONS: CFC GROUPS

- ▶ **If a U.S. person acquires multiple CFCs from a single seller, should the CFCs have an aggregate Section 382 limitation and NUBIG/NUBIL?**
 - Except for consolidated groups, the Section 382 limitation is generally calculated on a separate company basis.
 - In the consolidated context, it is consistent with the Neutrality Principle to permit corporations to continue sharing losses following an ownership change if they were able to beforehand.
 - GILTI is calculated on an aggregate basis with respect to all CFCs owned by an Inclusion Shareholder and the Section 163(j) limitation may, by election, be determined with respect to ATI/BIE of a CFC group.
 - Applying a grouping principle also reduces the incentive to engage in related party transactions to move income to the right entity.

Application of Section 382 to CFCs

HIGHLIGHT OF RECOMMENDATIONS: CFC GROUPS (CONT'D)

- ▶ Example 5: USS owns 100% of CFC1 and CFC2, each of which has a NUBIL the deductions from which would be allocated to GILTI. The value of CFC1 is \$50 and the value of CFC2 is \$100. The applicable long-term tax-exempt rate is 2%. USS sells 100% of CFC 1 and CFC2 to USP, an unrelated U.S. corporation.



- Assuming Section 382 applies, CFC1's standalone limitation is \$1 and CFC2's standalone limitation is \$2. If CFC1 and CFC2 were treated as a group, the aggregate Section 382 limitation would be \$3.
- Reduces related party games
 - If CFC1's Section 382 limitation was exhausted for the year, but CFC2 had remaining limitations, USP would be incentivized to cause CFC1 to make a deductible (non-RBIL) payment to CFC2.
 - CFC1 would deduct the payment, reduce its tested income, and CFC2 would include the item but offset it with its remaining pre-change loss.
- ▶ Therefore, the Report recommended permitting an aggregate calculation.

Application of Section 382 to CFCs

FINALE: SHOULD SECTION 382 APPLY TO CFCs?

► Policy considerations: **is the complexity of these rules worth the benefit?**

■ Concerns:

- The IRS has a legitimate interest in policing loss trafficking transactions.
- NUBILs are not subject to limitation under any rules.
 - Acquiring foreign loss corporations with substantial built-in losses solely to offset the acquiror's GILTI / Subpart F inclusions.
- Mid-year acquisitions – acquiror can benefit from the current year tested loss of the corporate Inclusion Shareholder.

■ Countervailing considerations:

- Subpart F is an anti-abuse regime targeting only limited mobile or passive income.
- GILTI inclusions are subject to a lower tax rate (10.5%).
- Tested losses cannot be carried forward (thus eliminating the abuse Section 382 was aimed at).
- Section 338(g) -- which can be used to increase QBAI, convert Subpart F income into GILTI, eliminate unfavorable attributes, and avoid administrative hassles of computing attributes -- often makes the loss limitation regime inapplicable to a foreign target.
- Tested loss is reduced for the portion of a year a buyer did not own the CFC (compare Inclusion Shareholder).
- Interest carryforwards are already subject to a SRLY regime (i.e., CFCs joining a group can only benefit to the extent it contributes to the group).
- Inclusion Shareholders with large FTCs aren't incentivized to offset tested income of its existing CFCs.

Application of Section 382 to CFCs

FINALE: SHOULD SECTION 382 APPLY TO CFCs? (CONT'D)

► The Report's recommendation:

- There should be some form of limitation on the use of CFC attributes.
- Absent Congressional legislation, Section 382 is an existing system that literally applies and polices the type of loss trafficking that can occur in the context of a CFC acquisition.
- Other regimes have flaws as well.