NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 PH 518.463.3200 www.nysba.org

Report No. 1479
June 30, 2023

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Daniel I. Werfel
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William M. Paul
Principal Deputy Chief Counsel
and Deputy Chief Counsel
(Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

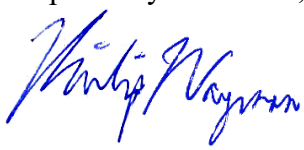
Re: Report No. 1479 - Report on Proposed Section 367(d) Regulations Concerning Repatriation of Intangible Property

Dear Ms. Batchelder and Messrs. Werfel and Paul:

I am pleased to submit Report No. 1479 of the Tax Section of the New York State Bar Association, which discusses regulations proposed under Section 367(d) of the Internal Revenue Code concerning repatriation of intangible property.

We appreciate your consideration of our Report. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

Respectfully submitted,



Philip Wagman
Chair

Enclosure

Cc:

Michael Plowgian
Deputy Assistant Secretary for International Tax Affairs
Department of the Treasury

Lindsay M. Kitzinger
International Tax Counsel
Department of the Treasury

Brenda Zent
Special Adviser
Department of the Treasury (Office of the International Tax Counsel)

Peter H. Blessing
Associate Chief Counsel (International)
Internal Revenue Service

Daniel M. McCall
Deputy Associate Chief Counsel (International)
Internal Revenue Service

John Merrick
Senior Level Counsel, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Laura Williams
Branch Chief, Office of the Associate Chief Counsel (International)
Internal Revenue Service

L. Ulysses Chatman
Senior Counsel, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Megan Hickman
Special Counsel, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Chadwick Rowland
Tax Attorney, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Robert B. Williams, Jr.
Senior Counsel, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Report No. 1479

New York State Bar Association Tax Section

Report on Proposed Section 367(d) Regulations Concerning Repatriation of Intangible Property

June 30, 2023

TABLE OF CONTENTS

Page

Report on Proposed Section 367(d) Regulations Concerning Repatriation of Intangible Property

The New York State Bar Association Tax Section is submitting this report (the "**Report**")[1] to address certain matters related to the proposed regulations issued under Sections 367(d) and 904(d) of the Internal Revenue Code of 1986, as amended (the "**Code**") that were published on May 3, 2023 (the "**Proposed Regulations**"). Broadly speaking these proposed rules would establish a framework for determining the circumstances in which – due to a repatriation of intangible property to the United States – it is appropriate to "turn off" deemed income inclusions that would otherwise be required under Section 367(d) with respect to that IP, as well as providing for a series of correlative inclusions and adjustments to properly account for the termination of the Section 367(d) deemed transactions. The Proposed Regulations would also clarify the extent to which the principles of Section 367(d) apply for purposes of Section 904(d).

The Proposed Regulations represent a significant step forward in removing technical impediments that may otherwise deter taxpayers from repatriating IP to the United States,[2] and we commend the Department of the Treasury ("**Treasury**" including as applicable the Internal Revenue Service (the "**IRS**")) for advancing this project. Moreover, we recognize that establishing a comprehensive regulatory framework for terminating the application of Section 367(d) is a complex endeavor that intersects with many difficult and longstanding issues related to the basic operation of Section 367(d). Against this backdrop, we applaud Treasury for making the administrative decision to release a regulatory package that addresses the simpler and more straight-forward IP repatriation scenarios (rather than deferring the release of this guidance until all the more difficult, and potentially more controversial scenarios, had been addressed by proposed regulations). We believe this approach is sound and will help to facilitate prompt adoption of useful guidance in many of the most common scenarios in which U.S. taxpayers are currently considering the repatriation of IP.

In this Report we provide comments that fall into two broad categories. First, we offer certain recommendations for modifying the Proposed Regulations in order to enhance their ability to achieve the intended goal of promoting IP repatriation to the United States. In making these recommendations, we have weighed the complexity and administrability of each proposal against the goal of prompt finalization of this guidance. In our view, the benefits of these recommendations outweigh concerns that they would delay finalization of the regulations. The

---

[1] The principal authors of this Report were Paul Seraganian and Michael Mollerus. Helpful comments were received from Robert Cassanos, Peter Connors, David Hardy, Stephen Land, Steven Massed, Richard Nugent, Arvind Ravichandran, Gary Scanlon, Michael Schler, Wade Sutton and Philip Wagman. This Report reflects solely the views of the Tax Section of the New York State Bar Association ("**NYSBA**") and not those of NYSBA's Executive Committee or its House of Delegates.

[2] Promoting the ownership of intellectual property in the United States was one of the stated goals of the Tax Cuts and Jobs Act, Pub. L. 115-97. *See, e.g.*, Committee Print, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Prt. 115-20 (December 2017), p. 375 ("The location of intangible income in [non-U.S.] jurisdictions may require, or be facilitated by, the location of valuable economic activity in those jurisdictions. One of the Committee's goals in tax reform is to remove the tax incentive to locate intangible income abroad and encourage U.S. taxpayers to locate intangible income, and potentially valuable economic activity, in the United States.").
.

second category of comments relate to areas in which the Section 367(d) rules may, even if the Proposed Regulations are adopted, continue to impede or frustrate IP repatriation. In many cases these residual points of friction are rooted in deeper unresolved Section 367(d) issues that have lingered for several decades. While we do not purport to address those long-standing concerns comprehensively in this Report, we do offer some initial views on how those matters may be addressed in subsequent regulatory guidance.

I. Summary of Principal Recommendations

We recommend that Treasury consider the following in light of our discussion below.[3]

1. Expand the definition of QDP to include certain partnerships in cases where either (i) all of the partners in the partnership are QDPs, or (ii) the partnership is the same entity that made the original outbound transfer of the IP and there is substantial continuity of QDP ownership of the partnership during the period beginning with the outbound transfer and ending on repatriation of the IP.

    a. A partnership that meets one of these tests at the time IP is repatriated nevertheless would not be treated as a QDP, if there is an increase in the ownership of partnership capital or profits by (or an addition to the partnership agreement of special allocations of IP-related income to) a non-QDP partner which occurs within a specified time period after the IP repatriation, or which occurs pursuant to a series of related transactions that includes the repatriation.

    b. However, if requested by a taxpayer, the Commissioner should be entitled to exercise discretion to determine that a post-repatriation alteration to a partnership's ownership or allocations of the type just described does not produce inappropriate results and does not prevent the partnership from being treated as a QDP.

2. Clarify whether, in a case where a domestic partnership that is treated as a Successor UST under the current Section 367(d) regulations receives a repatriating transfer of IP, the requirement for the partnership to include amounts under Section 367(d) is terminated in accordance with authorities applying "extinguishment" principles in analogous situations.

3. In future guidance under Section 367(d), consider providing that taxable gain recognized in connection with an inbound repatriation of IP to a partnership that is allocable to QDP partners of that partnership may be credited against any remaining Section 367(d) inclusions for the UST.

4. Expand the definition of QDP to include S corporations.

5. Clarify that "allowable deductions" contemplated in Prop. Reg. Section 1.367(d)-1(c)(2)(ii) are not limited only to the classes of income enumerated in that

[3] Capitalized terms used in Part I have the definitions stated in Part II.

provision and, instead, such deductions are generally available (including to U.S. taxpayers).

6. In future guidance under Section 367(d), consider providing guidance addressing the possible reduction in the adjusted tax basis of repatriated IP in the hands of a QDP, which can occur in circumstances where there has been an unrelated prior taxable transfer of the IP by a TFC to a related person, or where a TFC has incurred costs with respect to the IP that have been capitalized under Section 263(a).

7. Provide that, in a situation where IP is ultimately repatriated to a QDP pursuant to a series of related transactions that includes one or more taxable transfers of the IP by a TFC to another TFC before the final repatriation of the IP to the QDP, (i) on the repatriation of the IP to the QDP, the gain required to be recognized by the U.S. transferor and the QDP's adjusted basis in the IP will be determined under the rules that apply to IP that is not transferred basis property, even if the IP would otherwise constitute transferred basis property to the QDP, and (ii) the rule reducing a TFC's gross income and earnings and profits will apply to the TFC(s) that recognize income or gain in the prior taxable transfers.

8. Finalize the Proposed Regulations without inclusion of Prop. Reg. Section 1.904-4(f)(2)(vi)(D)(4). Instead, Treasury should take further time to consider whether it is possible to achieve greater harmonization between the manner in which Section 367(d) principles apply in the branch context and the way they apply in the corporate context. If Treasury determines it is desirable to do so, it could adopt this rule on a temporary basis pending such additional consideration.

9. Clarify certain aspects of the relief provisions in the Proposed Regulations as well as the analysis in one of the examples.

II. Background

A. Section 367(d) of the Code

Section 367(d) was enacted, in its modern form, as part of the Tax Reform Act of 1984. Broadly speaking, Section 367(d) applies when a U.S. person transfers intangible property[4] ("**IP**")[5] to a foreign corporation in a Section 351 or Section 361 non-recognition transfer. For outbound transfers within this scope, Section 367(d) treats the U.S. transferor ("**UST**") as

[4] Section 367(d)(4) defines intangible property to mean any (A) patent, invention, formula, process, design, pattern or know-how, (B) copyright, literary, musical, or artistic composition, (C) trademark, trade name, or brand name, (D) franchise, license, or contract, (E) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data, (F) goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment), or (G) other item the value or potential value of which is not attributable to tangible property or the services of any individual.

[5] Except to the extent otherwise noted in this Report, references to IP are references to IP that has been transferred in an outbound Section 351 or Section 361 transfer to which Section 367(d) applies.

i. having sold the IP to the transferee foreign corporation ("**TFC**") in exchange for payments which are contingent upon the productivity, use or disposition of such property, and

ii. receiving amounts which reasonably reflect the amounts which would have been received (I) annually in the form of such payments over the useful life of such property, or (II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.[6]

The amounts taken into account by the UST are required to be "commensurate with the income" attributable to the expatriated IP.[7]

Section 367(d)(2)(B) provides that the earnings and profits ("**E&P**") of the TFC are reduced by the amount of the UST's deemed income inclusions under Section 367(d). Under Section 367(d)(2)(C), the gross income inclusions of the UST are treated as ordinary income and, for purposes of Section 904(d), the inclusions are treated as if they were royalties.

B. Existing Treasury Regulations under Section 367(d)

Current and temporary Treasury Regulations issued under Section 367(d) of the Code materially elaborate on the application of this regime. For example, Treas. Reg. Section 1.367(d)-1T(c) provides that the UST's deemed annual income inclusion under Section 367(d) over the useful life of the IP is required to be determined under Section 482 of the Code. Additionally, this regulation also establishes that, for purposes of Subpart F of the Code, the TFC may treat any deemed Section 367(d) payment as an expense (whether or not actually paid) that is properly allocable and apportioned to gross income subject to Subpart F.[8]

---

[6] Section 367(d)(2).

[7] Notice 2012-39, 2012-31 IRB 95 (July 13, 2012) provided guidance on how Section 367(d) would apply to outbound transfers of IP in a Section 361 exchange with boot. In particular, this notice was issued because the IRS became aware that certain taxpayers were seeking to leverage the Section 367(d) mechanics as a vehicle for tax efficient repatriation of earnings when combined with an outbound transfer of IP through a Section 361 exchange with boot. In the Notice, Treasury announced its intention to issue regulations that would essentially treat the boot in the outbound reorganization as a prepayment of the deemed annual Section 367(d) inclusions that the U.S. transferor is required to include in income (in full) as a Section 367(d) inclusion in the year of the outbound transfer. Certain shareholders of the U.S. transferor that are treated as "qualified successors" under the Notice are further required to include their proportionate share of the regular annual Section 367(d) inclusions that the U.S. transferor would have had to include had it not liquidated in connection with the outbound reorganization. However, to avoid duplication, the qualified successors are entitled to exclude these deemed annual Section 367(d) inclusions to the extent of their share of U.S. transferor's prepaid 367(d) inclusion. The rules announced in the Notice would apply to transfers occurring on or after July 13, 2012; however, they have not yet been implemented as final regulations.

[8] Treas. Reg. Section 1.367(d)-1T(c)(2)(ii). Treas. Reg. Section 1.951A-2(c)(2)(ii), effective as of June 21, 2019 (see T.D. 9866, 84 Fed. Reg. 29288 (June 21, 2019)), provides that deemed payments by a TFC under Section 367(d)(2)(A) are treated similarly for purposes of determining tested income or tested loss of controlled foreign corporation for GILTI purposes. The current temporary regulations limit the availability of this deemed TFC expense to subpart F income and tested income. See Treas. Reg. Section 1.367(d)-1T(c)(2) flush language which provides "[n]o other special adjustments to earnings the [sic] profits, basis, or gross income shall be permitted by reason of the recognition of a deemed payment under this paragraph (c)".

Of particular relevance to the topic of this Report, the regulations provide rules addressing the impact that subsequent direct or indirect transfers of the IP during the usual life of the IP have on the operation of Section 367(d). A brief overview of these rules is provided below.

1. UST transfers stock of TFC to an unrelated[9] person. If the UST transfers stock of TFC to an unrelated person, the UST is treated as having sold the IP to the unrelated acquiror of TFC stock. In this case, the UST is required to recognize gain (but not loss) in an amount equal to the difference between (x) the fair market value of the transferred IP on the date of the subsequent transfer, and (y) UST's former adjusted basis in the property, determined as of the date of the original outbound transfer.[10]

2. UST transfers stock of TFC to a related person. If the UST transfers stock of the TFC to a related *U.S. person* (referred to as a "**Successor UST**"), the related U.S. transferee essentially steps into the shoes of the UST and is required to include a proportionate share of the Section 367(d) inclusions that the UST would have been required to include in gross income over the remaining useful life of the IP.[11] If the UST transfers stock of the TFC to a related *non-U.S. person*, there is no impact on the operation of Section 367(d).

3. TFC transfers IP to an unrelated person. If the TFC transfers the IP to an unrelated person, the UST is required to recognize gain in an amount equal to the excess of (x) the fair market value of the IP on the subsequent transfer date, and (y) the UST's former adjusted basis in the IP, as determined on the date of the original expatriation transfer. After this gain recognition, the UST is not required to recognize any further deemed Section 367(d) inclusions.[12]

---

[9] Treas. Reg. Section 1.367(d)-1T(h) provides that persons are considered to be "related" if (1) they are partners or partnerships described in Section 707(b)(1) of the Code (effectively requiring a greater than 50 percent interest in capital or profits to establish relatedness), or (2) they are related within the meaning of Section 267(b), (c) and (f) of the Code (except that the "more than 50 percent" standard of those provisions is replaced with a "10 percent or more" standard for this purpose).

[10] *See generally* Treas. Reg. Section 1.367(d)-1T(d). Treas. Reg. Section 1.367(d)-1T(d)(2) provides for certain adjustments in connection with such transfers, including that the TFC's tax basis in the IP that was treated as sold is adjusted to equal to its fair market value. We note that, in circumstances in which the original outbound transfer by the UST is a transfer with boot (and, correspondingly, the UST is treated as having prepaid some portion of the Section 367(d) inclusions under the rules contemplated in Notice 2012-39, as described above in footnote 7), the deemed sale arising under this provision could result in double taxation of the same economic value if appropriate adjustments are not made. Accordingly, when Notice 2012-39 is incorporated into regulations, we recommend that this point be taken into account and addressed.

[11] *See generally* Treas. Reg. Section 1.367(d)-1T(e). After such a transfer, the Successor UST is treated as the original UST (to the extent of the proportionate amount of TFC stock transferred by the original UST to such transferee). Unless otherwise specified in this Report, references to a UST include any applicable Successor USTs. Treas. Reg. Section 1.367(d)-1T(e)(2) provides for certain adjustments in connection with these transfers.

[12] *See generally* Treas. Reg. Section 1.367(d)-1T(f)(1). In connection with a subsequent transfer of IP to an unrelated person, the UST is also required to recognize a final Section 367(d) inclusion for the portion of the year

4. TFC transfers IP to a related person. If the TFC transfers IP to a related person (whether U.S. or non-U.S.), the operation of Section 367(d) is generally not affected, except that for purposes of any required adjustments, the related transferee of the IP is treated as the TFC going forward.[13]

Importantly, as noted above, the rule addressing transfers by the TFC of the expatriated IP to related persons does not differentiate between transfers to related U.S. and non-U.S. persons. Among other things, this means that a repatriating transfer to a related U.S. person would not turn off the Section 367(d) inclusions, notwithstanding that the new U.S. owner of the IP would be required to include any earnings related to the exploitation of such IP in its gross income for U.S. federal income tax purposes (and may not be permitted to claim a deduction for the deemed payments made by it to UST pursuant to Treas. Reg. Section 1.367(d)-1T(c)(2)). The prospect of regular income taxation in the hands of the U.S. transferee and concurrent Section 367(d) inclusions for the UST has served as a practical deterrent for the repatriation of IP.

C. The Proposed Regulations under Section 367(d)

The preamble to the Proposed Regulations (the "**Preamble**") recognizes that the failure of the existing regulations to turn off Section 367(d) inclusions in the context of a repatriating transfer to a related U.S. person is a point of friction for taxpayers that are considering bringing IP back onshore to the United States. In particular, the Preamble observes that:

> there is a concern that, in certain cases, the section 367(d) regulations can inappropriately require the U.S. transferor to continue recognizing an annual section 367(d) inclusion even if the intangible property is transferred to a related U.S. person that is subject to U.S. taxation on income earned from the intangible property….In addition, the deemed (substituted) transferee foreign corporation is not allowed a deduction that could reduce taxable income, even though that deemed transferee foreign corporation is the U.S. transferor or a related U.S. person. Continuing to apply section 367(d) in such cases could give rise to excessive U.S. taxation and disincentivize taxpayers from repatriating that property.[14]

Although Treasury observes that, in certain relatively narrow circumstances, taxpayers may be able to pull other levers[15] to turn off the stream of Section 367(d) inclusions in connection with a

---

the IP was held by the TFC. Treas. Reg. Section 1.367(d)-1T(f)(2) provides for certain adjustments in connection with these transfers: (i) the E&P of the TFC is reduced by the amount of gain required to be recognized by the UST, and (ii) UST's recognition of gain permits the establishment of an equivalent account receivable from the TFC. We note that the potential double taxation concern referred to in footnote 10 (related to outbound transfers of IP that had resulted in a prepayment of Section 367(d) inclusions in accordance with Notice 2012-39) can also apply in this context.

[13] *See generally* Treas. Reg. Section 1.367(d)-1T(f)(3).

[14] REG-124064-19, 88 Fed. Reg. 27819, 27821 (May 3, 2023).

[15] The IRS has granted at least two private letter rulings to taxpayers seeking relief from this type of excessive taxation under Section 367(d). In PLR 201936004 (Sept. 6, 2019), the taxpayer repatriated IP that had previously been expatriated in a transaction that was subject to 367(d). In particular, during the useful life of the IP, the

repatriation of IP, it observes that there is a need to address the application of Section 367(d) to repatriation transactions "more broadly".

The Preamble recognizes that it is appropriate to turn off the application of Section 367(d) in circumstances where all the income produced by the IP, as well as gain from its disposition, "will be subject to current tax in the United States as to the qualified domestic person [broadly, UST or certain other U.S. persons, as discussed below] while that person holds the property".[16] Additionally, the Preamble observes that it is appropriate to terminate the application of Section 367(d) upon a repatriation to the UST because doing so "merely restores the circumstances that existed at the time of the original outbound transfer subject to section 367(d)".[17]

Based on this conceptual foundation, the Proposed Regulations terminate the application of deemed income inclusions under Section 367(d) only when the TFC repatriates the IP to a "qualified domestic person" ("**QDP**") and certain reporting requirements are met.[18] The Proposed Regulations define a QDP to be:

---

taxpayer repatriated the IP to a member of the same consolidated group that included the original UST. Due to the facts that, (a) the repatriation itself did not prematurely terminate the deemed income inclusions under Section 367(d) for the UST, and (b) the consolidated group member that received the IP in the repatriation transaction was not allowed a correlative deduction for income tax purposes (the IRS noted that, although Treas. Reg. 1.367(d)-1T(c)(2) allows the deemed "payor" of the Section 367(d) inclusion amount to reduce its E&P by the amount of the deemed inclusion, "the payor is allowed no other adjustments to its earnings and profits, basis, or gross income"), the consolidated group was at risk of excessive U.S. taxation. In this case, the IRS exercised it discretion under Treas. Reg. 1.1502-13(c)(6)(ii)(D) to treat the deemed Section 367(d) inclusion as excluded from gross income of the UST. The IRS provided a similar ruling in PLR 202107011 (Feb. 19, 2021).

Additionally, in circumstances where a TFC repatriates the IP to the UST that had originally expatriated that IP (or a successor UST), a taxpayer might reasonably take the position that any deemed contingent payments created under Section 367(d) must be extinguished. More particularly, where there is convergence of both the UST (deemed IP seller under the Section 367(d) fiction) and TFC (deemed IP purchaser under the Section 367(d) fiction) positions, the situation can be analogized to the scenario where a taxpayer acquires its own debt, causing the debt's extinguishment. *See, e.g.* Estate of Gilmore v. Commissioner, 40 B.T.A. 945 (1939) (distribution of a shareholder note by a liquidating corporation to its shareholder extinguished the note); Rev. Rul. 74-54, 1974-1 C.B. 76; (extinguishment of a parent corporation's note received in connection with the complete liquidation of its wholly-owned subsidiary); *see also* Rev. Rul. 72-464, 1972-2 C.B. 214 (extinguishment of debt between two parties as a result of a Section 368(a)(1)(A) reorganization).

[16] 88 Fed. Reg. at 27824.

[17] *Id*.

[18] In particular, under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B), the UST is required to provide information described in Prop. Reg. Section 1.6038B-1(d)(2)(iv) in order to crystallize the termination of Section 367(d) deemed inclusions. In turn, Prop. Reg. Section 1.6038B-1(d)(2)(iv) requires the UST to provide the following:

> (A) A statement providing that Treas. Reg. Section 1.367(d)-1(f)(4)(i)(B) applies to the subsequent transfer;
>
> (B) A general description of the transfer and any wider transaction of which it forms a part, including the UST's former adjusted basis in the IP and the TFC's adjusted basis in the IP (as determined immediately before the subsequent transfer), the amount and computation of any gain recognized by the UST under Treas. Reg. Section 1.367(d)-1(f)(4)(i)(A), and a description of whether the IP was, or is expected to be,

a) The UST that initially expatriated the IP.

b) A U.S. person that is treated as a Successor UST and that is an individual or corporation other than (i) a tax-exempt corporation under Section 501(a), (ii) a RIC, (iii) a REIT, (iv) a domestic international sales corporation, or (v) an S corporation (any such person a "**Qualified Successor UST**").

c) A U.S. individual that is related (within the meaning of Treas. Reg. Section 1.367(d)-1T(h)) to the UST or Qualified Successor UST.

d) A U.S. corporation that is related (within the meaning of Treas. Reg. Section 1.367(d)-1T(h)) to the UST or Qualified Successor UST) other than (i) a tax-exempt corporation under Section 501(a), (ii) a RIC, (iii) a REIT, (iv) a domestic international sales corporation, or (v) an S corporation.

In order to provide assurance that the Section 367(d) provisions will be turned off only in circumstances where the long-term "home" of the IP will be a QDP, the Proposed Regulations also provide a "related transactions" rule. Under this rule, if, as part of a series of related transactions that includes the repatriation transfer, the IP is subsequently transferred to one or more other persons, then the initial transferee of the IP is treated as a QDP only if the ultimate recipient is a QDP.[19]

As a mechanical matter, when there is a repatriation of IP by the TFC to a QDP (and the associated reporting requirements are met), the Proposed Regulations prescribe that the following will occur:

1. Apportionment of Current Year 367(d) Inclusion. In the year of repatriation to the QDP, the UST will include a regular Section 367(d) inclusion for the portion of the current year ending on the date of repatriation.[20]

---

subsequently transferred to one or more other persons (as described in Treas. Reg. Section 1.367(d)-1(f)(4)(v));

(C) A description of the IP;

(D) A copy of the IRS Form 926 with respect to the original transfer of the IP and any attachments identifying the IP as within the scope of Section 367(d);

(E) The name, address, and taxpayer identification number of the QDP that receives the IP, including a statement describing the relationship between the UST and the QDP, and, if applicable, such information regarding any other persons described in Treas. Reg. Section 1.367(d)-1(f)(4)(v); and;

(F) Any other information as may be prescribed by the Commissioner in publications, forms, instructions, or other guidance.

For purposes of this Report (and unless otherwise provided), we assume that the UST has provided this required information in connection with any inbound repatriation of IP to a QDP.

[19] *See* Prop. Reg. Section 1.367(d)-1(f)(4)(v).

[20] *See* Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B)(1).

2. Possible Gain Recognition for UST. If, by reason of the repatriation transfer, the IP is "transferred basis property"[21] in the hands of the QDP, the UST must recognize an amount of gain equal to the amount of gain (if any) that the TFC would recognize in connection with the repatriation transfer if its tax basis in the IP were equal to UST's former adjusted basis in the IP. By contrast, if the IP is not transferred basis property in the hands of the QDP as a result of the repatriation transfer, the UST is required to recognize gain equal to the excess of (x) the fair market value of the IP on the date of repatriation, over (y) the UST's former basis in the IP, determined as of the time of the original expatriation transfer.[22]

3. Termination of Section 367(d) Deemed Inclusions. The UST is relieved of further deemed inclusions under Section 367(d).[23]

4. QDP's tax basis in IP. In cases where the repatriated IP is transferred basis property, the QDP's tax basis in that IP is equal to the lesser of (a) the UST's former tax basis in the IP at the time of the original expatriation, or (b) the TFC's tax basis in the IP immediately prior to the repatriation, in each case increased by the greater of the amount of gain recognized by the UST in connection with the rule described in (2) above or the gain (if any) recognized by the TFC as to the IP by reason of the repatriation. Conversely, if the IP is not transferred basis property in the hands of the QDP, the QDP takes a tax basis in the IP equal to the fair market value of such IP (determined as of the date of the repatriation).[24]

5. Adjustments for TFC. In order to neutralize excessive taxation that would occur if both (a) the UST recognizes gain in connection with a taxable IP repatriation to a QDP (as contemplated in item (2) above), and, concurrently (b) the TFC's repatriation of the IP generates a GILTI or subpart F inclusion for its U.S. owner, Prop. Reg. Section 1.367(d)-1(f)(2) provides that, for purposes of chapter 1 of the Code, the TFC reduces (not below zero) the portion of its E&P and gross income arising by reason of the repatriation by the amount of gain recognized by the UST (the "**reduction rule**").[25]

---

[21] "Transferred Basis Property" is defined in Section 7701(a)(43) of the Code to mean property having a basis determined under any provision of subtitle A providing that the basis shall be determined in whole or in part by reference to the basis in the hands of the donor, grantor, or other transferor.

[22] *See* Prop. Reg. Section 1.367(d)-1(f)(4)(ii). The Preamble notes that the UST gain recognition rules triggered in connection with the repatriation to a QDP are intended to ensure that a QDP "does not receive a tax-free increase to the adjusted basis in the repatriated intangible property". 88 Fed. Reg. at 27822.

[23] *See* Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B)(2).

[24] *See* Prop. Reg. Section 1.367(d)-1(f)(4)(iv).

[25] *See* Prop. Reg. Section 1.367(d)-1(f)(2)(i).

As an additional modification, the Proposed Regulations made alterations to the manner in which the TFC treats deemed annual payments to UST during periods in which Section 367(d) is operative. Specifically, the current regulations provide that such deemed payments are treated by TFC as an expense that is properly allocated and apportioned against gross income subject to subpart F (and, effective as of June 21, 2019, GILTI). The Proposed Regulations provide that the deemed payment to UST is treated as an "allowable deduction" (rather that as an "expense" as provided in the existing regulations[26]) that is to be "properly allocated and apportioned to the appropriate classes of gross income in accordance with §§1.882-4(b)(1), 1.951A-2(c)(3), 1.954-1(c), 1.960-1(c), and 1.960-1(d), as applicable". The Preamble observes that this proposed rule, "thus clarifies that the allowable deduction is allocated and apportioned under the provisions cited … potentially to any class (or classes) of gross income (as appropriate) rather than solely to gross income subject to subpart F in all circumstances".[27]

D. Section 904(d)

As part of the basic design of the U.S. foreign tax credit rules, Section 904 of the Code provides that the foreign tax credit limitations prescribed under the Code are to be applied separately to each of four distinct baskets of income prescribed in Section 904(d). Section 904(d)(1)(B) provides that "foreign branch income" is one of these baskets. Complex rules under Treas. Reg. Section 1.904-4(f) establish the framework for allocating gross income between a U.S. taxpayer (the "**foreign branch owner**") and certain "foreign branches" of that taxpayer. As part of this regime, the gross income of a foreign branch and foreign branch owner is adjusted upward or downward, as applicable, to reflect the economic effect of certain disregarded payments made between a foreign branch and the foreign branch owner or between two foreign branches. As noted in the Preamble, however, contributions and branch remittances (which represent unilateral transfers of value in respect of which there is no corresponding payment) are generally not taken into account in determining gross income for purposes of these rules. Treasury was concerned, however, that a contribution or remittance transfer of intangible property between a foreign branch and foreign branch owner (or between foreign branches) could distort gross income apportionment between these units and allow taxpayers to engineer non-economic foreign tax crediting results.

In order to address this concern, Treasury Department included the so-called "**intangible property rule**" of Treas. Reg. Section 1.904-4(f)(2)(vi)(D) in regulations that were finalized in 2019.[28] This rule effectively provides that the determination of foreign branch income takes into

---

[26] The Preamble notes, however, that the choice to replace references to "expense" with "allowable deduction" was made for purposes of clarity and that this change was not intended to be a substantive change. 88 Fed. Reg. at 27825.

[27] *Id*.

[28] The proposal of the intangible property rule in 2018 attracted significant criticism, including the observation that this rule would discourage the "inbound" repatriation of IP (contrary to the policy objectives of the TCJA). In particular, commentators noted that if a foreign branch were to remit IP to the foreign branch owner, the intangible property rule would result in Section 367(d) imputing a series of deemed payments by the foreign branch owner to the foreign branch. They observed that this would have the effect (for Section 904(d) purposes) of increasing the foreign branch income and, correspondingly, decreasing the foreign branch owner's non-branch income (e.g. general category income). This reduction would, in turn, through operation of Section 250(b)(3)(A)(VI) (which effectively backs out foreign branch income for purposes of determining a U.S. corporation's "deduction eligible income"

account "all transactions" in which IP is transferred to or from a foreign branch or between foreign branches, whether or not a disregarded payment is made in connection with such transaction. To achieve this objective, this rule provides that, for purposes of determining the amount of gross income attributed to or from a foreign branch, the principles of Sections 367(d) and 482 apply. For this purpose, the intangible property rule treats a foreign branch as a separate foreign corporation and an "outbound" transfer of IP from a foreign branch owner to a foreign branch is hypothesized as a Section 351 transfer for purposes of applying the Section 367(d) principles. Similarly, an "inbound" repatriation of IP from a foreign branch to the foreign branch owner is hypothesized (for purposes of the Section 904 regulations) as a sale by the foreign branch to the foreign branch owner in exchange for annual payments contingent on the productivity or use of the IP.

E. The Proposed Regulations under Section 904(d)

The Proposed Regulations clarify that, although the "principles" of Section 367(d) should be applied in the foreign branch context, the "subsequent transfer" rules of the existing Section 367(d) regulations and the Section 367(d) termination rule introduced in the Proposed Regulations are not applicable for purposes of Section 904. Specifically, the Proposed Regulations would add a new Treas. Reg. Section 1.904-4(d)(f)(2)(vi)(D)(4) which prescribes that if the same IP is transferred in a series of transfers between a foreign branch owner and a foreign branch (or between foreign branches), each successive transfer is separately subject to intangible property rule and will not terminate or otherwise affect the application of such rule to a prior transfer. In support of this partial decoupling of Section 367(d) principles from the Section 904(d) regulations, the Preamble notes that:

> due to the differing scopes and purposes of section 367(d) and §1.904-4(f)(2)(iv)(D), the consequences of a subsequent transfer for purposes of determining a U.S. transferor's section 367(d) inclusion do not necessarily inform the appropriate treatment for purposes of the section 904(d) branch

---

under Section 250), also reduce the ability of the U.S. taxpayer to claim foreign-derived intangible income ("**FDII**") benefits with respect to income earned in connection with the repatriated IP. This would be expected to have the net effect of causing some portion of the economic returns from the repatriated IP to be subject to tax at the regular 21% rates, rather than the more beneficial FDII rates. Faced with this prospect, commentators asserted that many taxpayers may conclude that they are better off (from a U.S. tax perspective) keeping the IP offshore and elect not to repatriate IP under these rules. After assessing this and other criticisms, Treasury Department concluded that retaining the intangible property rule was appropriate and observed that: "While the intangible property rule may increase compliance burdens and increase the disparity between the gross income attributable to a foreign branch and the gross income taxable by a foreign country, the Treasury Department and the IRS have determined that those concerns are outweighed by the benefits derived from the rule. In general, § 1.904-4(f)(2)(vi)(A) adjusts the attribution of gross income when disregarded payments are made between a foreign branch and a foreign branch owner, or between foreign branches. Disregarded remittances or contributions, however, do not result in the reattribution of gross income. Section 1.904–4(f)(2)(vi)(C)(2) and (3). Accordingly, when a disregarded transaction with a foreign branch may be structured as either a remittance or contribution, on the one hand, or as a sale, exchange, or license, on the other hand, the amount of gross income attributed to a foreign branch could be manipulated. This concern is heightened when the property in question is highly mobile and highly valuable, as is generally true of intangible property (and less frequently true of tangible property). In light of the higher risk of manipulation for transfers of intangible property, the Treasury Department and the IRS have determined that the anti-abuse rule in § 1.904–4(f)(2)(v) does not sufficiently protect against manipulation, necessitating the more specific and mechanical intangible property rule". T.D. 9882, 84 FR 69022 (December 17, 2019) (the "**904 Preamble**").

> income rules …. If there are multiple transfers of an item of intangible property over time, each transfer must be separately evaluated and could result in differing amounts of deemed annual payments depending on any interim changes in value of the intangible property between successive transfers.[29]

As a result, although an IP expatriation of IP subject to Section 367(d) that is followed by a subsequent repatriation of that IP to a QDP may result in a termination of the deemed payments in the corporate context, the same sequence of transactions in a branch context would be expected to result in overlapping deemed payments going in both directions between foreign branch and foreign branch owner (for purposes of determining foreign branch income and, by extension, the foreign branch owner's FDII eligible income).

III. Discussion and Recommendations

A. Definition of Qualified Domestic Person

The definition of QDP plays a central gatekeeping role in the Proposed Regulations given that the termination of Section 367(d) inclusions can only occur if the IP is repatriated to a QDP. As such, there is an inherent tension between (a) wanting the definition of QDP to be as broad as possible, so as to provide broadly the helpful relief that is intended to encourage IP repatriation, and (b) not overextending the scope of the QDP definition such that administrability of the regime becomes unwieldy and/or the continuing legitimate policy objectives of Section 367(d) are undermined. As with many design choices in the Section 367(d) context, finding the appropriate balance is challenging. We offer below recommendations for limited expansions to the definition of QDP in the Proposed Regulations.

1. Partnerships

The Preamble notes that Treasury Department considered the possibility of including domestic partnerships within the scope of the QDP definition but ultimately declined to do so. In particular, the Preamble indicates that consideration was given to treating the partnership as an aggregate for purposes of the QDP definition, which would parallel the manner in which a partnership is treated when testing whether an outbound transfer of IP by a partnership is subject to Section 367(d) in the first instance.[30] However, this approach was not adopted because doing so "could allow taxpayers to circumvent the purposes of the Proposed Regulations and other related regulations following a repatriation to a domestic partnership. This could occur if, for example, the partnership allocations are changed after the repatriation or if the transferee foreign

[29] 88 Fed. Reg. at 27825 - 27826.

[30] Under Treas. Reg. Section 1.367(a)-1T(c)(3)(i), when a partnership (U.S. or non-U.S.) transfers property to a foreign corporation, then a U.S. person that is a partner in the partnership is treated as having transferred a proportionate share of the partnership's property to the foreign corporation. Treas. Reg. Section 1.367(d)-1T(a) provides that this rule applies for purposes of determining whether a U.S. person has made a transfer of IP for purposes of Section 367(d).

corporation (or a related foreign corporation) has liquidation rights to the IP following the transfer".[31]

Furthermore, the Preamble indicates there are concerns about applying aggregate treatment to partnerships with both QDP and non-QDP partners, since this would require a bifurcated approach in which Section 367(d) partially terminates and partially continues. While Treasury contemplated the possibility of making the termination of Section 367(d) subject to a gain recognition agreement (in order to provide assurance that post-repatriation income related to the IP actually remains subject to current taxation in the hands of a U.S. taxpayer), they determined not to adopt this approach since it would be "unworkable due to the compliance and administrative burden".[32]

(a) Recommendations for Proposed Regulations

(i) Allow Certain Partnerships to be QDPs

While we acknowledge the complications identified by Treasury in the Preamble we believe that, on balance, the QDP definition should be expanded modestly to include certain kinds of partnerships. In particular, we believe that a QDP should include a partnership (whether domestic or foreign) where either of the following conditions are met:

1) The partnership's only partners are QDPs (the "**QDP Partnership**" case), or

2) The partnership is the same entity that expatriated the IP in the original transfer that triggered the application of Section 367(d) and the aggregate amount of interests in partnership capital and profits held by QDPs at the time of the repatriation is not less than (say) 95% of the aggregate amount of interests in partnership capital and profits that were held by QDPs at the time of the IP expatriation transfer that gave rise to the application of Section 367(d) (the "**Same Partnership**" case).[33]

The inclusion of a QDP Partnership within the definition of QDP appears benign since all the partnership's income will flow to persons that would be QDPs and because Section 367(d) would have been terminated under the terms of the Proposed Regulations if such partners had received their allocable portion of the IP directly. While we recognize that there is reluctance on the part of Treasury to adopt an aggregate conceptualization of partnerships for purposes of repatriation transfers, in this scenario it is difficult to see why application of aggregate principles is harmful or unworkable (apart from concerns about post-repatriation changes to the identity of,

---

[31] 88 Fed. Reg. at 27824.

[32] *Id*.

[33] The rationale for the 95% limitation is to provide some amount of flexibility for small changes in ownership by QDPs between the time of expatriation and repatriation. We believe this is a reasonable balance between (a) expanding the inclusivity of QDP relief to a broader range of "real world" repatriation scenarios, and (b) upholding the purpose and function of Section 367(d). As a possible fallback formulation, Same Partnership status could be limited to partnerships that meet the following, more restrictive, qualifications: (i) the partners of the partnership at the time of repatriation are the same as (or successors to) the partners of the partnership at the time of the expatriation, and (ii) there has been no intervening change to the manner in which such partners share profits and capital of the partnership.

or allocations among, partners which we address below).[34] Similarly, in the Same Partnership case the repatriation results in a restoration of a factual situation that is substantially the same as the one that existed at the time of the expatriation. Conceptually and substantively, this effective reversal of the expatriation transaction represents a state of facts where the termination of Section 367(d) is justified – as it is where the IP is directly repatriated to the original UST.[35]

In making the above recommendations, we acknowledge the concerns expressed by Treasury in the Preamble about the potential for taxpayers to engage in post-repatriation actions that could circumvent the Proposed Regulations, which are premised on the income from the IP after repatriation being recognized by U.S. persons (as well as concerns about the administrative complexity of rules that would be required to neutralize such activity). We considered various alternatives that would both allow for the recommended QDP expansions described above and address the legitimate concerns identified by Treasury. For example, we considered addressing post-repatriation maneuvers that modify partnership allocations or distribution entitlements through the "related transfer" rule of Prop. Reg. Section 1.367(d)-1(f)(4)(v). Specifically, the special rule for related transfers could be expanded (including by way of illustrative examples) to provide that the "Same Partnership" or "QDP Partnership" exceptions would not apply if, as part of a series of related transactions that includes the repatriation transfer, (i) a non-QDP partner acquires an interest in a QDP Partnership, or non-QDP partners increase their aggregate capital or profits interest in the Same Partnership, (ii) partnership allocations are amended to shift future profits from the IP away from QDPs to non-QDP partners, or (iii) other changes are implemented that have the effect of causing future income from the IP to be redirected to non-QDPs.

On balance, and having regard to the important objective of finalizing the Proposed Regulations in the near term, we recommend the following framework for implementing the QDP Partnership and Same Partnership concepts. This framework is based on the "related transfer" rule, refined in a manner designed to increase the rule's efficiency and fairness.

(i) A QDP Partnership or Same Partnership would be treated as a QDP for purposes of the Proposed Regulations provided that (A) the partnership meets the QDP Partnership or Same Partnership requirements as of the date of the repatriation,

---

[34] If Treasury is nonetheless concerned about expanding the scope of the QDP definition to include QDP Partnerships, Treasury could address such concerns by considering an even more limited expansion of the definition of QDP to include only partnerships in which all of the partners are (i) QDPs *and* (ii) members of the same consolidated group.

[35] We note that the only reason why the Same Partnership is not regarded as "the same U.S. transferor that initially transferred the intangible property" within the meaning of Prop. Reg. Section 1.367(d)-1T(f)(4)(iii) is because of an embedded asymmetry within Section 367(d) regarding the aggregate vs. entity treatment of partnerships. In particular, as noted above, for purposes of determining whether an <u>outbound</u> transfer of IP by a partnership to a foreign corporation is subject to Section 367(d) the partners are treated as transferring their proportionate share of partnership property to the foreign corporate transferee (*i.e.* aggregate principles apply). Conversely, for purposes of determining whether an <u>inbound</u> transfer of IP to a partnership is eligible for QDP treatment, the repatriating transfer is treated as a transfer to the partnership rather than to the partners (*i.e.* entity principles apply). Moreover, in the Same Partnership case, it would appear reasonable for the partnership to assert that there is, based on common law principles (see authorities cited at footnote 15), an extinguishment of the deemed income inclusion arrangement based on the observation that continued application of the deemed contingent payment regime of Section 367(d) would effectively result in each partner being both the payor and payee of their proportionate share of the deemed payments.

and (B) no proscribed change in the partnership's ownership or terms occurs (x) during a specified number of years following the repatriation, or (y) pursuant to a series of related transactions that includes the repatriation. Thus, there would be a time-based rule treating such a change as automatically disqualifying a partnership from being a QDP, and a facts-and-circumstances relatedness test (which would not be time-limited) as a backstop; and

(ii) Final regulations would also create a mechanism through which, if requested by a taxpayer, the Commissioner of the IRS would be able to exercise their discretion to determine that a post-repatriation alteration to partnership's ownership or terms during the defined time period would not cause the partnership to become disqualified from the benefits of QDP Partnership or Same Partnership status.[36] Thus, taxpayers potentially could obtain relief where an alteration to a partnership occurs within the relevant fixed period after repatriation of IP, if they could establish to the IRS's satisfaction the alteration did not produce inappropriate results; and for an alteration occurring after the end of that period, taxpayers also could gain certainty about the impact on the treatment of the prior IP repatriation.[37]

We believe that the framework described above would provide a robust basis on which to extend the reach of the QDP exception to certain partnerships while, at the same time, safeguarding against post-repatriation actions that may compromise the purpose and function of Section 367(d) more generally.

(ii) Clarify Application of the "Extinguishment" Concept

We note that, in certain circumstances, a domestic partnership may be treated as a Successor UST under the current Section 367(d) regulations. In particular, if a UST transfers stock of the TFC to a domestic partnership that is related to the UST within the meaning of Treas. Reg. Section 1.367(d)-1T(h), the partnership may succeed to the UST as a Successor UST and be required to include future Section 367(d) inclusions related to the underlying IP in its income pursuant to Treas. Reg. Section 1.367(d)-1T(e)(1). In such a case, if the TFC subsequently repatriates the IP to the partnership, it would seem reasonable under existing law for the partnership to take the position that Section 367(d) fiction is extinguished by virtue of converging the deemed Section 367(d) seller and purchaser positions into a single person (i.e.,

[36] We expect that taxpayers would be able to request that the Commissioner exercise this discretion in any particular case under a process similar to that associated with Treas. Reg. Section 1.1502-13(c)(6)(ii)(D) (related to the Commissioner's ability to determine that an intercompany item is excluded from gross income under the consolidated return regulations).

[37] If this recommendation is adopted, it would appear logical to follow a similar approach in determining whether, under the rule in Prop. Reg. Section 1.367(d)-1(f)(4)(v), a post-repatriation transfer by a QDP that is an individual or a corporation to a partnership is a "related transfer." Thus, for instance, a repatriation of IP to such a QDP, followed by a transfer of the IP to a partnership solely owned by QDPs, would not be treated as related. If the individual or corporate QDP transfers the IP to a partnership partly owned by (say) a foreign person within the specified fixed period after repatriation, or if the transfer occurs later but based on the facts it constitutes a related transaction, then the repatriation would be treated as not having been made to a QDP, unless the taxpayer requested and received relief through the mechanism described in the text.

the partnership).[38] While we recognize that turning off future Section 367(d) inclusions under the extinguishment concept is analytically different from treating a partnership as a QDP, we believe that there is significant conceptual overlap and that the extinguishment scenario should be addressed in final regulations. Doing so would address an apparent conceptual gap in the existing Section 367(d) rules and the Proposed Regulations (i.e., what happens when the UST and TFC positions become unified). To us, it seems reasonable to view this situation as conceptually similar to the Same Partnership case, and it appears to be an appropriate juncture at which to terminate the Section 367(d) deemed sale fiction. It would improve the overall coherence of the Section 367(d) regime if Treasury confirmed this result.

(b) Considerations for Future Guidance

If Treasury does not adopt either the QDP Partnership or Same Partnership exception proposed above, further consideration should be given to the correlative effects under Section 367(d) of an inbound repatriation of IP to a partnership. In particular, the repatriation transaction itself would generally be a taxable transaction either (a) as a Section 331 liquidation of TFC into the partnership (which may give rise to GILTI or subpart F inclusions for U.S. shareholders and/or taxable gain to the partnership on the deemed disposition of TFC shares), or (b) as a taxable distribution by the TFC to the partnership under Section 311(b) (which, again, may give rise to GILTI or subpart F inclusions for U.S. shareholders and/or taxable Section 301(c)(3) gain to the partnership). Among other things, the transferee partnership would also take a tax basis in the IP equal to its fair market value (and presumably be able to amortize that basis going forward). However, despite the fully taxable nature of this repatriation scenario, this related party transfer would not turn off the remaining Section 367(d) inclusions that are required by reason of the original outbound transfer subject to Section 367(d). In particular, Treas. Reg. Section 1.367(d)-1T(f)(3) provides that UST's requirement to recognize annual income inclusions or gain under Treas. Reg. Section 1.367(d)-1T(c) (annual inclusions) or -1T(e) (subsequent dispositions) "shall not be affected" by this related party repatriation. In other words, there is no attempt to harmonize the fact that gain is recognized (by both TFC and the partnership) on the repatriation transfer with the future income inclusions prescribed under Section 367(d) (which is a state of affairs that seems inappropriate, particularly given the potential non-availability of notional deductions to match the deemed Section 367(d) inclusions for UST – see discussion below in Part III.B).

We believe that further consideration should be given to harmonizing (i) the fact that there is "lump sum" gain recognition based on the fair market value of the IP at the time of repatriation to a partnership (which may give rise to gain recognition on a deemed disposition of TFC shares or subpart F income or tested income to the U.S. shareholders of TFC), with (ii) the future income inclusions prescribed under Section 367(d). We acknowledge that this predicament conceptually arises in any case where there is a post-expatriation taxable transfer by a TFC to a related non-QDP (as discussed below in Parts III.C and III.D of this Report) and that the appropriate treatment of these issues generally has been a long-standing open question in the Section 367(d) arena. We do not believe that Treasury should delay the finalization the Proposed Regulations to address these more foundational issues.

[38] This position would be supported by the general authorities cited in footnote 15.

We observe, however, that the absence of guidance on taxable transfers to related non-QDPs has a particularly adverse effect when the related non-QDP is a partnership with QDP partners (who will be subject to U.S. taxation on income earned from exploitation of the IP going forward). We are concerned that the failure to achieve greater harmonization of these items will engender excessive taxation and inhibit otherwise desirable IP repatriation due to overly rigid mechanics. As one possible approach to achieving this flexibility, we believe it would be reasonable to provide that gain recognized in connection with the inbound transfer of IP by a TFC to a related partnership and allocated to a QDP partner, would be allowed as a credit that may be applied by the UST to offset future Section 367(d) annual income inclusions associated with the transferred IP. The credit or offset mechanism would be modelled after the one contemplated in Notice 2012-39.[39]

We appreciate that, in some ways, a taxable repatriation to a partnership may resemble an elective "prepayment" of the remaining Section 367(d) inclusions by the TFC and, as a result, Treasury may be inclined to follow the approach adopted in AM 2022-003, which denied the ability of a TFC to make an elective prepayment of Section 367(d) inclusions.[40] However, this ruling is factually distinguishable in that the ruling does not involve a repatriation of the underlying IP and also appears to have been materially influenced by policy concerns that taxpayers were using the mechanics of Section 367(d) as a device for artificially accelerating income recognition or for the distribution of foreign earnings to a U.S. shareholder without taxation (which concerns would not have application in the scenario we are contemplating here). Accordingly, strict adherence to the principles of AM 2022-003 in this case does not appear compelling, if the goal is to remove technical obstructions to IP repatriation.

Rather, in the scenario described above (i.e., where IP is repatriated to a non-QDP partnership), we believe it is reasonable to analogize the taxable repatriation transaction to the outbound 351 transfer with boot scenario contemplated in Notice 2012-39. In particular, Notice 2012-39 allows for Section 367(d) "prepayment" treatment for boot delivered to UST at the time of the *outbound* transfer that triggers the application of Section 367(d). We believe there is a logical symmetry to allowing taxable consideration received at the time of a reversing *inbound* transfer of the same IP to be similarly eligible for such "prepayment" treatment (particularly when a failure to do so might preempt an otherwise economically rationale IP repatriation).

We recognize that the considerations outlined above involve a mix of competing concerns and that further deliberation may be appropriate. However, it seems fairly evident that partnerships considering an inbound repatriation of IP are confronted by a range of unique challenges and face heightened risks of excessive taxation as compared to similarly situated corporations. The Proposed Regulations, in their current form, do little to address these concerns

---

[39] Alternatively, UST could be treated as having an income inclusion under Section 367(d) equal to the TFC's gain recognized at the time of repatriation, with a corresponding reduction in TFC's gross income and E&P (similar to the reduction rule in the Proposed Regulations) and a credit against UST's future annual income inclusions under Section 367(d).

[40] In AM 2022-003 (Oct. 21, 2022), the IRS denied the taxpayer's attempt to treat the elective prepayment by TFC of future Section 367(d) inclusions to UST as an advance against those future Section 367(d) inclusions (and, instead, concluded the prepayment was subject to taxation under general tax principles – e.g., as a Section 301 distribution that was separate from the IP transfer).

and introduce material disparity between the treatment of repatriating corporations and partnerships. To the extent that Treasury is able to address these considerations and reduce the disparity in treatment between repatriating corporations and partnerships, this would, in our view, significantly improve the reach and practical usefulness of the regulations.[41]

As a related observation, to the extent Treasury is concerned about the use of partnerships with foreign partners to inappropriately shift income or deductions related to IP, consideration can be given to a broader, more systemic approach to addressing this area (including, for example, amended regulations under Section 721(c)). It is not clear that a U.S. person that happens to be subject to the Section 367(d) regime should, by virtue of that history, be subject to more onerous consequences upon a transfer of the applicable IP into a partnership structure than a U.S. person that is not subject to Section 367(d) and licenses or otherwise transfers IP to a related partnership with foreign partners. Rather, it appears a U.S. taxpayer should be subject to rules under Section 367(d) that provide for appropriate consequences upon a repatriation of IP, as well as rules that apply uniformly (whether or not there has been a previous Section 367(d) transfer) to limit uses of cross-border partnership structures in ways perceived to be inappropriate.

2. S Corporations

Under our reading of the Proposed Regulations, an S corporation may be a QDP only in cases where the S corporation was, itself, the original UST in the outbound transfer of IP that triggered the application of Section 367(d). Stated differently, under the Proposed Regulations, an S corporation may not be a QDP under alternative prongs of that definition (such as a Qualified Successor UST or as a corporation "related" to a UST (or a Qualified Successor UST)).

In general, under Section 1361 of the Code, the shareholders of an S corporation must be taxable U.S. individuals.[42] Given this organizational precondition for S corporation status, it seems reasonable to presume that income attributable to IP that is repatriated to an S corporation would be subject to U.S. taxation after the repatriation. Moreover, S corporations would not appear to present the kinds of concerns that the Treasury Department has identified as potentially problematic in the case of partnerships. Against this backdrop, it is not apparent to us why S corporations are allowed to be QDPs in some cases, but not others. We recommend that the QDP definition be expanded to allow S corporations to be both Qualified Successor USTs or a related corporation within the meaning of Prop. Reg. Section 1.367(d)-1(f)(4)(iii)(D).

---

[41] Clarification that a partnership to which IP is repatriated is entitled to a deduction for deemed payments it makes under Section 367(d) would also be helpful in this regard, as discussed in Part III.B below.

[42] A Section 401(a) retirement plan or Section 501(c)(3) organization is permitted as a shareholder of an S corporation. Under Section 512(e)(1), such a plan (other than an employee stock ownership plan) or organization is required to treat its entire share of the S corporation's income as unrelated business taxable income. An ESOP is not subject to Section 512(e)(1) but is subject to limitations under Section 409(p) that are designed to protect the policy goals Congress sought to further by permitting ESOPs as shareholders of S corporations.

B. Availability of a TFC's "Allowable Deduction"

We recommend that Treasury clarify whether the "allowable deduction" contemplated in Prop. Reg. Section 1.367(d)-1(c)(2)(ii) is a generally available deduction under Section 162 (subject to limitations of general application). There is currently some ambiguity about how broadly available this deduction is given the wording of this provision in the Proposed Regulations, which is reproduced here:

> The deemed payment is treated as an allowable deduction (whether or not that amount is paid) of the transferee foreign corporation properly allocated and apportioned to the appropriate classes of gross income in accordance with §§ 1.882-4(b)(1) [effectively connected income], 1.951A-2(c)(3) [tested income], 1.954-1(c) [foreign base company income], 1.960-1(c) [computation of foreign income taxes deemed paid], and 1.960-1(d) [computation of income in a Section 904 category], as applicable.

It is not entirely clear whether the phrase beginning with the words "properly allocated and apportioned to…" is meant to merely illustrate certain of the classes of income against which the allowable deduction may be allocated or, alternatively, whether that language is meant to affirmatively confine the usage of the deduction to those enumerated provisions. It may be that the itemized list of provisions in Prop. Reg. Section 1.367(d)-1(c)(2) was limited to classes of income or foreign tax credit computations that are applicable to non-U.S. corporations based on the preconception that the TFC benefitting from these adjustments will, in fact, be a foreign corporation. However, when one takes into account the reality that a U.S. person may be required to step into the shoes of a TFC, this preconception breaks down, particularly when the related U.S. person does not qualify as a QDP.

We believe that Prop. Reg. Section 1.367(d)-1(c)(2)(ii) should not be interpreted to confine the "allowable deduction" to these narrow classes of itemized income because doing so would affirmatively create the conditions for excessive U.S. taxation in connection with repatriation of IP to related U.S. persons that, for whatever reason, are not QDPs. A contrary interpretation would mean that (a) the related U.S. person would be required to include revenue from exploitation of the IP in its income, (b) the UST would concurrently be required to include annual deemed payments in income pursuant to Section 367(d) for the remainder of the useful life of the IP, and (c) the deemed payments by the related U.S. person (as successor TFC) to UST would not be available to offset the U.S. taxable income contemplated in (a) or (b). In our view there is a compelling case, buoyed by the strong policy considerations supporting IP repatriation, for Treasury to allow deemed Section 367(d) payments by a successor TFC that is a U.S. person to be treated as an allowable deduction for all U.S. federal income purposes, subject to limitations of general application. Arguably, this is the proper interpretation of Prop. Reg. 1.367(d)-1(c)(2)(ii) as currently drafted, but we request that Treasury clarify this when finalizing the regulations. In any case, the availability (or non-availability) of this deduction to U.S. taxpayers is an important conceptual piece of the overall Section 367(d) framework and should not be left ambiguous.

While this recommendation is not limited to repatriations involving partnerships, we note that it may provide a relatively straightforward way to reach appropriate outcomes in cases where IP is repatriated to a partnership that does not qualify for our recommended QDP

Partnership or Same Partnership relief rules. For example, suppose that UST has previously made an outbound transfer of IP to TFC, and UST and a foreign person (FP) now own 60% and 40% respectively of the capital and profits interests in a partnership that, in turn, owns TFC and is not a Successor UST. If TFC repatriates the IP to the partnership, then UST will continue to have deemed income inclusions under Section 367(d), and also will be allocated 60% of the partnership's deduction attributable to the deemed Section 367(d) payments made to it by the partnership. UST thus will have a result that at least roughly approximates the result if the repatriation transaction had been bifurcated and application of Section 367(d) had been terminated in part: 60% of UST's Section 367(d) income inclusions will be matched by its allocable share of the partnership's related deductions, and UST will be allocated 60% of the partnership's income from exploitation of the IP; and UST will continue to recognize the remaining 40% of its Section 367(d) inclusions with no offset.[43] This would appear to be a logical result and would not require particularly complex rules.

C. Prior Unrelated Transfers and QDP Basis

1. Discussion

As summarized above, when IP is repatriated to a QDP in a manner where the IP is transferred basis property in the hands of the QDP, the Proposed Regulations provide that the QDP's tax basis in the IP is the lesser of (a) the UST's former adjusted basis in the transferred IP or (b) the TFC's adjusted basis in the transferred IP (as determined immediately before the subsequent disposition, in each case increased by the greater of (x) the amount of gain (if any) described in Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(A) and recognized by the U.S. transferor or (y) the amount of gain (if any) recognized by the TFC as to the transferred IP by reason of the subsequent disposition.[44] This rule is aimed at preventing the QDP from acquiring basis in the repatriated IP that is greater that the U.S. transferor's former adjusted basis in the IP, except to the extent of the gain recognized by the U.S. transferor by reason of the repatriation transaction

[43] We recognize that Treasury might have concerns about the possibility that taxpayers may seek to inappropriately manipulate the manner in which these deductions (and/or income related to the IP) are allocated by a transferee partnership after a repatriation transfer (in a way that parallels the concerns expressed by Treasury in the Preamble which ultimately led Treasury to conclude that partnerships should not be eligible to be QDPs). If these concerns were sufficiently material, then consideration could be given to adopting guidance that prescribes the manner in which this deductible item must be allocated to partners. For example, it appears that the partnership's deductible expense in respect to deemed Section 367(d) payments would not have substantial economic effect for purposes of the regulations under Section 704(b). As such, this deduction may presumably be allocated in accordance with each partner's interest in the partnership, in accordance with Treas. Reg. Section 1.704-1(b)(3). An allocation of this deduction in the same manner as the income to which such expense is attributable under the principles of the regulations under Section 861 might be viewed as fitting with the principles of Treas. Reg. Section 1.704-1(b)(3). *Cf*. Treas. Reg. Section 1.704-1(b)(3)(iv), (b)(4)(viii) (allocating creditable foreign tax expenditures). Alternatively, it may be reasonable to provide that these deduction items must be allocated to the partners in proportion to their rights to receive proceeds from a disposition of the IP by the partnership.

[44] Prop. Reg. Section 1.367(d)-1(f)(4)(iv).

under the Proposed Regulations or, if greater, the gain recognized by the TFC by reason of such transaction.[45]

However, the application of this rule can result in a reduction in the adjusted tax basis of the repatriated IP in the hands of the QDP (as compared to the adjusted tax basis of the IP in the hands of the TFC immediately before the subsequent disposition), even in cases where the UST recognizes gain under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A). This basis elimination may arise, for example, in the situation where, prior to the IP repatriation, there has been a taxable transfer of the IP by the initial TFC to a related person, to which Treas. Reg. Section 1.367(d)-1T(f)(3) applies (and, as a result, the related person succeeds to the transferor as the successor TFC). This result is illustrated by the following example.[46]

> **Example A**. In year 1, USP transfers IP, with a $0 adjusted basis and fair market value of $100x, in a section 351 exchange to CFC1 (TFC), a controlled foreign corporation wholly owned by USP in a transfer subject to Section 367(d). In year 2, USP contributes all of the stock of CFC1 to USS, a related person (within the meaning of Treas. Reg. Section 1.367(d)-1T(h) and Prop. Reg. Section 1.367(d)-1(h)(2)(ii)), in a Section 351 exchange to which Treas. Reg. 1.367(d)-1T(e)(1) applies. Later in year 2, CFC1 sells the IP, still with a $0 adjusted basis, for $100x to CFC2, a controlled foreign corporation wholly owned by USS and also a related person, in a transfer subject to Treas. Reg. Section 1.367(d)-1T(f)(3) (the "**year 2 sale**"). As a result of the year 2 sale, CFC2 succeeds CFC1 as the TFC. In year 3, in a transaction unrelated to the year 2 sale, CFC2 distributes all of its property, including the IP, to USS pursuant to a complete liquidation to which Sections 332 and 337 apply (the "**year 3 liquidation**"). The all E&P amount determined under Treas. Reg. Section 1.367(b)-2(d) with respect to the stock of CFC2 held by USS is $0. USS provides the information described in Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B) for the taxable year that includes the year 3 liquidation.

This example is similar to Example 1 in Prop. Reg. Section 1.367(d)-1(f)(6)(ii)(C), except that there is the introduction of a taxable transfer of the IP from CFC1 to CFC2 in between the expatriation and repatriation of the IP. In Example 1 in the Proposed Regulations, under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A) and -1(f)(4)(ii)(A), USS recognizes $0 of gain by reason of the year 3 liquidation, regardless of the adjusted basis in the transferred IP, because the TFC does not recognize gain with respect to the transferred IP by reason of the liquidation. Additionally, under Prop. Reg. Section 1.367(d)-1(f)(4)(iv)(A), USS's adjusted basis in the transferred IP is $0, which is equal to USP's former adjusted basis in the transferred IP, increased by the greater of (i) the amount of gain recognized by USS under Prop. Reg. Section

---

[45] The Preamble observes that the UST gain recognition rule (together with the required adjustments contemplated in the Proposed Regulations) "generally ensures that a qualified domestic person does not receive a tax-free increase to the adjusted basis in the repatriated intangible property." 88 Fed. Reg. at 27822.

[46] Unless otherwise indicated herein, the nomenclature and assumed facts in Prop. Reg. Section 1.367(d)-1(f)(6)(i), which apply for purposes of the examples in Prop. Reg. Section 1.367(d)-1(f)(6), also apply for purposes of the examples in this Report.

1.367(d)-1(f)(4)(i)(A), which is $0, or (ii) the amount of gain recognized by the TFC by reason of the year 3 liquidation, which is also $0.

The results of the year 3 liquidation in the example above are the same as in Example 1 in the Proposed Regulations. However, unlike Example 1 in the Proposed Regulations, in the above example CFC2 had a basis of $100x in the IP that it acquired in the year 2 sale – which means that the subsequent disposition in the year 3 liquidation results in a step-down in the adjusted tax basis of the IP to $0, with the result that USS will, over time, have $100x more in net taxable income than it would otherwise have if its adjusted tax basis of the transferred IP stayed at $100x.[47]

Viewed as a whole, this series of transactions can therefore effectively result in a double inclusion of income with respect to the transferred IP – the first inclusion being CFC1's recognition of $100x of gain on the year 2 sale of the IP (which may be taxable to USS either as GILTI (currently at a 10.5% rate) or as subpart F income (currently taxable at 21% rate)), and the second being USS's inclusion of income earned through post-repatriation exploitation of the zero-basis IP without any offsetting amortization deductions.[48] It is important to note, however, that, just because CFC1 recognizes $100 of gain on the year 2 sale, this does not mean that USS will necessarily actually incur additional U.S. federal income tax at any particular rate with respect to such gain. For example, it is unclear whether the gain recognized by CFC1 triggers a corresponding accelerated income inclusion for USS under Section 367(d) and Treas. Reg. Section 1.367(d)-1T(c), or if the recognition of such gain does not affect the timing and amounts of USS's inclusions under such provisions.[49] Additionally, if such gain results only in an inclusion of subpart F income or GILTI to USS under Section 951 or Section 951A, such income may be sheltered by foreign tax credits or, if it is GILTI, be subject to the reduced tax rate applicable to GILTI (although it should be noted that the Section 367(d) inclusions by a UST are eligible for treatment as foreign-derived intangible income under Section 250, and so may also benefit from a reduced rate of tax).[50] Moreover, if CFC1 was not wholly owned but had

---

[47] A similar loss of tax basis can occur if a TFC incurs costs to improve the IP, which costs are capitalized into tax basis, during the period that the TFC owns the IP prior to its repatriation in a subsequent disposition that involves a nonrecognition transaction. *See* Treas. Reg. Section 1.263(a)-4.

[48] A more direct double inclusion result occurs if the subsequent disposition of the transferred IP by CFC2 to USS occurs by way of a taxable transaction, e.g., a distribution of the transferred IP by way of a section 301 distribution rather than by a nontaxable liquidation. In that situation, USS would recognize $100x of gain under Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(B). USS would also take an adjusted basis of $100x in the transferred IP under Prop. Reg. Section 1.367(d)-1(f)(4)(iv)(B), which it would presumably be able to amortize in the future and offset against future taxable income.

[49] On this point, we note that Treas. Reg. Section 1.367(d)-1T(f)(3) provides that "the requirement that a U.S. person recognize gain under paragraph (c) or (e) of this section shall not be affected by the [TFC's] subsequent disposition of the transferred intangible to a related person". This may be fairly interpreted to mean that a related party taxable transaction (like the year 2 sale) does not modify in any way the pre-existing operation of Section 367(d) – including as it relates to the timing and quantum of the inclusions.

[50] Note that a similar issue can arise in reverse, where the UST has tax basis in the transferred IP that carries over to and is amortized, in whole or in part, by the TFC. Such U.S. tax basis, to the extent amortized while held by the TFC, is not "resurrected" on the occurrence of a repatriation to a QDP, even though those amortization deductions may not have produced any U.S. tax benefit (or produced U.S. tax benefits at less than a 21% tax rate). However,

minority shareholders, USS may not be required to include 100% of such gain its income under Section 951 or Section 951A, further reducing the extent to which USS would be subject to U.S. federal income tax on such gain.

2. Considerations for Future Guidance

At the margin, the loss of tax basis in the transferred IP in such a situation may disincentivize the repatriation of IP, which would undercut one of the primary purposes of the Proposed Regulations. However, it is apparent to us that trying to develop rules to address this situation would necessarily require Treasury (i) to develop a broader set of rules that address the tax consequences under Section 367(d) of the recognition of gain by a TFC on a taxable transfer of IP to a related person (that is not a subsequent disposition that is subject to the Proposed Regulations),[51] and (ii) if such rules require a corresponding income inclusion to the UST under Section 367(d), to determine under what circumstances it would then be appropriate to permit a UST not to recognize gain (or recognize a reduced amount of gain) on a subsequent taxable repatriation under the Proposed Regulations or, in the case of a nontaxable repatriation, to permit a QDP to inherit all or a portion of a TFC's adjusted tax basis in the transferred property.[52] Because these are both difficult and complex issues that will require careful analysis and time to assess, and because we understand that Treasury have a strong interest in finalizing the Proposed Regulations in an expeditious manner in order to promote the repatriation of transferred IP in situations where these issues are not present (with which we agree), we recommend that

---

we do not believe that, in general, the failure to "resurrect" this basis would significantly affect a U.S. taxpayer's decision whether to repatriate the transferred IP, and therefore do not believe that Treasury needs to make changes to the Proposed Regulations to address this fact pattern.

[51] For example, Treasury could amend the Section 367(d) regulations to provide that the UST is required to recognize currently an amount of gain that corresponds to the gain recognized by the TFC on a transfer to a related person (with a corresponding reduction in the TFC's gross income and E&P, similar to the way the reduction rule operates in the Proposed Regulations), but thereafter UST's deemed income inclusions under Section 367(d) would be reduced by the amount of gain recognized by the UST. However, to the extent that the position taken by the Service in AM 2022-003, that a taxpayer cannot elect to make advance payments of annual Section 367(d) deemed inclusions, reflects not just a technical interpretation of the statute and regulations, but also a broader policy concern about UST's ability to alter the timing of income inclusions under Section 367(d) after an outbound transfer of IP in a situation where the IP is still held by a TFC, the approach described in the preceding sentence could implicate similar policy concerns.

[52] For example, Treasury conceivably could try to calibrate the amount of gain that the UST was required to recognize, or the QDP's adjusted tax basis in the transferred property, to reflect the actual U.S. tax liability incurred by the UST or a related person in connection with the taxable transfer of the IP from the TFC to a related non-U.S. person (in a transaction that is unrelated to the subsequent repatriation of that IP). However, given the complexity involved with trying to determine such actual tax liability, we strongly suspect such a rule would prove in practice difficult, if not impossible, to administer. Treasury considered and rejected a similar approach in adopting regulations under Section 367(b) addressing so-called "Killer B" transactions. *See* T.D. 9526, 76 Fed. Reg. 28890 (May 19, 2011) ("The IRS and Treasury Department recognize that in some cases it may be appropriate for the priority rule to take into account the amount of resulting U.S. tax. However, the IRS and Treasury Department do not believe it would be administrable to take into account the resulting U.S. tax in all cases, because this could require consideration of numerous attributes of various parties . . . .").

Treasury finalize the Proposed Regulations without addressing the issues discussed in this paragraph, and instead reserve them for future consideration.[53]

D. Multiple Related Transfers

1. Discussion

In some cases, a repatriation of transferred IP to the United States may involve one or more related taxable transfers[54] by one or more TFCs before a final transfer that is a repatriation of the IP to a QDP. We believe that the Proposed Regulations do not adequately address the U.S. federal income tax consequences of such a series of related transfers.

> **Example B**. In year 1, USP transfers IP, with a $0 adjusted basis and fair market value of $100x, in a Section 351 exchange to CFC1 (TFC), a controlled foreign corporation wholly owned by USP in a transfer that is subject to Section 367(d). In year 2, USP contributes all of the stock of CFC1 to related USS in a Section 351 exchange to which Treas. Reg. 1.367(d)-1T(e)(1) applies (and, as a result, USS becomes a Successor UST). Also in year 2, CFC1 contributes the IP, still with a $0 adjusted basis, to related CFC2, a controlled foreign corporation wholly owned by CFC1 in a Section 351 exchange to which Treas. Reg. Section 1.367(d)-1T(f)(3) applies (with CFC2 succeeding CFC1 as the transferee foreign corporation). In year 3, pursuant to a series of related transactions, CFC2 first distributes the transferred IP, which at the time of the distribution has a $0 adjusted basis and fair market value of $100x, to CFC1 as a distribution on the stock of CFC 2 (the "**CFC2 distribution**"). As a result of the CFC2 distribution, CFC2 recognizes $100 of gain under Section 311(b), CFC1 takes a basis of $100x in the transferred IP under Section 301(d), and CFC1 succeeds CFC2 as the TFC under Treas. Reg. Section 1.367(d)-1T(f)(3). CFC1 then distributes the transferred IP to USS, a QDP, as a distribution on the stock of CFC1 (the "**CFC1 distribution**"). As a result of the CFC1 distribution,

---

[53] We also note that the Proposed Regulations do not address the interaction of the Proposed Regulations and Notice 2012-39 with respect to any income required to be included by the UST under Section 4.02 of the Notice that, at the time of a repatriation of the relevant IP to a QDP, has not given rise to a corresponding reduction in the amount of contingent annual payments required to be included in income by a qualified successor under Section 4.04 of the Notice. In such circumstances, Treasury should consider permitting the UST to reduce the amount of gain it is required to recognize by reason of the repatriation, if any, or allowing the QDP to increase its basis in the IP, in each case by the amount of such income.

[54] For purposes of this section, we use the term "taxable transfer" to mean a transfer in which the transferred IP, in the hands of the transferee, is not transferred basis property (as defined in Section 7701(a)(43)) by reason of the transfer. We recognize that it is possible that a transferor could recognize gain in a related transfer in which the transferred IP was transferred basis property in the hands of the transferee (e.g., where the transfer qualifies as a Section 351 transaction but the transferor receives boot and recognizes gain), and many, if not all, of the same considerations discussed in this section would similarly apply to such a related transfer. However, because we think that this type of related transfer would be relatively uncommon in the context of most repatriations, and because drafting rules to deal with partial gain recognition and partial basis step-ups occurring in related transfers could be complex, we do not recommend that Treasury revise the Proposed Regulations to deal with these types of related transfers.

> CFC1 recognizes $0 of gain under Section 311(b), and USS takes a basis of $100x in the transferred IP under Prop. Reg. Section 1.367(d)-1(f)(4)(iv)(B). USS provides the information described in Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B) for the taxable year that includes the distributions.

This example is similar to Example 2 in Prop. Reg. Section 1.367(d)-1(f)(6)(ii)(C), except that Example 2 involves only a single TFC that is both the transferee of the IP and the distributor of the IP to USS in the subsequent disposition. In Example 2 of the Proposed Regulations, USS recognizes gain of $100x under Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(B) and, by reason of USS's recognition of gain, TFC reduces (but not below zero) the portion of its E&P and gross income arising by reason of the distribution ($100x) by the amount of USS's gain under the reduction rule. As a result of the application of the reduction rule, TFC has no E&P or gross income that arise by reason of the distribution, and USS may establish an account receivable from TFC equal to $100x under Prop. Reg. Section 1.367(d)-1(f)(2)(ii). In other words, the reduction rule effectively neutralizes the subpart F or GILTI tested income that would otherwise arise for TFC in connection with the taxable repatriation in Example 2 of the Proposed Regulations.

By contrast, in Example B above, CFC1 – which is the TFC after the CFC2 distribution – does not recognize any gain on the CFC1 distribution; all of the gain on the transferred IP has already been recognized by CFC 2 by reason of the CFC2 distribution. As in Example 2 of the Proposed Regulations, USS recognizes gain of $100x under Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(B), but because CFC1 does not recognize any gain, CFC1 does not have any E&P or gross income "arising by reason of the subsequent disposition" of the IP to reduce under the reduction rule. CFC2, which did recognize $100x of gain on the distribution of the transferred IP in the CFC2 distribution, does not get to reduce its earnings or profits or gross income under the reduction rule because it ceased to be the TFC when it made the CFC2 distribution, and thus is not the TFC with respect to the subsequent disposition (i.e., the CFC1 distribution) to which the reduction rule applies. The end result is that the same $100x gain in the transferred IP is recognized twice – first by CFC2 in the CFC2 distribution, and then again by USS by reason of the CFC1 distribution and Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(B).

Note, however, that if CFC1 transferred the IP to USS not by way of a taxable distribution, but instead in a nontaxable transaction (e.g., a Section 332 liquidation of CFC1 into USS), USS would recognize $0 of gain under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A), because Prop. Reg. Section 1.367(d)-1(f)(4)(ii)(A) would apply to determine the amount of gain by reference to the amount of gain that CFC1 would recognize in the liquidation if its basis in the transferred IP were equal to the UST's former adjusted basis in the property (which would be $0 by reason of Section 337). See, e.g., Prop. Reg. Section 1.367(d)-1(f)(6)(A) (Example 1). This would, however, come at the cost of USS taking a zero basis in the transferred IP under Prop. Reg. Section 1.367(d)-1(f)(4)(iv)(A), effectively resulting in the deferral of, rather than a permanent reduction in, U.S. taxable income. Nonetheless, USP and USS might prefer this result to a double inclusion of gain (with accompanying basis in the transferred IP), especially if, as is discussed above, the gain recognized by CFC2 on the CFC2 distribution is, when included

by USS, sheltered by available foreign tax credits, or subject to taxation at the reduced rate that applies to GILTI.[55]

2. Recommendations for Proposed Regulations

We believe that the results described above are not appropriate, insofar as they could lead to excessive U.S. taxation and disincentivize certain repatriations of IP, or the deferral of U.S. income recognition and tax on the repatriation of IP. Moreover, we do not believe that it should make a difference, in the case where IP is repatriated through multiple related transactions that include at least one taxable transfer (rather than a single taxable transaction), which TFC(s) recognize the relevant income or gain. Accordingly, we recommend that, in the situation where IP is ultimately repatriated to a QDP pursuant to a series of related transactions that includes one or more taxable transfers of the IP by a TFC to another TFC in a transaction that is subject to Treas. Reg. Section 1.367(d)-1T(f)(3) before the final repatriation of the IP to the QDP, the following rules apply: (i) on the repatriation of the IP to the QDP, the gain required to be recognized by the U.S. transferor and the QDP's adjusted basis in the transferred IP should be determined under the rules that apply to IP that is not transferred basis property, even if the IP would otherwise constitute transferred basis property to the QDP, and (ii) the reduction rule should apply to the TFC(s) that recognize income or gain in such prior taxable transaction(s).

Applying this approach to Example B above, regardless of whether CFC2's transfer of the transferred IP occurred by way of a taxable distribution or a nontaxable transaction, (i) USS would recognize $100x of gain, and (ii) CFC2 would be permitted to reduce its E&P and gross income arising by reason of the CFC2 distribution ($100x) by the amount of gain recognized by USS ($100x).

We recognize that, while Treasury appear to be comfortable with the use of a "related transactions" approach in Prop. Reg. Section 1.367-1(f)(4)(v) for purposes of determining whether an initial transferee is a QDP, using a similar concept for these purposes may present more difficult issues for determining whether a prior taxable transaction involving transferred IP is part of a series of related taxable transactions involving a subsequent disposition by a TFC to a QDP. For example, a taxpayer who has effected a prior taxable transfer of IP between related foreign corporations may be incentivized to later assert that the taxable transfer is part of a series of related transactions culminating in a subsequent disposition to a QDP in order to reduce or eliminate the E&P and gross income generated by the prior taxable transfer, or vice versa. It may therefore be appropriate to include (i) rebuttable presumptions that (x) transactions that occur within a specific time period (such as by the time for filing (including extensions) by UST of its tax return for the tax year in which the first such transaction occurs)) are related, and (y) transactions that do not occur within such period are not related, and (ii) a rule that transactions occurring within such time period are automatically treated as related if they occur pursuant to a single written plan entered into before the first transaction occurs. In addition, where income or gain is recognized by multiple transferors of transferred IP in the series of related transactions, it may be appropriate to include an ordering rule for determining how the reduction rule applies

[55] In addition, as noted above, the benefits of this alternative may be enhanced if CFC2 is not wholly-owned, but has minority shareholders, such that less than 100% of the income recognized by CFC2 on the CFC2 distribution would be includible by USS under Section 951 or Section 951A.

(e.g., by applying the reduction rule to the income or gain recognized by the transferors in the order of the transactions in which such income or gain was recognized).

E. Section 904(d) Proposed Regulations

As noted above, the Proposed Regulations provide that, although the principles of Section 367(d) apply for purposes of determining foreign branch income, there is a limit to how far these principles apply in that arena. Specifically, the Proposed Regulations have the effect of clarifying that the subsequent transaction rules in the existing Section 367(d) regulations and the QDP rules contained in the Proposed Regulations do not apply for purposes of Section 904. As a result, a U.S. corporation considering the repatriation of IP held in a non-U.S. branch is faced with a very different (and potentially much more complicated) set of considerations than a similarly situated U.S. corporation holding IP through a foreign corporate subsidiary.

1. Recommendations for Proposed Regulations

We recognize that, even though the intangible property rule of Treas. Reg. Section 1.904-4(f)(2)(vi)(D) is tethered to the "principles" of Section 367(d), there are different substantive considerations applicable to each of Sections 367(d) and 904(d). However, as noted below, we believe that further consideration should be given to the possibility of achieving greater harmonization between the Section 904 regulations and the Section 367(d) regulations (or at least to simplifying the manner in which Section 367(d) principles apply in the context of the Section 904(d) regulations). Accordingly, we recommend that the Proposed Regulations be implemented without the inclusion of Prop. Reg. Section 1.904-4(f)(2)(vi)(D)(4) as a final regulation and that further time be taken to consider this topic. In this case, the preamble to the final regulations could state that, until the implementation of final regulations addressing that point, Treasury intends that the Section 367(d) subsequent transaction rules (including the rules that turn off Section 367(d) payments in connection with the repatriation of IP to a QDP) will not apply for purposes of Section 904(d). Alternatively, Treasury could adopt Treas. Reg. Section 1.904-4(f)(2)(vi)(D)(4) on a temporary basis, and announce in the preamble to the temporary regulation that Treasury plans to study the applicability of this rule further.

2. Recommendations for Future Guidance

While we appreciate it is difficult to realize the objective of applying Section 367(d) principles under Section 904(d), we believe that the omission of Section 367(d) relief in the context of branch repatriations represents a meaningful missed opportunity in terms of encouraging broad based IP repatriation. Moreover, when one takes into account the potentially adverse knock-on FDII effects[56] of failing to import the helpful QDP rule into Section 904(d), the asymmetry between treatment of IP repatriation under Section 367(d) and Section 904(d) is substantial. Additionally, the rules applicable to multiple inbound/outbound disregarded payments under Treas. Reg. Section 1.904-4(f)(2)(vi)(F) are complex and ambiguous, and the

[56] As noted above, the "repatriation" of IP from a foreign branch to the U.S. home office would, under the Proposed Regulations and the Section 904 regulations, create a stream of 367(d) income inclusions for the foreign branch. In turn, these Section 367(d) inclusions would reduce (under Section 250(b)(3)(A)(VI) of the Code) the ability of the U.S. taxpayer to claim FDII benefits with respect to its otherwise FDII eligible income earned in connection with IP. This degradation in FDII capacity could be a meaningful deterrent to bringing the IP back from the foreign branch.

failure to apply the helpful QDP rule to IP transfers from a foreign branch to its owner will increase the frequency with which these rules apply.

We have given preliminary consideration to alternatives that potentially could be pursued here.

In particular, we believe that further consideration should be given to "turning off" the original stream of inbound Section 367(d) inclusions to the branch owner once the IP is repatriated back to such owner. Under this approach, following repatriation, there would no longer be attribution to the foreign branch owner of income corresponding to deemed payments with respect to such IP under the principles of Section 367(d). Instead, all income from the exploitation of the IP would generally be attributed to the foreign branch owner. The only exception to such treatment would be that, to the extent activity or expenditures by the foreign branch had added value to the IP prior to the repatriation, income would be attributed to the foreign branch under the principles of Sections 367(d) and 482 to reflect the branch's incremental economic contribution since the time of expatriation.

This approach would generally put the foreign branch owner in the substantially the same position as it had been in before the outbound transfer of IP to the foreign branch. In addition, attribution to the foreign branch of income corresponding to the incremental value it had added to the IP would prevent economic distortion or manipulation.[57] Because the policy of encouraging repatriation of IP is not implicated where IP is transferred from one foreign branch to another, it does not appear necessary to apply this approach to inter-branch transfers.

F. Other Recommendations

1. Clarify Relief Provisions

As noted above, under Prop. Reg. Section 1.367(d)-1(f)(4), the Section 367(d) regime may be turned off when previously expatriated IP is repatriated to a QDP, but only if certain reporting requirements are met. These include the requirement under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B) (the "**Section 6038B Reporting Requirement**") that the U.S. transferor provides the information described in Treas. Reg. Section 1.6038B-1(d)(2)(iv). When a failure to comply with these reporting requirements occurs, the IP repatriated to the QDP generally remains subject to the full battery of Section 367(d) provisions, even though the UST is still required to recognize gain under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A).

[57] In some ways, our proposed elimination of the "inbound" income inclusion (created at the time of the "expatriation" to the foreign branch) coupled with the incremental "outbound" income inclusion (created at the time of the repatriation) may be seen as an effective "netting" of the income streams associated with these two separate IP transfers. The 904 Preamble indicates that netting of disregarded payments between a branch and branch owner (or between branches) could lead to technical distortions in the proper functioning of the Section 904 rules and produce arbitrary outcomes because, among other things,"[n]etting disregarded payments would distort these rules by preventing the disregarded payment rule from accurately identifying the source and character of gross income that is attributable to the foreign branch and its owner, respectively." We believe that our proposed approach represents a feasible way to balance the technical concerns associated with the sound operation of Section 904(d) and the objective of encouraging broad-based IP repatriation.

However, in order to mitigate the harsh effects that might otherwise prevail, Prop. Reg. Section 1.367(d)-1(f)(5) offers relief for the failure of the U.S. transferor to comply with these information reporting requirements:

> Nevertheless, a failure to comply is deemed not to have occurred (regardless of whether the U.S. transferor continued to include amounts in gross income under § 1.367(d)-1T(c) or (e) after the subsequent disposition), and the requirements of paragraph (f)(4)(i)(B) of this section are treated as satisfied as of the date of the subsequent disposition if, promptly after the U.S. transferor becomes aware of the failure, the U.S. transferor provides such information and provides a reasonable explanation for its failure to comply to the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate). Additionally, the U.S. transferor must timely file an amended return for the taxable year in which the subsequent disposition occurred (and, if applicable, for each taxable year starting with the taxable year immediately after the taxable year in which the subsequent disposition occurred and ending with the taxable year in which the U.S. transferor seeks relief under this paragraph (f)(5)) that includes the information required by paragraph (f)(4)(i)(B) of this section. If any taxable year of the U.S. transferor is under examination when an amended return is filed, a copy of the amended return (or, if applicable, amended returns) must be provided to the Internal Revenue Service personnel conducting the examination.

We agree that a relief provision for a failure to comply with the Section 6038B Reporting Requirement is appropriate and commend Treasury for including such a provision. However, we have several minor comments with respect to the provision that we think will make it more administrable and avoid uncertainty as to the requirements that must be met for it to apply:

- First, we are concerned that the use of the word "promptly" does not provide either taxpayers or the IRS with enough guidance to determine when a U.S. transferor has timely satisfied its obligation to provide the required information to the IRS. Balancing the interests of the Service and taxpayers, we would recommend that a U.S. transferor be required to provide the required information to the IRS no later than (say) 45 days after the end of the year in which the U.S. transferor first becomes aware of a failure to comply.

- Second, with respect to the manner in which the required information is to be provided to the Service, it is unusual, in our experience, for a taxpayer to be required to provide information required under a Treasury regulation (and which affects the tax consequences of a transaction to the taxpayer or related taxpayers) directly to a specified official within the IRS. While we do not have reason based on past experience to believe that this manner of providing the required information to the IRS will be problematic, we nonetheless suggest that the IRS consider in the future prescribing a particular form and manner of filing for the provision of the required information (and potentially refer to the relevant form in the final version of the Proposed Regulations).

- Finally, the last two sentences of Prop. Reg. Section 1.367(d)-1(f)(5) state that "[a]dditionally," the U.S. transferor "must" (i) timely file one or more amended returns for the taxable year in which the subsequent transfer occurred and succeeding years, and (ii) if the U.S. transferor is under examination when an amended return is filed, provide a copy of the amended return(s) to the IRS personnel conducting the examination. It is unclear whether, if the U.S. transferor fails to comply with these requirements, the relief provision applies. The first sentence quoted above provides flatly that the relief provision applies if promptly after becoming aware of the failure to comply, the U.S. transferor provides that required information to the IRS; such sentence does not state that the availability of the relief is conditioned on compliance with the two additional requirements in the last two sentences of Prop. Reg. Section 1.367(d)-1(f)(5). As drafted, therefore, relief does not appear to be conditioned on compliance with these two additional requirements, and there are no stated consequences for a failure to comply with either or both of these two requirements. At a minimum, we would recommend that Treasury revise the relief provision to make it clear whether or not relief is conditioned on such compliance. In terms of whether or not relief should be conditioned on such compliance, it seems appropriate to us for relief to be conditioned on the requirement that a taxpayer timely file the required amended return(s), but not for a failure to provide the amended returns to the examination team. Similar to the point discussed in the preceding bullet, in our experience it is unusual for a taxpayer to provide an amended return directly to a specified IRS official or officials.

2. Expand the Analysis in Example 3

Prop. Reg. Section 1.367(d)-1(f)(6)(ii)(C) (Example 3) builds on Prop. Reg. Section 1.367(d)-1(f)(6)(ii)(C) (Example 1). In Example 1, in year 2, USP transfers all of the stock of TFC to USS, a related person within the meaning of Treas. Reg. Section 1.367(d)-1T(h) and Prop. Reg. Section 1.367(d)-1(h)(2)(ii), in a Section 351 exchange to which Treas. Reg. 1.367(d)-1T(e)(1) applies. In year 3, TFC distributes all of its property (including the transferred IP) to USS pursuant to a complete liquidation under Section 332. There is no "all earnings and profits amount" under Treas. Reg. Section 1.367(b)-2(d) with respect to the stock of TFC held by USS. USS complies with the information reporting requirements in Treas. Reg. Section 1.6038B-1(d)(2)(iv), as required by Prop. Reg. Section 1.367(d)-1(f)(4)(i)(B).

In Example 3, the facts are the same as in Example 1, except that (i) the transfer of stock of TFC to USS in year 2 does not occur and instead of a liquidation in year 3, TFC transfers the transferred IP to USS (a QDP) in an exchange described in Section 351(b) "pursuant to which TFC recognizes $50x of gain [presumably because TFC is treated as receiving at least $50 of boot in the form of property or assumption of liabilities and has at least $50x of gain in the transferred IP], and USP recognizes $50x of gain" under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A). The analysis section in Example 3 deals only with USS's adjusted basis in the transferred IP, stating that such basis is $50x, the amount equal to the lesser of USP's former basis in the transferred IP ($0) or TFC's adjusted basis in the transferred IP (also $0), increased by the greater of the amount of gain recognized by USP under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A) ($50x) or the amount of gain recognized by TFC upon the year 3 exchange (also $50x).

We agree with the result and the analysis in Example 3 insofar as it relates to USS's basis in the IP. However, we are concerned that readers of the example may be confused by the statement in the example that the amount of gain recognized by TFC upon the year 3 exchange is $50x. While that is true under the facts of the example, the example omits the fact that, under Prop. Reg. Section 1.367(d)-1(f)(2)(i), TFC reduces (but not below zero) the portion of its E&P and gross income arising by reason of the year 3 exchange by the amount of gain recognized by USP under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A). Since Prop. Reg. Section 1.367(d)-1(f)(2)(i) technically does not reduce the amount of *gain recognized* by TFC upon the year 3 exchange, but reduces only TFC's E&P and *gross income* arising by reason of the year 3 exchange, the example is technically correct. However, this is a subtle distinction that may be lost on some readers. In order to avoid confusion, we recommend that either (i) Treasury expand the analysis section of Example 3 to cover all of the material consequences of the application of the Proposed Regulations to the facts of Example 3, similar to the analysis section in Example 1, or (ii) at the very least add a sentence to Example 3 noting that under Prop. Reg. Section 1.367(d)-1(f)(2)(i), TFC will reduce its E&P and gross income by $50x, the amount of gain recognized by USP under Prop. Reg. Section 1.367(d)-1(f)(4)(i)(A).