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

Report No. 1496
July 25, 2024

The Honorable Aviva Aron-Dine
Acting 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 Marjorie A. Rollinson
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Dear Mses. Aron-Dine and Rollinson, and Mr. Werfel:

I am pleased to submit Report No. 1496 of the Tax Section of the New York State Bar Association, which discusses Notice 2024-16.

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,

Jiyeon Lee-Lim
Chair

Enclosure

cc:

Scott Levine
Acting Deputy Assistant Secretary (International Tax Affairs)
Department of the Treasury

Lindsay M. Kitzinger
International Tax Counsel
Department of the Treasury

James Wang
Deputy International Tax Counsel
Department of the Treasury

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

William M. Paul
Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical)
Internal Revenue Service

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

Azeka Abramoff
Special Counsel, Office of the Associate Chief Counsel (International)
Internal Revenue Service

Teisha M. Ruggiero
Branch Chief, Branch 4, Office of Associate Chief Counsel (International)
Internal Revenue Service

Chadwick P. Roland

Senior Technical Reviewer, Branch 4, Office of Associate Chief Counsel (International)
Internal Revenue Service

Karen R. Li
Senior Counsel, Branch 4, Office of Associate Chief Counsel (International)
Internal Revenue Service

Brady Plastaras
General Attorney, Branch 4, Office of Associate Chief Counsel (International)
Internal Revenue Service

Shane M. McCarrick
Special Counsel, Office of Associate Chief Counsel (International)
Internal Revenue Service

Andrew F. Gordon
Special Counsel, Office of Associate Chief Counsel (International)
Internal Revenue Service

Report No. 1496

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

REPORT ON NOTICE 2024-16

GUIDANCE RELATED TO SECTION 961 AND CERTAIN INBOUND NON-RECOGNITION TRANSACTIONS

July 25, 2024

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New York State Bar Association Tax Section

Report on Notice 2024-16
Guidance Related to Section 961 and Certain Inbound Nonrecognition Transactions[1]

I. Introduction

On December 28, 2023, Treasury[2] released Notice 2024-16 (the "**Notice**") announcing their intention to issue proposed regulations addressing the treatment of basis adjustments under section 961(c) in connection with certain inbound transactions. This report (the "**Report**") addresses the Notice and provides recommendations for the proposed regulations.

The Report is divided into five parts. Following this Introduction (Part I), Part II summarizes our principal recommendations for consideration. Part III provides an overview of the relevant statutory provisions, summarizes the Notice's proposal for future regulations, and considers the overall design and policy objectives of section 961(c). Part IV analyzes the scope of relief provided under the Notice and makes recommendations regarding whether, and how, to expand the Notice's scope. Finally, Part V addresses various other issues relevant to the Notice and makes recommendations regarding the allocation of interest in respect of inherited basis adjustments under section 961(c), currency translation under the Notice, and the Notice's consistency rule.

II. Summary of Principal Recommendations[3]

1. Treasury should relax the provisions of the Notice denying relief to inbound transactions that cause more than a *de minimis* shift of the benefit of section 961(c) basis from the inclusion U.S. shareholder to a person other than the inclusion U.S. shareholder or a member of its consolidated group. If such provisions are retained, in whole or in part, Treasury should identify the specific concerns raised by inbound transactions that cause more than a *de minimis* shift in ownership and grant the Service ruling authority to preserve section 961(c) basis in circumstances that do not implicate those concerns.

2. Treasury should extend the relief provided under the Notice to transferor CFCs owned by partnerships, S corporations, RICs, REITs, and individuals.

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[1] The principal authors of this Report are Bradley Ahrens, Kristen Gamboa, Stephen Massed, Gary Scanlon, and Wade Sutton. This Report reflects comments and contributions from Kimberly Blanchard, Peter Connors, Gloria LaBerge, Jiyeon Lee-Lim, Michael Mollerus, Barbara Rasch, Michael Schler, Eric Sloan, Laura Williams, and Libin Zhang. 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] Except as otherwise noted, a reference to "**Treasury**" is a reference to the U.S. Department of the Treasury, including the U.S. Internal Revenue Service (the "**Service**"), a reference to "**section**" is a reference to a section of the Internal Revenue Code of 1986, as amended (the "**Code**"), a reference to the "**regulations**" is a reference to the Treasury Regulations promulgated thereunder, and a reference to "**Treas. Reg. §**" is a reference to a section of the regulations.

[3] Terms used in this Part II and not yet defined have the meanings provided below.

3. Treasury should eliminate the BIL CFC exception. Alternatively, if Treasury remains concerned about allowing a domestic acquiring corporation to recognize a loss attributable to section 961(c) basis, it should replace the BIL CFC exception with the section 961(c) loss disallowance rule (as described below).

4. Treasury should eliminate the subsequent transfer exceptions. If the subsequent transfer exceptions are retained in the proposed regulations, Treasury should make the following changes:

a. Revise the other transfer exception to provide that it does not apply to subsequent recapitalizations or asset reorganizations of the acquired CFC;

b. Remove the *per se* rule of the other transfer exception or convert it into a rebuttable presumption;

c. Clarify that, in the case of a subsequent transfer of an acquired CFC to a foreign corporation subject to a subsequent transfer exception, the transferor CFC's section 961(c) basis in the stock of the acquired CFC attributable to the inclusion U.S. shareholder that existed prior to the inbound transaction is preserved after the transaction, with adjustments for distributions of PTEP while held directly by the U.S. shareholder;

d. Permit the section 961(c) basis in the hands of the domestic acquiring corporation to operate provisionally as adjusted basis for the interim period between the inbound transaction and the subsequent outbound transfer that is subject to the subsequent transfer exception; and

e. Permit the section 961(c) basis to be considered for purposes of determining collateral consequences of a subsequent outbound transfer of the acquired CFC by the domestic acquiring corporation.

5. Treasury should clarify that section 961(c) basis that becomes adjusted basis is excluded from stock basis for purposes of interest expense apportionment.

6. Treasury should clarify the parameters of what constitutes a "reasonable method" for the conversion of section 961(c) basis into U.S. dollars.

7. Treasury should clarify (a) the intended scope of the consistency rule and (b) that the consistency rule applies only prospectively from the date of the Notice.

III. Background

A. Overview of Relevant Statutory Provisions

A United States person (or "**U.S. person**") is taxed currently on its share of certain income of a controlled foreign corporation (or "**CFC**") of which it is a United States shareholder (or "**U.S. shareholder**"). A CFC is a foreign corporation that is owned more than 50 percent, by vote or

value, by U.S. shareholders.[4] A U.S. shareholder of a foreign corporation is a U.S. person that owns directly or indirectly under section 958(a) (or constructively under 958(b)) 10 percent or more of either the total combined voting power of all classes of stock entitled to vote of such foreign corporation or the total value of shares of all classes of stock of such foreign corporation.[5] A U.S. person includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and an estate that is not a foreign estate, and certain trusts.[6]

1. CFC Inclusions

Section 951(a) provides that a U.S. shareholder of a CFC that owns directly or indirectly (under section 958(a)) stock in the CFC on the last day in the taxable year on which such corporation was a CFC includes in its gross income its pro rata share of the CFC's subpart F income (as defined in section 952(a)) (such inclusion, a "**subpart F inclusion**"). Generally, a U.S. shareholder's pro rata share of a CFC's subpart F income is generally determined based on its proportionate share of a hypothetical distribution of all the current E&P of the CFC.[7]

Similarly, section 951A requires that each U.S. shareholder of a CFC include in gross income its global intangible low-taxed income (such inclusion, a "**GILTI inclusion**") for the taxable year. In computing its GILTI inclusion, a U.S. shareholder must take into account its pro rata share of each "tested item" of all its CFCs (*e.g.*, tested income and tested loss).[8] In general, a U.S. shareholder's pro rata share of any tested item is determined under rules similar to determining the shareholder's pro rata share of subpart F income.[9]

A GILTI inclusion is treated the same as a subpart F inclusion for purposes of several Code provisions, including sections 959, 961, and 962.[10] Because of this similar treatment, except as the context requires, this Report generally does not distinguish between a subpart F inclusion or a GILTI inclusion, referring to each as a "**CFC inclusion**," except when necessary to differentiate between the two types of inclusions.

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[4] Section 957(a).

[5] Section 951(b).

[6] Sections 957(c) and 7701(a)(30).

[7] Section 951(a)(1); Treas. Reg. §§ 1.951-1(b)(1)(i), (e)(1).

[8] Sections 951A(c)(1)(A), (B); Treas. Reg. § 1.951A-1(c).

[9] Section 951A(e)(1); Treas. Reg. § 1.951A-1(d); *see also* section 951(a)(2); Treas. Reg. §§ 1.951-1(b), (e).

[10] *See* Section 951A(f)(1)(A) (providing that a GILTI inclusion is treated in the same manner as a subpart F inclusion for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4)). For these purposes, the portion of a U.S. shareholder's GILTI inclusion that is treated as being with respect to a CFC is (a) for a CFC with a tested loss or no tested income, zero, and (b) for a CFC with tested income, the GILTI inclusion multiplied by the ratio of: (i) the U.S. shareholder's pro rata share of the CFC's tested income, over (ii) the shareholder's aggregate pro rata share of the tested income of all of its CFCs. Section 959(f)(2).

2. PTEP and Basis Adjustments

(a) Section 959

Section 959 provides rules for avoiding double taxation of income and earnings taxed to a U.S. shareholder under sections 951(a) and 951A (such U.S. shareholder, an "**inclusion U.S. shareholder**"). Section 959(a) provides an exclusion from the income of inclusion U.S. shareholders for previously taxed earnings and profits ("**PTEP**") subsequently distributed to such shareholders or invested in U.S. property. Section 959(d) provides that a distribution of PTEP excluded under section 959(a) is not treated as a dividend for purposes of chapter 1 of the Code, but such distribution will reduce earnings and profits ("**E&P**") of the distributing CFC. Section 959(b) provides a similar exclusion for distributions of PTEP from a lower-tier CFC to a higher-tier CFC, excluding such distributions from the gross income of the higher-tier CFC for purposes of computing the inclusion U.S. shareholder's subpart F inclusion.[11] Section 959(c) provides rules for determining the E&P source of a distribution, stating that distributions are sourced first out of PTEP and then out of untaxed E&P.

Section 959 also applies to any U.S. person that acquires from an inclusion U.S. shareholder stock in a foreign corporation with respect to which the shareholder has had an inclusion (such U.S. person, a "**section 959 successor**").[12] However, a section 959 successor may claim an exclusion from gross income under section 959(a) on PTEP distributions only to the extent the section 959 successor establishes to the satisfaction of the Service its right to the exclusion.[13] The regulations prescribe the information that a section 959 successor must furnish to the Service to establish its right to an exclusion.[14]

(b) Section 961

Section 961 contains rules for adjusting an inclusion U.S. shareholder's basis in CFC stock to reflect CFC inclusions and PTEP distributions. Section 961(a) generally provides that an inclusion U.S. shareholder's basis in its shares of CFC stock, or the basis of property by reason of

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[11] It is unclear whether section 959(b) also excludes CFC-to-CFC distributions of PTEP from the recipient CFC's tested income. However, even if section 959(b) does not apply for purposes of computing tested income, a CFC's receipt of PTEP from a related CFC would be treated as a related party dividend (because section 959(d) does not apply to treat a CFC-to-CFC PTEP distribution as "not a dividend") that is excluded from tested income under section 951A(c)(2)(A)(i)(IV) and Treas. Reg. § 1.951A-2(c)(1)(iv). *See also* Douglas Poms, *The Elusive Nature of Code Sec. 961(c) Basis in a Post-TCJA Multiverse*, INT'L TAX J., Sept.-Oct. 2022, at 57-58.

[12] *See* section 959(a) (flush language); Treas. Reg. § 1.959-1(d) (flush language).

[13] Treas. Reg. § 1.959-1(d) (flush language).

[14] A section 959 successor establishes its right to the exclusion for distributions of PTEP by providing the following information: (1) the name, address, and taxable year of the foreign corporation from which the distribution is received and of all other corporations, partnerships, trusts, or estates in any applicable chain of ownership described in section 958(a); (2) the name, address, and taxpayer identification number of the person from whom the stock interest was acquired; (3) a description of the stock interest acquired and its relation, if any, to a chain of ownership described in section 958(a); (4) the amount for which an exclusion under section 959(a) is claimed; and (5) evidence showing that the E&P for which an exclusion is claimed are attributable to amounts subject to a CFC inclusion, that such amounts were not previously excluded from the gross income of a U.S. person, and the identity of the U.S. shareholder including such amounts. Treas. Reg. § 1.959-1(d)(1)-(5).

which the shareholder owns the CFC (*e.g.*, the stock of an upper-tier CFC or interest in an upper-tier partnership), is increased by the amount of a CFC inclusion. Section 961(b)(1) generally provides that an inclusion U.S. shareholder's basis in CFC stock is reduced by a subsequent distribution of PTEP. Net positive basis adjustments under section 961(a), taken into account the reduction under section 961(b)(1), are referred to in this Report as "**section 961(a) basis**." If a distribution of PTEP exceeds a U.S. shareholder's basis in the distributing CFC stock, section 961(b)(2) provides that the excess amount is treated as gain from the sale or exchange of property.[15]

Section 961(c) was added to the Code by the Taxpayer Relief Act of 1997[16] (the "**TRA**") to address the basis consequences where one CFC (an "**upper-tier CFC**") disposes of stock in another CFC (a "**lower-tier CFC**") with undistributed PTEP. Specifically, section 961(c) provides that, under regulations provided by Treasury, if an inclusion U.S. shareholder is treated under section 958(a)(2) as owning stock in lower-tier CFC owned by an upper-tier CFC, then adjustments similar to adjustments under section 961(a) and (b) must be made to the basis of such stock, and the basis of stock in any other CFC by reason of which the U.S. shareholder is considered under section 958(a)(2) as owning the stock in the lower-tier CFC (net positive basis adjustments under section 961(c), "**section 961(c) basis**"). However, section 961(c) basis applies "only for the purposes of determining the amount included under section 951 in the gross income of such U.S. shareholder."[17]

The Senate Report to the TRA describes the operation of section 961(c) as follows:

> Under the bill, when a lower-tier CFC earns subpart F income, and stock in that corporation is later disposed of by an upper-tier CFC, the resulting income inclusion of the U.S. 10-percent shareholders, under regulations, is to be adjusted to account for previous inclusions, in a manner similar to the adjustments provided to the basis of stock in a first-tier CFC. Thus, just as the basis of a U.S. 10-percent shareholder in a first-tier CFC rises when subpart F income is earned and falls when previously taxed income is distributed, so as to avoid double taxation of the income on a later disposition of the stock of that company, the subpart F income from gain on the disposition of a lower-tier CFC generally is reduced by income inclusions of earnings that were not subsequently distributed by the lower-tier CFC.
>
> For example, assume that a U.S. person is the owner of all of the stock of a first-tier CFC which, in turn, is the sole shareholder of a second-tier CFC. In year 1, the second-tier CFC earns $100 of subpart F income which is included in the U.S. person's gross income for that year. In year 2, the first-tier CFC disposes of the second-tier CFC's stock and recognizes $300 of income with respect to the disposition. All of that income constitutes

[15] As discussed below in Part IV.C of the Report, special rules in section 961 apply to an inclusion U.S. shareholder that makes a section 962 election (*i.e.*, an electing U.S. shareholder).

[16] PUB. L. NO. 105-34, § 1122(c), 111 Stat. 788, 969 (1997).

[17] Section 961(c) (flush language).

> subpart F foreign personal holding company income. Under the bill, the Secretary is granted regulatory authority to reduce the U.S. person's year 2 subpart F inclusion by $100—the amount of year 1 subpart F income of the second-tier CFC that was included, in that year, in the U.S. person's gross income. Such an adjustment, in effect, allows for a step-up in the basis of the stock of the second-tier CFC to the extent of its subpart F income previously included in the U.S. person's gross income.[18]

The discussion of section 961(c) in the conference report accompanying the TRA and the General Explanation of Tax Legislation Enacted in 1997 are substantially similar to the description in the Senate Report.[19]

B. The Notice

1. General Rule

Prior to the Notice, it was unclear whether a corporate U.S. shareholder (a "**domestic acquiring corporation**") acquiring the stock of a lower-tier CFC (an "**acquired CFC**") from an upper-tier CFC (a "**transferor CFC**") in an inbound liquidation under section 332 (an "**inbound liquidation**") or an inbound asset reorganization described in section 368 (an "**inbound reorganization**," and, with an inbound liquidation, an "**inbound transaction**") could inherit the transferor CFC's section 961(c) basis with respect to the stock of the acquired CFC. The domestic acquiring corporation in an inbound transaction generally inherits the basis of the transferor CFC in the stock of the acquired CFC under section 334(b) or section 362(b). Section 961(c) basis, however, applies solely for the purpose of determining a U.S. shareholder's subpart F inclusion. Taxpayers were concerned that a domestic acquiring corporation could not use section 961(c) basis to reduce its own non-economic gain on subsequent PTEP distributions from the acquired CFC or on the subsequent sale of the stock of the acquired CFC.

The Notice announces Treasury's intention to issue proposed regulations that would treat a transferor CFC's section 961(c) basis as adjusted basis (*i.e.*, basis for all purposes of the Code) to determine the adjusted basis that a domestic acquiring corporation in a covered inbound transaction receives in the stock of an acquired CFC under section 334(b) or section 362(b).[20] The proposed regulations would therefore allow a domestic acquiring corporation in a covered inbound transaction to inherit section 961(c) basis with respect to an acquired CFC.[21]

A "**covered inbound transaction**" is any inbound transaction described in one of two categories of inbound transactions: (a) inbound liquidations and upstream inbound reorganizations

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[18] S. REP. NO. 105-33 (1997) (the "**Senate Report**"), at 206.

[19] *See* H.R. REP. NO. 105-220, at 620 (1997) (the "**House Report**"); STAFF OF J. COMM. ON TAXATION, 105TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1997, at 305 (Comm. Print 1997).

[20] Notice, § 3.01.

[21] This Report does not express a view as to Treasury's authority to issue regulations implementing the Notice. It should be noted, though, that all covered inbound transactions are described under section 367(b), which provides authority to make "adjustments . . . to earnings and profits, basis of stock or securities, and basis of assets" in connection with such transactions. Section 367(b)(2)(B).

under section 368(a)(1)(A) (an "**upstream A reorganization**") and section 368(a)(1)(C) (an "**upstream C reorganization**," and, together with an inbound liquidation, an "**upstream inbound transaction**") and (b) inbound nontriangular reorganizations under section 368(a)(1)(A) (an "**A reorganization**") and section 368(a)(1)(C) (a "**C reorganization**"), nondivisive asset reorganizations under section 368(a)(1)(D) (a "**D reorganization**"), and reorganizations described under section 368(a)(1)(F) (an "**F reorganization**" and, together with a nontriangular A reorganization, C reorganization, and D reorganization, a "**sideways inbound transaction**").[22] For any inbound transaction to qualify as a covered inbound transaction, two ownership requirements must be satisfied:

1. **Acquired CFC ownership requirement** – the domestic acquiring corporation must acquire all the stock of the acquired CFC from a transferor CFC that, immediately before the transaction and any related transactions, owns (directly or indirectly under section 958(a)(2)) all of the stock of the acquired CFC.

2. **Transferor CFC ownership requirement** – immediately before the inbound transaction, all of the stock of the transferor CFC must be owned directly, in the case of an upstream inbound transaction, by the domestic acquiring corporation or, in the case of a sideways inbound transaction, a single domestic corporation (or members of the same consolidated group) (any domestic corporation described in this paragraph, including members of a consolidated group, the "**prescribed domestic corporation**").

One additional ownership requirement must be satisfied for a sideways inbound transaction to qualify as a covered inbound transaction. Specifically, the prescribed domestic corporation that directly owns all of the stock of the transferor CFC immediately before the sideways inbound transaction must directly own all the stock of the domestic acquiring corporation immediately after the transaction and any related transactions (the "**domestic acquiring corporation ownership requirement**").

The strict stock ownership requirements for covered inbound transactions are subject to limited *de minimis* exceptions.[23] First, a transaction will not fail the transferor CFC ownership requirement solely because one or more persons other than the prescribed domestic corporation own, in the aggregate, one percent or less of the total fair market value of the stock of the transferor CFC immediately before the transaction.[24] Second, for purposes of the acquired CFC ownership requirement, stock of the acquired CFC owned by one or more persons other than the transferor CFC immediately before the transaction and any related transactions that represents (in the aggregate) one percent or less of the total fair market value of the stock of the acquired CFC is disregarded, provided that if such person(s) is not related to the prescribed domestic corporation

[22] Notice, § 3.02(1)-(2).

[23] *Id.*, § 3.03.

[24] *Id.*

within the meaning of section 267(b) or 707(b)(1), such person(s) must continue to own the acquired CFC stock after the transaction and any related transactions.[25]

2. Exceptions

In addition to the ownership limitations described above, the Notice provides several exceptions to the definition of covered inbound transaction.[26] Specifically, an inbound transaction that would otherwise satisfy the requirements of a covered inbound transaction does not constitute a covered inbound transaction if:

- Money or other property (*i.e.*, boot) received as part of the transaction exceeds one percent of the total fair market value of the stock of the transferor CFC.

- The acquired CFC stock has a built-in loss (such CFC, a "**BIL CFC**" and such stock, "**BIL CFC stock**") immediately before the covered inbound transaction (the "**BIL CFC exception**").

- Stock of the acquired CFC is transferred in a transaction described in section 368(a)(2)(C) or Treas. Reg. § 1.368-2(k)(1), unless the transferee is (i) a member of the same consolidated group of the domestic acquiring corporation and wholly-owned by one or more members of that consolidated group or (ii) is the common parent of that consolidated group (the "**controlled transfer exception**").

- Stock of the acquired CFC is transferred to a partnership or foreign corporation pursuant to a plan (or series of related transactions) (the "**other transfer exception**" and, with the controlled transfer exception, the "**subsequent transfer exceptions**").[27]

- The domestic acquiring corporation is a regulated investment company (a "**RIC**"), a real estate investment trust (a "**REIT**"), or an S corporation.

If the stock of multiple acquired CFCs is transferred by a single transferor CFC in a transaction that would otherwise satisfy the requirements of a covered inbound transaction, the BIL CFC exception and the subsequent transfer exceptions apply separately with respect to each acquired CFC.[28] Therefore, for example, if a transferor CFC that owns both a BIL CFC and a CFC whose stock has a built-in gain (such CFC, a "**BIG CFC**") engages in an inbound liquidation that otherwise satisfies the requirements of a covered inbound transaction, the liquidation would not

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[25] *Id.*

[26] *Id.*, § 3.04(1)-(5).

[27] A plan is deemed to exist for transfers to a partnership or a foreign corporation within two years of the completion date of the covered inbound transaction. *Id.*, § 3.04(4).

[28] *Id.*, § 3.04 (final paragraph).

qualify as a covered inbound transaction with respect to the BIL CFC but would still qualify as a covered inbound transaction with respect to the BIG CFC.

3. Reliance

Taxpayers may rely on the guidance in the Notice for covered inbound transactions completed on or before the date of the forthcoming proposed regulations, provided the taxpayer and all related parties consistently apply all the rules in the Notice.[29] However, the Notice states that taxpayers should not draw inferences about the treatment of section 961(c) basis in transactions other than covered inbound transactions.[30] The Notice indicates that Treasury will consider extending the relief described in the Notice to transactions that are not covered inbound transaction in future guidance.[31]

Taxpayers that rely on the Notice that maintain section 961(c) basis in a currency other than the U.S. dollar ("**USD**") must translate the section 961(c) basis to USD under a reasonable method applied consistently to all acquired CFCs in any covered inbound transaction.[32] A reasonable method uses an exchange rate that reflects the original USD amounts of the section 961(c) basis reduced, as applicable, to take into consideration distributions of PTEP.[33]

C. The Policy Objective of Section 961(c)

The avoidance of double taxation is the clear policy objective of section 961(c). Both the House Report and the Senate Report analogize section 961(c) basis to section 961(a) basis as a means "to avoid double taxation of the income on a later disposition of the stock of that company."[34] The Notice similarly identifies the avoidance of double taxation as a rationale for providing relief for covered inbound transactions:

> A domestic acquiring corporation may recognize gain on a subsequent distribution of [PTEP] from the acquired CFC under section 961(b)(2) or recognize gain attributable to PTEP on a disposition of stock in the acquired CFC if the domestic acquiring corporation's adjusted basis in the stock of the acquired CFC does not reflect the section 961(c) basis that the transferor CFC had in the stock of the acquired CFC before the [inbound transaction]. The Treasury Department and the IRS are of the view that, in certain cases, this result may prevent taxpayers from engaging in [inbound transactions]

[29] Notice, § 4.

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] H.R. REP. NO. 105-220, at 620 (1997); S. REP. NO. 105-33, at 206 (1997).

> and would be inconsistent with one of the purposes of section 961, which is to prevent double taxation of the same CFC earnings.[35]

Section 961(a) basis is also intended to address double taxation, but such basis is considered adjusted basis for all purposes of the Code and thus is not inextricably linked to a single shareholder. As a result, a U.S. shareholder, by contributing its stock in a CFC to a domestic corporation in a nonrecognition transaction, can shift the indirect benefit of its section 961(a) basis with respect to the CFC to the other shareholders of such domestic corporation, in the same manner as the benefit of adjusted basis may generally be shifted under the normal operation of the rules of Subchapter C.[36]

Section 961(c) addresses double taxation differently than section 961(a) by providing for basis adjustments that apply solely for purposes of determining the subpart F inclusion of an inclusion U.S. shareholder.[37] Thus, section 961(c) basis operates as an attribute of the inclusion U.S. shareholder, rather than an attribute of the upper-tier CFC shared indirectly by all shareholders, with the limited purpose of reducing that shareholder's subsequent subpart F inclusion.[38] This shareholder-specific characteristic of section 961(c) basis is necessary, in the first instance, to ensure that only the inclusion U.S. shareholder that was taxed on the income giving rise to section 961(c) basis benefits from such basis where the upper-tier CFC is owned, directly or indirectly, by other shareholders. If section 961(c) basis were adjusted basis of the upper-tier CFC in the stock of the lower-tier CFC for all purposes of the Code without regard to the identity of the inclusion U.S. shareholder, a portion of the benefit of such basis could shift from the inclusion U.S. shareholder to other U.S. owners of the upper-tier CFC. Section 961(a) basis, in contrast, is naturally shareholder-specific, because the section 961(a) basis adjustments occur solely with respect to stock or property owned directly by the inclusion U.S. shareholder. Thus, the shareholder-specific nature of section 961(c) is a necessary extension of section 961(a).

For the reasons discussed below, we do not believe the shareholder-specific nature of section 961(c) basis should guide Treasury in determining the scope of the relief afforded in the Notice. In particular, when the anti-double taxation objective of section 961(c) conflicts with its shareholder-specific design, the observations and recommendations in this Report prioritize the former. The discussion below and any recommendations and observations consider only a limited set of issues related to the Notice's scope, definitions, exceptions, limitations, and various other related issues.

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[35] Notice, § 2.

[36] *See* Part IV.A, Example 4, *infra*, for an illustration of the ability to shift adjusted basis in nonrecognition transactions.

[37] As discussed below in Part IV.A of the Report, there is some uncertainty regarding whether, and to what extent, section 961(c) basis is taken into account for purposes of computing the tested income of an upper-tier CFC.

[38] S. REP. NO. 105-33, at 206. (stating that the adjustments called for under section 961(c) are made to "the resulting income inclusion of the U.S. 10 percent shareholders"). As the Senate Report example reprinted in Part III.C of this Report illustrates, an inclusion U.S. shareholder's section 961(c) basis with respect to a lower-tier CFC merely reduces the resulting subpart F *inclusion* of the inclusion U.S. shareholder upon a disposition of the lower-tier CFC; such basis does not reduce the subpart F *income* (or E&P) of the upper-tier CFC.

IV. Scope of Relief Provided Under the Notice

A. Section 961(c) Basis Shifting

As discussed in Part III.C of this Report, section 961(c) basis is an attribute of the inclusion U.S. shareholder. Certain provisions of the Notice appear to be designed to safeguard the shareholder-specific nature of section 961(c) by turning off the Notice's relief for an inbound transaction where such relief, if applicable, would otherwise cause a more than *de minimis* shift of the benefit of the section 961(c) basis from the inclusion U.S. shareholder to a person other than the inclusion U.S. shareholder or a member of its consolidated group. In particular, the strict ownership requirements of the Notice appear intended to address this concern, as illustrated in Examples 1 and 2.

> Example 1 – USP and A own 51 percent and 49 percent, respectively, of CFC1, which owns 100 percent of the stock of CFC2. CFC1 has no adjusted basis in the CFC2 stock, but CFC1 has $100x of section 961(c) basis in its CFC2 stock attributable to USP. CFC1 transfers the stock of CFC2 to USNewCo, a domestic corporation, in an F reorganization. Absent the transferor CFC ownership requirement, CFC1's section 961(c) basis attributable to USP would become adjusted basis of USNewCo under section 362(b) such that USNewCo's adjusted basis in the CFC2 stock would be $100x. As a result, A would indirectly acquire (and USP would indirectly lose) the benefit of $49x of the section 961(c) basis attributable to USP before the transaction.
>
> Example 2 – USP owns 100 percent of the stock of CFC1, which owns 100 percent of the stock of CFC2. CFC1 has no adjusted basis in the CFC2 stock, but CFC1 has $100x of section 961(c) basis in its CFC2 stock attributable to USP. USOldCo, a domestic corporation, owned 100 percent by A before the transaction, acquires all of the assets and liabilities of CFC1 (including the stock of CFC2) in a D reorganization, with USP receiving 51 percent of the stock of USOldCo in exchange for its CFC1 stock. Absent the domestic acquiring corporation ownership requirement, CFC1's section 961(c) basis in the CFC2 stock attributable to USP would become adjusted basis of USOldCo under section 362(b) such that USOldCo's adjusted basis in the CFC2 stock would be $100x. As a result, A would acquire (and USP would indirectly lose) the benefit of $49x of the section 961(c) basis attributable to USP before the transaction.

The shareholder-specific nature of section 961(c) basis appears to have also motivated the subsequent transfer exceptions, as illustrated in Example 3.

> Example 3 – USP owns 100 percent of the stock of CFC1, which owns 100 percent of the stock of CFC2. CFC1 has no adjusted basis in the CFC2 stock, but CFC1 has $100x of section 961(c) basis in CFC2 attributable to USP. CFC1 transfers the stock of CFC2 to USP in an upstream inbound transaction. Subsequent to the upstream inbound transaction, USP

> contributes the CFC2 stock to FNewCo, a newly-formed foreign corporation, in exchange for 51 percent of the stock of FNewCo, and A contributes property to FNewCo in exchange for the other 49 percent of the stock of FNewCo. Absent the subsequent transfer exceptions, CFC1's section 961(c) basis with respect to its CFC2 stock attributable to USP would become adjusted basis of FNewCo under section 362(a) such that FNewCo's adjusted basis in the CFC2 stock would be $100x. As a result, A would acquire (and USP would indirectly lose) the benefit of $49x of the section 961(c) basis attributable to USP before the transaction.

We do not believe that the shareholder-specific nature of section 961(c) should be protected at the expense of frustrating Congress's policy objective in enacting section 961(c)—preventing the double taxation of an inclusion U.S. shareholder. The strict stock ownership requirements and subsequent transfer exceptions, if retained in the future guidance, will generally result in double taxation upon the repatriation of the PTEP or disposition of the acquired CFC stock, which is contrary to the stated goals of the Notice and the legislative history of section 961(c). In contrast, as illustrated in Examples 1, 2, and 3, relaxing the Notice's strict ownership requirements would result in a mere *shifting* of the benefit of the section 961(c) basis from the original inclusion U.S. shareholder to its successor with respect to the acquired CFC's PTEP.

If the choice is between double taxation and the shifting of the incidence of taxation, the latter is preferable to the former, particularly in the context of nonrecognition transactions under subchapter C. Indeed, in any tax-free exchange under section 351(a) or reorganization described in section 368, U.S. tax attributes, including adjusted basis in transferred property, may be "mixed" in corporate solution, such that one shareholder may indirectly enjoy the benefit (or suffer the detriment) of another shareholder's contributed depreciated (or appreciated) property. This effect is illustrated in Example 4 below.

> Example 4 – P, a corporation, owns Asset 1 worth $51x and with a tax basis of $51x. A, an individual, owns Asset 2 worth $49x and with zero tax basis. If P and A contribute their property to a newly-formed corporation, NewCo, in exchange for 51 percent and 49 percent of the equity of NewCo, respectively, in a section 351 exchange, A will indirectly benefit from $24.99x of basis attributable to Asset 1 (*i.e.*, 49 percent of $51x) with P indirectly suffering a corresponding detriment attributable to the gain in Asset 2.[39]

It is true that section 961(c) basis is personal to an inclusion U.S. shareholder. However, all basis in stock, including section 961(a) basis, is personal to the shareholder that owns such stock, and yet the rules of Subchapter C permit the shifting of the benefit of such basis to other persons pursuant to nonrecognition transactions. We do not perceive any special considerations in the context of CFCs and PTEP that would warrant a different approach, particularly where the alternative is double taxation.

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[39] This example ignores the effect of corporate taxes or the application of provisions such as section 362(e) or 367, which may limit the ability for shareholders to indirectly share in the tax basis of contributed property.

It is also questionable whether section 961(c) is even the most appropriate paradigm to guide the rules for determining the basis consequences of an inbound transaction of an upper-tier CFC. As discussed above, section 961(a) basis is freely "transferable," since it is adjusted basis for all purposes of the Code. If the acquired CFC had been owned by the inclusion U.S. shareholder directly (within the meaning of section 958(a)(1)) at the time of a CFC inclusion that gave rise to PTEP and basis adjustments, the shareholder could transfer the resulting section 961(a) basis to another domestic corporation in a nonrecognition transaction without any limitation. There is no obvious reason to prefer the section 961(c) model over the section 961(a) model, that is, to treat the basis an inclusion U.S. shareholder has in the stock of a CFC differently depending on whether that stock had been owned directly or indirectly at the time of the inclusion. For that reason, a reasonable model for determining the basis consequences upon the inbounding of acquired CFC stock could be to view the inbound transaction as resulting not in the "importation" of the transferor CFC's section 961(c) basis in the acquired CFC, but rather the "springing" of USP's "inchoate" section 961(a) basis in the acquired CFC.

The implications of this observation are also relevant to the treatment of partnerships, which are denied relief under the Notice because of their inability to satisfy the transferor CFC ownership requirement and the domestic acquiring corporation ownership requirement. Specifically, a sideways inbound transaction[40] of a transferor CFC owned by a partnership would not qualify as a covered inbound transaction because the transferor CFC is not owned by a domestic corporation immediately before the transaction (thus failing the transferor CFC ownership requirement) and the domestic acquiring corporation is not owned by a domestic corporation immediately after the transaction (thus failing the domestic acquiring corporation ownership requirement). Treasury may have excluded partnership-owned CFCs from the relief afforded by the Notice based on a concern that the benefit of section 961(c) basis attributable to a U.S. shareholder partner could effectively be shifted to the other partners through a sideways inbound transaction, in much the same manner as other inbound transactions can shift the benefit where the transferor CFC (or the domestic acquiring corporation) is owned by multiple shareholders after the transaction. For the same reasons discussed above, we do not believe that it is appropriate to impose double taxation to address this basis shifting concern. Therefore, we recommend that the ownership requirements be modified to provide for relief where a partnership owns the transferor CFC.[41]

In contrast to partnerships, S corporations are expressly excluded from qualification as a domestic acquiring corporation, with the result that an upstream inbound transaction into an S corporation cannot qualify as a covered inbound transaction.[42] S corporations are generally treated as a partnerships for purposes of the international provisions of the Code, including subpart F.[43]

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[40] A partnership-owned transferor CFC could not engage in an upstream inbound transaction because a partnership cannot be an acquiring corporation for purposes of sections 332 and 368.

[41] As discussed in more detail in Part IV.C of the Report, the strict ownership requirements would also deny relief for CFCs owned by individuals. For the reasons discussed in Part IV.C, we believe that the ownership requirements should also be relaxed in the context of a top-tier CFC owned by individuals.

[42] Notice, § 3.04(5).

[43] Section 1373(a). *See also* Treas. Reg. § 1.958-1(d)(1) (treating partnerships as not owning stock of foreign corporations under section 958(a) in applying sections 951, 951A, or 956).

The exclusion of an S corporation from qualification as a domestic acquiring corporation may have been motivated by the same basis shifting concern discussed above. If S corporations were excluded for this purpose, for the same reasons discussed above with respect to partnerships, we do not believe that S corporations should be denied the relief afforded by the Notice.

Further, the exclusion of an S corporation from qualification as a domestic acquiring corporation appears to only deny an S corporation the benefit of section 961(c) basis in the case of an *upstream* inbound transaction (*i.e.*, where the S corporation itself is the domestic acquiring corporation); the Notice does not prevent the S corporation from qualifying as a prescribed domestic corporation for purposes of permitting a *sideways* inbound transaction to satisfy the ownership requirements. It is unclear why, if basis shifting were a concern, that concern is more implicated in the context of an upstream inbound transaction than in a sideways inbound transaction. Therefore, we recommend that the exclusion of S corporation from the definition of a domestic acquiring corporation be eliminated in the proposed regulations.[44]

Finally, the basis shifting that appears to have motivated many of the restrictions and exceptions in the Notice can already be achieved by taxpayers under current law through the conversion of section 961(c) basis into property, as illustrated in Example 5 below.

> Example 5 – USP owns 100 percent of the stock of CFC1, which owns 100 percent of the stock of CFC2. CFC2 has $100x of PTEP and CFC1 has $100x of section 961(c) basis in the stock of CFC2 attributable to USP. CFC2 distributes $100x of cash to CFC1, which distribution is sourced entirely from CFC2's PTEP. Therefore, CFC1 includes none of the distribution in its gross income for purposes of subpart F under section 959(b), and CFC1's section 961(c) basis in the stock of CFC2 attributable to USP is reduced to $0. CFC1 has fair market value basis in the $100x of cash under section 301(d), and the value of the CFC2 stock owned by CFC1 is reduced by $100x as a result of the distribution. If CFC1 and A, an unrelated individual, were to contribute the $100x cash, the CFC2 shares, and other property, to USNewCo, a domestic corporation, in a section 351 exchange, with CFC1 receiving 51 percent of the stock of USNewCo in exchange for the cash and CFC2 shares, CFC1's original section 961(c) basis in the CFC2 stock attributable to USP would effectively become adjusted basis of USNewCo in the cash under section 362(b) and any potential gain associated with the CFC2 stock would have been eliminated as a result of the distribution. As a result, A would acquire (and USP would indirectly lose) the benefit of $49x of CFC1's original section 961(c) basis in the CFC2 stock attributable to USP.

In sum, we have identified no situation in which imposing double taxation upon the repatriation of PTEP or the disposition of acquired CFC stock is preferable to permitting a mere

[44] RICs and REITs are also expressly excluded from the definition of a domestic acquiring corporation. For the reasons discussed *infra* in Part IV.B of this Report, we do not believe that RICs and REITs implicate the same basis shifting concerns. In any case, as discussed in more detail below, we recommend that the exclusion of RICs and REITs from the definition of a domestic acquiring corporation also be eliminated in the proposed regulations.

shift of basis. Moreover, we have identified no situation in which such a basis shift would facilitate abusive tax planning opportunities.[45] If the ownership restrictions are retained, in whole or in part, we recommend that Treasury identify the specific concerns raised by inbound transactions that cause more than a *de minimis* shift in ownership and grant the Service ruling authority to preserve section 961(c) basis in circumstances that do not implicate those concerns.

B. RICs and REITs

The shareholder-specific nature of section 961(c) may also have motivated the exclusion of RICs and REITs from the definition of a domestic acquiring corporation under the Notice. However, as discussed below, expanding the relief provided under the Notice to RICs and REITs would not implicate this concern, and thus we recommend that RICs and REITs not be excluded from relief.

As background, RIC classification is generally available to a domestic corporation that is regulated under the Investment Company Act of 1940,[46] meets a diversification requirement,[47] and derives substantially all of its income from investments in stocks, securities, and related instruments.[48] A RIC is generally entitled to a dividends paid deduction (a "**DPD**") on its distributed (or deemed distributed) income and gains,[49] provided that the RIC distributes substantially all of its investment income and gains to its shareholders annually.[50]

REIT classification is generally available to a company that satisfies certain income tests[51] and asset tests.[52] Like RICs, REITs are generally entitled to a DPD on their distributed (or deemed

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[45] Notably, the basis shifting at issue in this Report is easily distinguishable from the partnership basis shifting transactions targeted in Notice 2024-54. *See* 2024-28 IRB 28 (June 17, 2024). In Notice 2024-54, Treasury and the Service announced their intention to issue two sets of proposed regulations that would address basis-shifting transactions involving partnerships and related parties. The basis shifting strategies targeted in Notice 2024-54 are the result of inside-outside basis disparities (*i.e.*, the basis a partnership has in its assets versus the basis that a partner has in its partnership interest) and involve the shifting of the outside basis to basis in assets under section 732, section 734(b), or section 743(b), thus generating increased cost recovery allowances or decreased gain on the disposition of property. *See also* Rev. Rul. 2024-14*,* 2024-28 IRB 18 (June 17, 2024) (ruling that basis adjustments under section 732, section 734(b), or section 743(b) in such transactions could be disregarded under the economic substance doctrine). In contrast, the basis shifting discussed in this Report does not involve a shifting of basis between assets, but rather merely the potential shifting of the benefit of section 961(c) basis from one U.S. person (*i.e.*, an inclusion U.S. shareholder) to another U.S. person.

[46] Section 851(a)(1).

[47] Section 851(b)(3).

[48] Section 851(b)(2). Subpart F income attributable to a RIC constitutes "qualifying income" to the extent it is either (1) timely and currently repatriated or (2) derived with respect to the RIC's business of investing in stock, securities, or currencies. Treas. Reg. § 1.851-2(b)(2). A GILTI inclusion is treated the same as a subpart F inclusion for purposes of section 851(b). *See* section 951A(f)(1)(A).

[49] Section 852(b).

[50] Section 852(a).

[51] Sections 856(c)(2)-(3). CFC inclusions attributable to a REIT's investment in CFCs constitute "qualifying income" for purposes of the income test under section 856(c)(2). Rev. Proc. 2018-48, 2018-40 I.R.B. 521.

[52] Sections 856(c)(4)-(5).

distributed) income and gains,[53] provided that the REIT distributes substantially all of the trust's taxable income available for distribution.[54]

RICs and REITs are corporations for U.S. federal income tax purposes and thus may be inclusion U.S. shareholders with respect to a CFC.[55] Thus, a RIC or REIT, as applicable, can have a CFC inclusion and, to the extent of such inclusion, is entitled to the basis adjustments provided under section 961, including section 961(c) basis with respect to a lower-tier CFC. Because of the availability of a DPD, and the requirement that a RIC or REIT must distribute substantially all of its income to shareholders to avail itself of the DPD, the shareholders of a RIC or REIT, rather than the RIC or REIT itself, generally bear the tax burden of a CFC inclusion in the year of the inclusion. Further, because the stock of RICs and REITs are often publicly traded, the shareholder that bears the burden of the CFC inclusion often may be different from the shareholder that benefits from the section 961(c) basis in the year of the disposition of the lower-tier CFC. This disparity, however, is true of any U.S. tax attribute of relevance to a RIC or REIT, including section 961(a) basis, as well as the section 961(c) basis of any publicly traded domestic corporation.[56] Thus, we see no policy basis for distinguishing the treatment of section 961(c) basis of a RIC or REIT from its other attributes or from the section 961(c) basis of other domestic corporations. Consistent with this observation, we do not believe the conversion of an entity from a regular C corporation to a RIC or REIT and vice versa presents any potential for abuse in regard to section 961(c) basis and the relief provided under the Notice. Examples 6A though 6C provide illustrations in support of this discussion.

> Example 6A – US REIT, a publicly-traded, domestic REIT, owns 100 percent of the stock of CFC1, which owns 100 percent of the stock of CFC2. In Year 1, US REIT's CFC inclusion with respect to CFC2 is $100x. US REIT pays a $100x dividend to its shareholders in Year 1. In Year 2, CFC1 transfers the stock of CFC2 to US REIT in an upstream inbound transaction. Assume that the proposed regulations eliminate the exclusion of RICs and REITs from qualification as a domestic acquiring corporation. In Year 5, US REIT disposes of its CFC2 stock in taxable sale to an unrelated party for $100x. A material portion of public shareholders in Year 5 were not shareholders of US REIT in Year 1.
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> In Year 1, US REIT includes $100x in gross income, increases its section 961(c) basis in CFC2 by $100x, and receives a $100x deduction for dividends paid to its shareholders. CFC2 has $100x of undistributed PTEP at the end of Year 1. In Year 2, CFC1's section 961(c) basis in CFC2

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[53] Section 857(b).

[54] Section 857(a).

[55] In contrast, an S corporation, while potentially a U.S. shareholder, is treated as a partnership for purposes of subpart F (including GILTI), and its shareholders are treated as partners. *See* section 1373(a). *See also* Treas. Reg. § 1.958-1(d)(1) (treating partnerships as not owning stock of foreign corporations under section 958(a) in applying sections 951, 951A, or 956).

[56] While, unlike a RIC or REIT, a C corporation generally pays U.S. tax, ultimately the burden of that tax is still borne by its shareholders.

> attributable to US REIT is converted to $100x of adjusted basis for all purposes of the Code as a result of the upstream inbound transaction. CFC2 continues to have $100x of undistributed PTEP at the end of Year 2. In Year 5, upon the disposition of the CFC2 stock, US REIT recognizes no additional gain or loss.
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> Example 6B – The facts are the same as Example 6A except that "USP," a publicly traded, domestic C corporation, is substituted for "US REIT."
>
> In Year 1, USP includes $100x in gross income and increases its section 961(c) basis in CFC2 by $100x. CFC2 has $100x of undistributed PTEP at the end of Year 1 that remains undistributed at the time of sale in Year 5. In Year 2, USP's $100x of section 961(c) basis attributable to CFC2 is converted to $100x of adjusted basis for all purposes of the Code as a result of the upstream inbound transaction. In Year 5, upon the disposition of the CFC2 stock, USP recognizes no additional gain or loss.

The U.S. federal income tax consequences in Examples 6A and 6B are identical except that US REIT receives a DPD and USP does not receive a DPD. This is the expressly intended result of the DPD under section 857(b) and is not a function of any abuse or manipulation of CFC basis under the Notice or otherwise. Examples 6A and 6B apply with equal force to RICs, and accordingly, there is no clear rationale in favor of excluding RICs and REITs from the benefits of the Notice. In contrast, as Example 6C illustrates, failure to provide relief results in double taxation.

> Example 6C – The facts are the same as Example 6A except that the proposed regulations continue to exclude RICs and REITs from qualification as domestic acquiring corporations.
>
> In Year 1, US REIT includes $100x in gross income, increases its section 961(c) basis in CFC2 by $100x, and receives a $100x deduction for dividends paid to its shareholders. In Year 5, US REIT recognizes $100x of gain on its disposition of CFC2 stock and distributes another $100x to satisfy the requirement to distribute taxable income.

As Example 6C illustrates, without the benefit of the Notice, the shareholders of RICs and REITs may be subject to double taxation. First, RIC or REIT shareholders would be taxed on the RIC or REIT's current-year CFC inclusion from a lower-tier CFC through the distribution of the resulting earnings. Second, following an inbound reorganization of the lower-tier CFC, the shareholders could potentially recognize income again from dividends of E&P generated from non-economic gains on subsequent PTEP distributions from the acquired CFC to the RIC or REIT or on the subsequent sale by the RIC or REIT of the acquired CFC stock, having lost the benefit of its section 961(c) basis. This result would be inconsistent with section 961(c)'s policy objective of avoiding double taxation.

C. Individuals

While inclusion U.S. shareholders that are individuals (each, an "**individual U.S. shareholder**") are not explicitly excluded from the scope of the Notice, the Notice's ownership requirements have the effect of ensuring that a domestic acquiring corporation can never inherit the section 961(c) basis of an individual U.S. shareholder. Specifically, if a transferor CFC that is wholly owned by an individual U.S. shareholder engages in a sideways inbound transaction, the transaction will fail both the transferor CFC ownership requirement, because the transferor CFC is not wholly owned by a prescribed domestic corporation immediately before the transaction, and the domestic acquiring corporation ownership requirement, because the domestic acquiring corporation is not wholly owned by a prescribed domestic corporation immediately after the transaction.

The policy rationale for permitting a domestic acquiring corporation to inherit a transferor CFC's section 961(c) basis in an acquired CFC applies with equal force regardless of whether the transferor CFC was owned by a corporate U.S. shareholder or an individual U.S. shareholder immediately before an inbound transaction. In either case, the relief afforded by the Notice is necessary to prevent double taxation of CFC earnings, once in the hands of the inclusion U.S. shareholder and a second time in the hands of the domestic acquiring corporation under section 961(b)(2) upon a distribution of the PTEP or on the sale of the acquired CFC stock.[57] Therefore, we recommend that the ownership requirements of the Notice be modified to permit

[57] If not permitted the section 961(c) basis, a domestic acquiring corporation that acquires an acquired CFC in a sideways inbound transaction could potentially engage in self-help to avoid excess taxation on repatriation of the acquired CFC's PTEP. Specifically, assuming that the domestic acquiring corporation is a section 959 successor with respect to the acquired CFC (but see the analogous discussion in text below regarding the uncertainty of whether a domestic acquiring corporation can be a section 962(d) successor), it appears that the domestic acquiring corporation could intentionally fail to substantiate its ability to exclude a distribution of PTEP from its gross income under section 959(a). *See* Treas. Reg. § 1.959-1(d) (a section 959 successor can apply section 959(a) to exclude dividends of PTEP from their gross income "only to the extent that [the section 959 successor] establishes to the satisfaction of the district director his right to the exclusion"). By failing to substantiate its right to exclude the PTEP from its gross income, the domestic acquiring corporation could claim a section 245A DRD with respect to the PTEP distribution and not suffer a basis reduction under section 961(b), including gain recognition under section 961(b)(2), which is required only to the extent amounts are excluded from gross income under section 959(a). *But cf.* section 961(d) (requiring basis reduction by the amount of dividends for which a section 245A DRD is claimed, but solely for purposes of computing loss). However, there are many reasons a dividend may not qualify for the section 245A DRD, which presents realistic possibilities for overtaxing such a dividend. For example, in the context of a sideways inbound transaction, particularly one involving a newly-formed domestic corporation, the limitation contained in section 246(c)(5), which requires the domestic acquiring corporation to maintain U.S. shareholder status for more than one year, is a potential footfault. Further, even if the dividend does qualify for a section 245A DRD, if the dividend is an extraordinary dividend, the basis reduction under section 1059(b), including gain recognition under section 1059(b)(2), could result in noneconomic gain. For this purpose, an extraordinary dividend is generally a dividend the amount of which exceeds 10 percent (or 5 percent in the case of preferred stock) of the adjusted basis in stock if the stock with respect to which the dividend is paid is not held for more than 2 years. Section 1059(c)(1) and (2). However, for purposes of the 2-year holding period, tacked holding periods are generally taken into account. *See* section 1223 (providing tacked holding period rules "[f]or purposes of [Subtitle A]," which includes section 1059). Thus, section 1059 is less likely to apply in this situation, because the domestic acquiring corporation's holding period with respect to the acquired CFC stock should include the transferor CFC's holding period with respect to such stock. *See* section 1223(2).

ownership by individual U.S. shareholders of the transferor CFC immediately before the inbound transaction and the domestic acquiring corporation immediately after the inbound transaction.[58]

It is unclear why individual U.S. shareholders are not afforded the relief of the Notice. However, Treasury may have been concerned that an election under section 962 (a "**section 962 election**") made by an individual U.S. shareholder (an "**electing U.S. shareholder**") could make such relief inappropriate.[59] For the reasons discussed below, we do not believe that section 962 raises additional concerns in respect to the relief afforded by the Notice, and thus we recommend that such relief also be extended to section 961(c) basis attributable to an electing U.S. shareholder, except as described herein.

A section 962 election is intended to put an electing U.S. shareholder in the same (or, at least, similar)[60] place from a U.S. tax perspective as if the individual owns its CFC through a domestic corporation.[61] To accomplish this result, an electing U.S. shareholder is taxed at corporate tax rates rather than individual tax rates[62] on all its CFC inclusions with respect to all its

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[58] The relief in the Notice is also not afforded to sideways inbound transactions involving transferor CFCs directly owned by inclusion U.S. shareholders that are nongrantor trusts or estates or partnerships, trusts, or estates with partners or beneficiaries that are inclusion U.S. shareholders. We see no reason for entirely denying these inclusion U.S. shareholders the relief afforded by the Notice, particularly if such shareholders wholly own, directly or indirectly, the stock of the transferor CFC immediately before the inbound transaction and the stock of the domestic acquiring corporation immediately after the inbound transaction, so that there are no basis shifting concerns. Thus, we recommend that the relief afforded by the Notice be modified generally to permit for non-corporate ownership. However, for simplicity, in this Part IV.C, we discuss solely the application of the Notice to individual U.S. shareholders.

[59] A nongrantor trust or estate may also make a section 962 election. *See* Treas. Reg. § 1.962-2(a).

[60] For an illustration of one difference between the effect of a section 962 election and the actual ownership of CFC stock through a domestic corporation, *see Smith v. Comm'r of Internal Revenue*, 151 T.C. 41 (2018), in which the Tax Court held that a section 962 election does not render a dividend from a Hong Kong corporation to an electing U.S. shareholder qualified dividend income ("**QDI**") within the meaning of section 1(h)(11)(B). A dividend can constitute QDI (and thus be entitled to long-term capital gains rates) only if received from a domestic corporation or a qualified foreign corporation. Section 1(h)(11)(B)(i). In general, a qualified foreign corporation is a foreign corporation either incorporated in a U.S. possession or eligible for benefits of a comprehensive tax treaty with the United States. Section 1(h)(11)(C); *see also* Notice 2024-11, I.R.B. 2024-02, updating Notice 2011-64, I.R.B. 231 (providing a list of U.S. income tax treaties that are treated as satisfying the requirements for QDI treatment). Because the United States does not have a comprehensive tax treaty with Hong Kong, a dividend from a Hong Kong corporation is not generally QDI. However, the taxpayers in *Smith* argued that an electing U.S. shareholder should get QDI rates on a dividend from a CFC with respect to which an election has been made, regardless of whether such CFC is a qualified foreign corporation, because the "fiction" of section 962 deems the dividend to be paid from a domestic corporation. The Tax Court in *Smith* rejected this argument, stating that "[an election under section 962 does] not create hypothetical corporations or change real-world facts," and thus does not create a "notional domestic corporation" allowing for QDI rates. *Id.* at 52-54.

[61] *See* S. REP. NO. 1881, 87th Cong., 2d Sess. (1962) at 92-93 ("The purpose of this provision is to avoid what might otherwise be a hardship in taxing a U.S. individual at high bracket rates with respect to earnings in a foreign corporation which he does not receive. This provision gives such individuals assurance that their tax burdens, with respect to these undistributed foreign earnings, will be no heavier than they would have been had they invested in an American corporation doing business abroad.").

[62] For tax years beginning after December 31, 2017, the highest effective U.S. federal corporate tax rate is 21 percent. *See* section 11(b). For tax years beginning after December 31, 2017, and before January 1, 2026, the highest individual marginal rate is 37 percent. *See* section 1(j).

CFCs for the taxable year the election is in effect.[63] Further, an electing U.S. shareholder may claim a foreign tax credit ("**FTC**") for income taxes deemed paid under sections 960(a) and 960(d) (an "**indirect FTC**") with respect to such inclusions.[64]

The benefits of a section 962 election—the ability for an electing U.S. shareholder to avail itself of the lower corporate rate and an indirect FTC—are primarily ones of deferral. These benefits are largely unwound when the E&P that gave rise to the electing U.S. shareholder's CFC inclusion are distributed to the shareholder or the stock of a CFC is sold. Specifically, while a CFC inclusion of an electing U.S. shareholder creates PTEP in the amount of the inclusion, when that PTEP is distributed to the shareholder, section 962(d) provides that the distribution will, notwithstanding section 959(a), be included in the electing U.S. shareholder's gross income to the extent the PTEP exceeds the amount of U.S. federal income tax previously paid by the U.S. shareholder on the amounts to which the election applied (the E&P of a CFC equal to the amount of U.S. federal income tax previously paid on the CFC inclusions, "**excludible section 962 E&P**," the E&P of a CFC attributable to the CFC inclusions that exceeds the excludible section 962 E&P is its "**taxable section 962 E&P**," and, collectively, "**section 962 E&P**").[65] Further, any increase in the electing U.S. shareholder's basis in its CFC stock under section 961(a) is limited to the amount of U.S. federal income tax paid by the shareholder by reason of the section 962 election (such basis adjustment, "**section 962 basis**").[66] Thus, all the CFC earnings that gave rise to the CFC inclusion generally will, once repatriated to the electing U.S. shareholder, be subject to the same aggregate amount of U.S. federal income tax as if the shareholder had owned the CFC stock through a domestic corporation.[67]

Treasury has not issued guidance in determining the appropriate basis adjustments under section 961(c) by reason of a section 962 election. However, while beyond the scope of this Report, it is expected that future guidance would provide that an upper-tier CFC's section 961(c) basis attributable to an electing U.S. shareholder, unlike such shareholder's section 961(a) basis with

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[63] Section 962(a)(1); Treas. Reg. § 1.962-2(c)(1); *see also* section 951A(f)(1)(A) and Treas. Reg. § 1.951A-5(b)(1) (treating a U.S. shareholder's GILTI inclusion the same as a subpart F inclusion for the purposes of section 962). An electing U.S. shareholder is also allowed a section 250 deduction for any GILTI inclusion and any amount included in income under section 78 with respect to the GILTI inclusion. Treas. Reg. § 1.962-1(b)(2)(i).

[64] Section 962(a)(2) and Treas. Reg. § 1.962-1(b)(2)(i).

[65] *See also* Treas. Reg. § 1.962-3(a), (b)(1)(i)-(ii). As section 962(d) and Treas. Reg. § 1.962-3(a) provide that the amount of the taxable section 962 E&P distribution is included in gross income, the general rules applicable to distributions of E&P under section 301 apply to distributions of taxable section 962 E&P. As noted by the Tax Court in *Smith*, discussed *supra*, Congress contemplated that taxable section 962 E&P would be treated as a dividend when distributed to an electing U.S. shareholder. 151 T.C. at 56, citing S. Rpt. No. 1881, 87th Cong., 2d Sess. (1962) at 92-93.

[66] Section 961(a) (second sentence) and Treas. Reg. § 1.961-1(a)(2). Similarly, if an electing U.S. shareholder is required to reduce its basis upon a distribution of PTEP under section 961(b)(1), the reduction will not exceed an amount equal to the amount of the excludible section 962 E&P distributed and any foreign taxes paid with respect to such excludible section 962 E&P. Treas. Reg. § 1.961-2(a)(2).

[67] As made clear by the taxpayer in *Smith*, discussed *supra*, this parity exists only if the dividend received by the electing U.S. shareholder from its CFC qualifies for the preferential rates for QDI under section 1(h)(11). If a dividend is not QDI (*e.g.*, because a CFC is not resident in a jurisdiction with the United States has a comprehensive tax treaty), the aggregate U.S. income tax paid by an electing U.S. shareholder with respect to its CFCs would be higher than if the shareholder owned their CFCs through a domestic corporation.

respect to the upper-tier CFC, is equal to the full amount of the CFC inclusion, rather than just the amount of the U.S. federal income tax paid on the inclusion. Failure to provide section 961(c) basis equal to the full amount of the CFC inclusion could lead to double taxation of the underlying subpart F income at corporate tax rates – first, on the CFC inclusion with respect to the subpart F income of the lower-tier CFC, and second, on the CFC inclusion from the upper-tier CFC's gain on the disposition of the lower-tier CFC to the extent that the amount of the initial CFC inclusion exceeded the U.S. federal income tax paid by the electing U.S. shareholder with respect to the earlier inclusion.[68] Also, providing full section 961(c) basis would be consistent with the treatment of a distribution of section 962 E&P from a lower-tier CFC to an upper-tier CFC, which would be fully excluded from the gross income of the upper-tier CFC for purposes of determining an electing U.S. shareholder's subpart F inclusion under section 959(b).[69]

If a U.S. person acquires from any person any portion of an electing U.S. shareholder's interest in a CFC, section 962(d) applies to the acquiring U.S. person (such a person, a "**section 962(d) successor**," and such rule, the "**section 962(d) successor rule**").[70] Thus, in general, a section 962(d) successor excludes from gross income PTEP distributions out of excludible section 962 E&P (to the extent the section 962(d) successor substantiates the amount of excludible section 962 E&P), and includes in gross income PTEP distributions out of taxable section 962 E&P.[71]

The rules for section 962(d) successors apply to all "U.S. persons" and do not distinguish between individual and corporate successors.[72] Thus, for example, if a domestic corporation acquires from an electing U.S. shareholder a CFC with section 962 E&P (such domestic corporation, a "**corporate section 962(d) successor**"), a subsequent distribution of the CFC's PTEP will only be excluded from the corporation's gross income under section 959(a) to the extent such distribution is out of excludible section 962 E&P.[73] However, it appears that, to the extent

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[68] The upper-tier CFC's gain on the disposition of the lower-tier CFC would be included in the upper-tier CFC's subpart F income either as gain or a dividend under section 964(e). *See* section 964(e)(1) ("If a controlled foreign corporation sells or exchanges stock in any other foreign corporation, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend *to the same extent that it would have been so included under section 1248(a) if such controlled foreign corporation were a United States person*.") (emphasis added). Section 1248(d)(1) excludes section 962 E&P, including taxable section 962 E&P, from E&P attributable to the stock of a CFC. *See* Treas. Reg. §§ 1.1248-2(e)(3)(iii) and 1.1248-3(e)(2)(i). This exclusion of section 962 E&P would presumably also apply for purposes of determining the consequences of a disposition by an upper-tier CFC of the stock of a lower-tier CFC under section 964(e).

[69] Section 962(d) only applies to limit the gross income exclusion for actual distributions to an electing U.S. shareholder that would otherwise be excluded from income under section 959(a)(1), and thus does not apply to CFC-to-CFC distributions of PTEP described in section 959(b). *See generally* Treas. Reg. § 1.962-3(a).

[70] Treas. Reg. § 1.962-3(c)(1).

[71] *Id.* Similar to the rules for establishing a section 959 successor's right to exclude PTEP distributions from its gross income (*see* Treas. Reg. § 1.959-1(d)), a section 962(d) successor must prove its right to the exclusion of excludible section 962 E&P by submitting the information prescribed in Treas. Reg. § 1.962-3(c).

[72] *Cf.* Treas. Reg. § 1.962-3(c)(2) (disallowing an indirect FTC under section 902 for a corporate section 962(d) successor that receives a distribution of section 962 E&P that were taken into account by the individual U.S. shareholder under section 962(a)(2) in any prior year; however, this provision is deadwood since the repeal of section 902, PUB. LAW NO. 115-97, § 14301(a), 131 Stat. 2054, 2221).

[73] As noted above, the distribution would be excludable only to the extent the corporation satisfies the substantiation requirements in Treas. Reg. § 1.962-3(c)(1).

such distribution is out of taxable section 962 E&P includible in gross income by reason of section 962(d), the corporate section 962(d) successor may qualify for the dividends received deduction under section 245A ("**section 245A DRD**").[74]

If a domestic acquiring corporation in an inbound transaction involving an acquired CFC were treated as a corporate section 962(d) successor, the corporation would be permitted to exclude from its gross income under section 959(a) a dividend from the acquired CFC only to the extent of the CFC's excludable 962 E&P, with any dividend out of the CFC's taxable section 962 E&P being included in the corporation's gross income (though potentially eligible for a section 245A DRD). However, it is not clear whether the section 962(d) successor rule applies to a domestic acquiring corporation that acquires an acquired CFC in an inbound transaction.[75] As discussed above, the section 962(d) successor rule applies if a U.S. person "acquires from any person any portion of the interest" in a CFC of an electing U.S. shareholder.[76] While a domestic acquiring corporation in an inbound transaction does not acquire an acquired CFC directly from an electing U.S. shareholder (it acquires the acquired CFC from the transferor CFC), the domestic acquiring corporation does acquire an interest in the acquired CFC owned by the electing U.S. shareholder indirectly under section 958(a)(2). Further, a transaction in which an electing U.S. shareholder exchanges its stock in an upper-tier CFC that holds a lower-tier CFC for stock of a domestic corporation in a section 351 exchange (to which the section 962(d) successor rule clearly applies) is economically similar to an exchange of stock in the upper-tier CFC (*i.e.*, a transferor CFC) in an inbound F reorganization. In either transaction, the electing U.S. shareholder will continue to own the lower-tier CFC indirectly through a domestic corporation. Therefore, we recommend that Treasury clarify that the section 962(d) successor rule applies to a domestic acquiring corporation that acquires stock of an acquired CFC subject to a section 962 election in a sideways inbound transaction.[77]

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[74] In general, a U.S. shareholder that is a domestic corporation is allowed a section 245A DRD for dividends received from a specified 10 percent owned foreign corporation for the amount equal to the foreign-source portion of the dividend. Section 245A(a). A distribution of taxable section 962 E&P would appear to be a dividend for this purpose since section 962(d) overrides section 959(a) and thus also overrides the treatment of the distribution as "not a dividend" under section 959(d). *See Smith*, 151 T.C. at 48 (noting that the Service had determined the dividend out of taxable section 962 E&P to be "ordinary dividend income under section 962(d)"). Thus, a corporate section 962(d) successor appears to be eligible for a section 245A DRD with respect to a dividend out of taxable section 962(d) E&P, provided it satisfies the eligibility requirements.

[75] The section 959 successor rule similarly applies if a U.S. person "acquires from any person any portion of the interest" in a CFC of an inclusion U.S. shareholder. *See* Treas. Reg. § 1.959-1(d). Therefore, the uncertainty raised in the text regarding the section 962(d) successor rule also exists with respect to the application of the section 959 successor rule.

[76] The section 959 successor rule similarly applies if a U.S. person "acquires from any person any portion of the interest" in a CFC of an inclusion U.S. shareholder. *See* Treas. Reg. § 1.959-1(d). Therefore, the uncertainty raised in the text regarding the section 962(d) successor rule exists with respect to the application of the section 959 successor rule.

[77] In this Report, we make no recommendation regarding whether it is generally appropriate to apply the section 962(d) successor rule to domestic corporations. However, we note that applying the section 962(d) successor rule to a domestic corporation can duplicate an electing U.S. shareholder's deferred tax liability on distributions of taxable section 962 E&P from a CFC with respect to which an election has been made if such distribution of taxable section

If Treasury does clarify that the section 962(d) successor rule applies to a domestic acquiring corporation in a sideways inbound transaction, we recommend that Treasury provide that the transferor CFC's section 961(c) basis in the acquired CFC inherited by the domestic acquiring corporation in such transaction be equal to the electing U.S. shareholder's lesser section 962 basis in the stock of the transferor CFC attributable to the acquired CFC's excludible section 962 E&P rather than the transferor CFC's greater section 961(c) basis in the acquired CFC stock. Permitting the domestic acquiring corporation only the lesser section 962 basis would ensure that a domestic acquiring corporation that acquires the stock of an acquired CFC in an inbound transaction is treated no better than any other corporate section 962(d) successor (*e.g.*, a domestic corporation that acquires a CFC from an electing U.S. shareholder in a section 351 exchange). Further, only the lesser section 962 basis is necessary to avoid double taxation on the distribution of the acquired CFC's excludible section 962 E&P. This approach is also consistent with the paradigm of treating "inherited" section 961(c) basis as "inchoate" section 961(a) basis. Specifically, if the electing U.S. shareholder had owned the acquired CFC directly at the time of its CFC inclusion, its basis with respect to such CFC would be increased under section 961(a) only by the amount of U.S. federal income tax paid with respect to such inclusion rather than the full amount of its CFC inclusion.

D. Certain Exceptions

1. The BIL CFC Exception

As noted in Part III.B.2 of this Report, the BIL CFC exception provides that a transaction is not a covered inbound transaction if the acquired CFC stock is BIL CFC stock immediately before the transaction. Thus, the BIL CFC exception has a cliff effect, denying a domestic acquiring corporation the benefits of section 961(c) basis if the acquired CFC stock has *any* built-in loss. The Notice does not provide any insight as to why Treasury thought the BIL CFC exception necessary, let alone the reason for its cliff effect. For the reasons discussed below, we believe that Treasury should reconsider the BIL CFC exception in the proposed regulations.

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962 E&P does not qualify for the section 245A DRD. The duplication could occur if (i) the domestic acquiring corporation is taxed on a distribution of taxable section 962 E&P from the acquired CFC, and then (ii) the electing U.S. shareholder (who owns the domestic corporation) is taxed on a dividend from the domestic acquiring corporation to the extent out of the E&P created by reason of distribution from the acquired CFC (*i.e.*, its E&P equal to the taxable section 962 E&P distributed by the CFC to the domestic corporation, less the U.S. federal income tax paid by the domestic corporation on the distribution). This seems particularly odd since the acquisition of a CFC subject to a section 962 election by a domestic acquiring corporation effectively places an electing U.S. shareholder in the very position that section 962 is intended to replicate; *i.e.*, the shareholder actually owns the acquitted CFC through a domestic corporation. On the other hand, the failure to apply section 962(d) to a corporate successor could result in an inappropriate *deferral* of taxation relative to a situation in which the electing U.S. shareholder has always owned the acquired CFC through such domestic corporation, assuming that the distribution does not create E&P. *See* AM 2015-001 (Feb. 9, 2015) (concluding that a corporate U.S. shareholder must increase its E&P by the amount of its subpart F inclusion for a CFC in the year that it includes the subpart F inclusion in income, rather than in the year of the distribution of the resulting PTEP). In that case, the domestic acquiring corporation would be able to exclude the full amount of the acquired CFC's section 962 E&P (including taxable section 962 E&P) from its income under section 959(a), and then a subsequent distribution by the domestic corporation of the amount repatriated could result in a return of basis (as opposed to a taxable dividend). As a result, the shareholder could potentially escape taxation until the shareholder disposes of its stock in the domestic acquiring corporation (or recognizes gain under section 301(c)(3) upon a distribution in excess of basis).

One obvious purpose of the BIL CFC exception is to prevent taxpayers from importing a built-in loss through covered inbound transactions. The Code, however, already has two provisions, sections 334(b)(1)(B) and 362(e)(1)(B), which prevent the importation of net built-in losses through inbound transactions. Specifically, these provisions provide that if the aggregate adjusted basis of imported property (*i.e.*, property that becomes subject to U.S. federal income tax as a result of an inbound transaction) is greater than the aggregate fair market value of such property, then the transferee corporation's basis in each item of imported property after the inbound transaction is equal to such item of property's fair market value. Thus, sections 334(b)(1)(B) and 362(e)(1)(B) allow taxpayers to import individual items of built-in loss property, provided they also import an amount of gain that at least offsets the aggregate imported loss, thereby protecting the U.S. fisc on an aggregate basis.

We believe that section 961(c) basis should not be treated differently than adjusted basis for loss importation purposes. Section 961(c) basis results from CFC inclusions recognized by a U.S. shareholder and thus represents a U.S. shareholder's U.S. tax basis in a CFC's realized undistributed earnings. Accordingly, as demonstrated by the following examples, section 961(c) basis generally will not create built-in loss for U.S. tax purposes.

> Example 7 – USP wholly owns CFC1, which wholly owns CFC2. CFC1's only assets are its CFC2 stock and Asset. USP has a $100 basis in its CFC1 stock, $20 of which is section 961(a) basis. CFC1 has $20 adjusted basis in its CFC2 stock. In addition, CFC1 has $20 of section 961(c) basis in its CFC2 stock attributable to USP. The fair market value of CFC2 is $30 and CFC2 has $20 of E&P, all of which is PTEP. CFC1 has an adjusted basis of $40 in Asset, which has a fair market value of $70.
>
> CFC2 distributes $20 cash to CFC1 and then CFC1 completes an inbound liquidation. Subsequent to the distribution and at the time of its liquidation, CFC1's CFC2 stock has a fair market value of $10 and an adjusted basis of $20 and thus a built-in loss of $10, and CFC1 has no section 961(c) basis with respect to CFC2. CFC1's liquidation does not result in the importation of a net built-in loss because, taking into account Asset, the aggregate basis of imported assets does not exceed their aggregate fair market value. Thus, USP takes a transferred basis of $20 in the CFC2 stock under section 334(b)(1)(B), preserving the BIL in the CFC2 stock. The Notice does not change this result.
>
> Example 8 – Same facts as Example 7, except CFC2 distributes $20 to USP after CFC1's liquidation. Before the CFC2 distribution and at the time of CFC1's liquidation, CFC1's CFC2 stock has a fair market value of $30 and adjusted basis of $20, and CFC1 has $20 of section 961(c) basis in its CFC2 stock attributable to USP. Similar to Example 7, CFC1's liquidation does not result in the importation of a net built-in loss and thus section 334(b)(1)(B) does not apply to the transaction. Unlike Example 7, however, because of the BIL CFC exception, CFC1's inbound liquidation is not a covered inbound liquidation. If CFC1's section 961(c) basis in the CFC2 attributable to USP is not converted into adjusted basis, USP will have a

noneconomic $10 built-in gain with respect to its CFC2 stock after CFC2's $20 distribution.[78]

Since section 961(c) basis results, dollar-for-dollar, from taxable CFC inclusions, section 961(c) should not impact the built-in loss of acquired CFC stock. As Example 7 illustrates, any built-in loss in acquired CFC stock will be attributable to economic losses and not the section 961(c) basis. Therefore, we believe that the BIL CFC exception should not be included in the proposed regulations and that Treasury should rely on sections 334(b)(1)(B) and 362(e)(1)(B) to govern the importation of BIL CFC stock, treating section 961(c) basis as "inchoate" section 961(a) basis for purposes of applying these sections.

Notwithstanding the above, we recognize that sections 334(b)(1)(B) and 362(e)(1)(B) can disadvantage the U.S. fisc from a timing perspective. Specifically, by allowing taxpayers to import separate items of built-in gain property and built-in loss property, these sections would not prevent taxpayers from recognizing the built-in loss with respect to imported property through a subsequent disposition, while deferring recognition of the built-in gain with respect to imported property. If this potential mismatch is an important concern to Treasury, then we recommend the proposed regulations replace the BIL CFC exception with a narrowly crafted anti-abuse rule to address this concern. For example, the proposed regulations could include a rule that prevents taxpayers from recognizing a loss with respect to a subsequent disposition of acquired CFC stock that occurs as part of the same plan (or series of related transactions) as a covered inbound transaction (the "**section 961(c) loss disallowance rule**").

The amount of loss potentially disallowed under the section 961(c) loss disallowance rule would be equal to the amount of an inclusion U.S. shareholder's section 961(c) built-in loss account with respect to the acquired CFC. An inclusion U.S. shareholder's "**section 961(c) built-in loss account**" would be equal to (i) the lesser of (A) the absolute value of the built-in loss in the acquired CFC stock at the time of a covered inbound transaction (treating section 961(c) basis as adjusted basis), and (B) the amount of section 961(c) basis with respect to the acquired CFC at the time of a covered inbound transaction, reduced by (ii) losses with respect to the acquired CFC stock previously disallowed by the section 961(c) loss disallowance rule. The section 961(c) loss disallowance rule could create a rebuttable presumption that a subsequent loss recognition transaction is part of the same plan (or series of related transactions) as a covered inbound transaction if it occurs during a proscribed period after the covered inbound transaction. If this approach is taken, we recommend the proscribed period for unrelated party transactions be shorter than that for related party transactions (*e.g.*, unrelated party transactions could have a two-year proscribed period and related party transactions could have a five-year proscribed period).

Another purpose of the BIL CFC exception could be to prevent taxpayers from double-dipping losses attributable to the same subpart F inclusion. Although not likely to frequently rise organically, the following example illustrates a double-dipping fact pattern with which Treasury may be concerned.

Example 9 – USS1 and USS2, members of the same U.S. consolidated group, each own 50 percent of CFC1, which wholly owns CFC2, which in

[78] The CFC2 stock will have a fair market value of $10 and an adjusted basis of zero.

turn wholly owns CFC3. CFC1's only asset is its CFC2 stock, and CFC2's only assets are its CFC3 stock and Asset.

USS1 and USS2 each have a $50 adjusted basis in their CFC1 stock, $10 of which is section 961(a) basis. CFC1 has $80 of adjusted basis in its CFC2 stock and CFC1 has $20 of section 961(c) basis in its CFC2 stock, $10 of which is attributable to each of USS1 and USS2. CFC2 has $40 of adjusted basis in its CFC3 stock, and CFC2 has $20 of section 961(c) basis in its CFC3 stock, $10 of which is attributable to each of USS1 and USS2. The fair market value of CFC3 is $30. CFC1 has an adjusted basis of $20 in Asset, which has a fair market value of $50.

CFC1 completes a section 331 liquidation. USS1 and USS2 each recognize a $10 loss with respect to their CFC1 stock, and CFC1 recognizes a $20 loss with respect to its CFC2 stock solely for the purpose of determining the subpart F inclusions of USS1 and USS2. USS1 and USS2 take a fair market value basis in the CFC2 stock received from CFC1.

After CFC1's liquidation, CFC2 completes a sideways inbound reorganization into a newly-formed domestic corporation ("**USS3**"). USS1 and USS2 each take an exchanged basis in their USS3 stock, and USS3 takes a carryover basis in Asset and the stock in CFC3.

If CFC2's section 961(c) basis in its CFC3 stock attributable to USS1 and USS2 were to become adjusted basis in the hands of USS3 and USS3 subsequently sold CFC3, USS3 would recognize a $20 loss that is attributable to the same CFC inclusion that gave rise to losses recognized by USS1 and USS2 as a result of CFC1's liquidation.

If the BIL CFC exception is intended to prevent taxpayers from double-dipping losses attributable to the same CFC inclusion, we believe that this objective can be accomplished through the section 961(c) loss disallowance rule described above, which would prevent USS3 in Example 9 from recognizing a loss with respect to a subsequent sale of CFC3 stock during the proscribed period.[79]

For the reasons discussed above, we recommend that the BIL CFC exception be excluded from the proposed regulations, which would leave sections 334(b)(1)(B) and 362(e)(1)(B) to address loss importation as regards section 961(c) basis, treating such basis as "inchoate" section 961(a) basis for these purposes. If, however, our primary recommendation is not accepted, we recommend that the section 961(c) loss disallowance rule replace the BIL CFC exception in the

79 Alternatively, a tracing regime could be developed to reduce USS3's loss from the sale of CFC3 stock for losses recognized by USS1 and USS2 with respect to their CFC1 stock. We believe the tracing regime would be more complex and difficult to apply than the section 961(c) loss disallowance rule discussed above, and thus is not our recommended approach.

proposed regulations.[80] In any event, we recommend that Treasury articulate the section 961(c) policy objectives it is trying to achieve with its chosen approach to the importation of BIL CFC stock.

2. Subsequent Transfer Exceptions

As discussed in Part III.B.2 of this Report, the definition of a covered inbound transaction is subject to two subsequent transfer exceptions: the controlled transfer exception and the other transfer exception. The controlled transfer exception applies if an acquired CFC is transferred in a transaction described in section 368(a)(2)(C) or Treas. Reg. § 1.368-2(k)(1) to a partnership or a corporation that is not a wholly-owned member of the same consolidated group that includes the domestic acquiring corporation or its common parent. Similarly, the other transfer exception applies if, pursuant to a plan or series of related transactions, the acquired CFC stock is transferred to either a partnership or foreign corporation in connection with a covered inbound transaction.[81] The Notice deems a plan to exist if the acquired CFC stock is transferred to a partnership or foreign corporation within two years of the covered inbound transaction (the "***per se* rule**").

As discussed in Part IV.A of this Report, the subsequent transfer exceptions appear to be intended to prevent taxpayers from effectively shifting the benefit of section 961(c) basis from the inclusion U.S. shareholder to another person. While the ability to shift the benefits of adjusted basis may be limited by certain Code provisions, such as section 362(e)(2)[82] or section 704(c)(1),[83] even where those provisions do not apply, as discussed above, the mixing of attributes attributable to contributed property is consistent with the results of ordinary corporate and partnership transactions.

In addition to the basis shifting concern, the subsequent transfer exceptions could also have been intended to prevent a taxpayer from using self-help to convert limited purpose, section 961(c) basis, which is taken into account "only for the purposes of determining the amount included under section 951 in the gross income," into adjusted basis that is taken into account for all purposes of the Code. Although we understand why the government might want to discourage this type of electivity, we are also cognizant that section 961(c)'s limited scope could result in the creation of duplicative tax benefits, such that the government might generally favor the conversion of section 961(c) basis into "real" basis wherever possible. Specifically, the duplicative tax benefit

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[80] We recognize that our recommendations would permit shifting losses between taxpayers. We believe that loss shifting raises the same considerations associated with basis shifting. *See* Part IV.A for a discussion of our views as regards basis shifting.

[81] While the Notice's heading for the other transfer exception is "[o]ther *subsequent* transfers" (emphasis added), the operative rule itself does not appear to require that the prohibited transfer occur after the inbound transaction, only that it occur "in connection with" the inbound transaction. Treasury should clarify this point.

[82] As discussed in Part IV.D.1 of this Report, section 362(e) limits the ability for a corporation to acquire property with a built-in loss in certain nonrecognition transactions. Section 362(e)(2) applies to transactions not covered by section (e)(1) where the adjusted basis of property in the hands of a transferee exceeds its fair market value. An election can be made under section 362(e)(2)(C) to preserve the basis of built-in loss assets in exchange for a step down in the basis of the transferee corporation's stock.

[83] Section 704(c)(1) ensures that pre-contribution gain or loss with respect to contributed property is allocated to the contributing partner in certain circumstances.

can arise because the section 961(c) basis is not taken into account for purposes of determining a CFC's E&P. As a result that, upon an upper-tier CFC's disposition of the stock of a lower-tier CFC, the upper-tier CFC's section 961(c) basis may not only reduce an inclusion U.S. shareholder's CFC inclusion, but also create E&P that is eligible for the section 245A DRD, which could in turn eliminate taxable gain on a subsequent disposition by a U.S. shareholder of the upper-tier CFC's stock.[84] We understand that this potential double benefit from section 961(c) basis may be addressed in forthcoming regulations and therefore is beyond the scope of this Report. Nevertheless, we emphasize that the potential duplicative benefit associated with the limited scope of section 961(c) basis is eliminated when that basis is converted to ordinary tax basis.

If Treasury determines it is appropriate to retain the subsequent transfer exceptions, it should at least consider substantially narrowing the other transfer exception, the application of which is potentially quite broad. For example, the rule would appear to apply to any subsequent transfer of an acquired CFC, including a subsequent sale to a foreign entity in a taxable section 1001 exchange. If the other transfer exception applied because of a subsequent sale, the inclusion U.S. shareholder could be subject to double taxation—once in the year of the CFC inclusion and a second time when the stock is sold. Further, we can discern no potential for abuse in a taxable sale because the foreign buyer would take a cost basis in the stock of the acquired CFC and thus could not benefit at all from section 961(c) basis in the acquired CFC attributable to an U.S. inclusion shareholder. As a result, we recommend that the other transfer exception provide an exception for subsequent sales for which the buyer takes a cost basis under section 1012.

Further, based on a plain reading of the rule, it would appear that the other transfer exception applies if the acquired CFC engages in a recapitalization or is acquired in an asset reorganization in connection with, or within two years following, the covered inbound acquisition. In the case of a recapitalization, the inclusion U.S. shareholder would exchange its acquired CFC stock for new acquired CFC stock. This "exchange" could also be viewed as a "transfer" by the inclusion U.S. shareholder to the acquired CFC, a foreign corporation. In the case of an asset reorganization, the acquired CFC would be treated as redeeming its stock held by the domestic acquiring corporation in exchange for stock of the foreign acquiring corporation. This too could be treated as a transfer by the domestic acquiring corporation of acquired CFC stock to a foreign corporation (*i.e.*, the acquired CFC itself), potentially subject to the other transfer exception.[85]

In the case of a subsequent recapitalization or an asset reorganization of the acquired CFC, any basis shifting concern is not present. Specifically, the inclusion U.S. shareholder's adjusted basis in the acquired CFC stock (including the transferor CFC's former section 961(c) basis

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[84] This issue is complex and beyond the scope of this Report. For an in-depth discussion of these issues, *see* Douglas Poms, *The Elusive Nature of Code Sec. 961(c) Basis in a Post-TCJA Multiverse*, INT'L TAX J., Sept.-Oct. 2022, at 56, 63-66 and Prae Kriengwatana, Marty Collins, and Matt Brown, *Most Thought §961(c) Was on the Sidelines During TCJA*, 49 TAX MGMT. INT'L J. 499 (2020).

[85] Although arguably the acquired CFC should not be treated as acquiring its own stock in the reorganization because it liquidates, the regulations under section 367(a) suggest otherwise. In particular, the section 367(a) regulations provide an exception to the application of section 367(a) where a domestic corporation transfers the stock of a foreign target to the foreign target itself in a section 354 exchange pursuant to an asset reorganization. *See* Treas. Reg. § 1.367(a)-3(a)(2)(ii). This exception implies that, absent guidance indicating otherwise, a section 354 exchange of acquired CFC stock for stock of a foreign acquiring corporation in an asset reorganization subsequent to an inbound transaction is a transfer of the acquired CFC stock to a foreign corporation that is subject to the other transfer exception.

attributable to the shareholder) is not subsequently inherited by any other person by reason of either of these transactions. In each case, the basis in the acquired CFC stock would continue to be reflected solely in the stock held by the inclusion U.S. shareholder—the acquired CFC stock after a recapitalization or the foreign acquiring corporation stock after an asset reorganization. This would be true even if the acquired CFC or foreign acquiring corporation issues shares to persons other than the inclusion U.S. shareholder in the transaction; in either case, the inclusion U.S. shareholder's post-transaction adjusted basis in the acquired CFC will not be inherited, directly or indirectly, by the other shareholders. As a result, we believe that the other transfer exception should not apply to subsequent recapitalizations or asset reorganizations of the acquired CFC.[86]

An additional concern for the other transfer exception is the *per se* rule, which captures all transactions within the two-year period following the covered inbound transaction. This rule is overly broad, capturing transactions that may not have been contemplated at the time of the covered inbound transaction. As a result, if the other transfer exception is retained, we recommend that the *per se* rule be eliminated or converted into a rebuttable presumption. Specifically, it could provide that a transfer within two years of the covered inbound transaction is presumed to be pursuant to the same plan or series of related transactions as the covered inbound transaction, unless the facts and circumstances establish otherwise, similar to the rules contained in Treas. Reg. § 1.707-3.

Finally, if the subsequent transfer exceptions are retained, we recommend that the proposed regulations clarify that, in the case of a subsequent transfer of acquired CFC to a foreign corporation, the transferor CFC's section 961(c) basis in the stock of the acquired CFC attributable to the inclusion U.S. shareholder that existed before the inbound transaction is preserved after the transaction. Without this rule, the inbound transfer of stock could potentially eliminate the section 961(c) basis, resulting in the U.S. transferor losing the benefit of the former section 961(c) basis after the subsequent transfer, notwithstanding that the transferor retains an indirect ownership (within the meaning of section 958(a)) in the acquired CFC after the inbound transaction.

> Example 10 – USP owns CFC1, which owns all 10 shares of CFC2. CFC1 has $100 of section 961(c) basis in its CFC2 stock attributable to USP. CFC1 liquidates, distributing its CFC2 stock to USP in liquidation. One year later, USP transfers CFC2 to its newly-formed foreign subsidiary, CFC3 in a tax-free section 351 exchange.
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> Because USP subsequently transfers the CFC2 stock to CFC3 within two years after the initial inbound transfer, the *per se* rule would apply and the inbound transaction would not be a covered inbound transaction under the other transfer exception. As a result, CFC1's section 961(c) basis in its CFC2 stock attributable to USP would not become adjusted basis in the hands of USP. Accordingly, when USP transfers CFC2 to CFC3, there is no obvious mechanism in the Notice for preserving CFC1's section 961(c)

[86] If Treasury were to accept this recommendation, it would need to provide "successor asset" rules, treating any stock the basis of which is determined (in whole or in part) by reference to the basis in the stock of the acquired CFC under section 358 as stock of the acquired CFC for purposes of the subsequent transfer exceptions.

basis in the CFC2 stock in the hands of CFC3, despite the fact that USP retains an indirect interest in CFC2.[87]

Given that the intent should be to put the parties in the same position they were in prior to the transactions, eliminating the section 961(c) basis under these facts would be contrary to the intended purpose of the section 961 rules and could potentially result in double taxation.

If Treasury accepts our recommendation with respect to the preservation of section 961(c) basis, we also recommend that the proposed regulations permit the section 961(c) basis in the hands of the domestic acquiring corporation to operate provisionally as adjusted basis for any distributions of PTEP or taxable dispositions of stock that occur during the period between the inbound transaction and the subsequent outbound transfer that triggers the subsequent transfer exception. Such provisional use of basis is necessary to avoid double taxation, particularly if the proposed regulations retain the 2-year *per se* rule. If Treasury accepts this recommendation, adjustments should be made to the section 961(c) basis after the subsequent outbound transfer to reflect any distributions of PTEP that occur between the inbound transaction and the outbound transaction.

> Example 11 – Same facts as Example 10, except that after CFC1 liquidates, but before the outbound transfer of CFC2 stock to CFC3, CFC2 distributes $10 of PTEP to USP. Also assume that CFC1 has no adjusted basis in the CFC2 stock immediately before the inbound transaction.
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> In order to ensure that CFC2's earnings are not double taxed, USP should be permitted to treat $10 of CFC1's section 961(c) basis in its CFC2 stock as adjusted basis in its hands to avoid gain under section 961(b)(2) on the distribution of the PTEP. Further, CFC3 should be permitted to inherit CFC1's pre-inbound transaction section 961(c) basis in the CFC2 stock after the transfer of that stock to CFC3. However, because $10 of the $100 of CFC2's PTEP has been repatriated to USP between the inbound transaction and the outbound transaction, CFC3's section 961(c) basis attributable to USP should be reduced to take into account this distribution. Thus, CFC3's section 961(c) basis attributable to USP should be $90 (*i.e.*, $100 of prior section 961(c) basis less $10 distributed to USP).
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> Example 12 – Same facts as Example 10, except that after CFC1 liquidates, USP sells 1 share of CFC2 stock to an unrelated U.S. individual for $10, and transfers the remaining 9 shares of CFC2 stock to CFC3. Immediately before the inbound liquidation, CFC1 had no adjusted basis in the CFC2

[87] An argument could be made that, upon the inbound transaction, CFC1's section 961(c) basis in the CFC2 stock is not eliminated, but rather inherited by USP under section 334(a) or 362(b), but with no effect. Under that view, USP's section 961(c) basis in CFC2 would then be inherited by CFC3 under section 362(a) upon USP's subsequent outbound transfer of the CFC2 stock to CFC3. However, we would recommend that, rather relying on the subchapter C basis carryover rules, which could potentially sweep in sections 358 and 362(e)(2), the proposed regulations should simply put USP back in the same position that it was vis-à-vis CFC2 before the inbound transaction by providing that the section 961(c) basis is restored in the hands of CFC3, as adjusted for any PTEP distributions in the interim (as discussed in text below).

share sold, but had $10 of section 961(c) basis in such share attributable to USP.

The sale of the 1 share of CFC2 stock to an unrelated U.S. individual does not implicate a subsequent transfer exception, but the subsequent transfer of the 9 shares of CFC2 stock to CFC3 does. Because the exceptions are applied separately with respect to each acquired CFC (*i.e.*, CFC2), and not with respect to each share, the outbound transfer of CFC2 stock to CFC3 causes the other transfer exception to apply, with the result that none of CFC1's section 961(c) basis in its CFC stock attributable to USP becomes adjusted basis in the hands of USP. However, in order to ensure that CFC2's earnings are not double taxed, USP should be permitted to treat $10 of CFC1's section 961(c) basis in the 1 share sold as adjusted basis in the hands of USP to avoid gain recognition under section 1001. Further, CFC3 should be permitted to inherit CFC1's pre-inbound transaction section 961(c) basis with respect to the 9 shares of CFC2 stock transferred to CFC3.

Further, to ensure that the parties are provided the full benefit of their prior section 961(c) basis, this provisional section 961(c) basis should be taken into account for purposes of determining the collateral consequences of a subsequent outbound transfer of the acquired CFC. For example, the provisional section 961(c) basis should be considered for purposes of determining the gain amount to be reported on a gain recognition agreement entered into in accordance with Treas. Reg. § 1.367(a)-8 as a result of an outbound stock transfer. In addition, such basis should also be considered in determining the U.S. transferor's basis in transferee stock received under section 358.[88] If such provisional basis were not considered, the taxpayer could potentially be subject to double taxation on amounts previously included in income.

V. Miscellaneous Issues

A. Interest Expense Apportionment

A U.S. person must allocate and apportion expenses to categories of gross income to calculate the foreign tax credit limitation under section 904. Generally, interest expense is apportioned based on the tax basis of the taxpayer's assets.[89] In the case of a nonaffiliated, 10-percent-owned corporation, tax basis is increased by the owner's share of the corporation's E&P, as well as the E&P of certain of its subsidiaries.[90]

Where a CFC has PTEP, the tax book value method could give rise to double counting, since both the E&P and section 961(a) basis attributable to such E&P would be counted in the interest expense apportionment formula. To address this potential problem, the regulations

[88] An alternative approach could be to provide the U.S. transferor with section 961(a) basis in the stock of the transferee foreign corporation received in an amount equal to the section 961(c) basis of the acquired CFC.

[89] Section 864(e).

[90] Section 864(e)(4); Treas. Reg. §§ 1.861-12(c), -12T(c).

disregard stock basis attributable to "any amount included in basis under section 961 or 1293(d) of the Code."[91]

There is some uncertainty as to whether inherited section 961(c) basis under the Notice would satisfy this definition. Specifically, the Notice says that inherited section 961(c) basis becomes "adjusted basis" in the hands of the domestic acquiring corporation, rather than basis under section 961. To avoid the over-apportionment of interest expense to categories of CFC income (*e.g.*, the section 951A category), any section 961(c) basis that becomes adjusted basis should also be excluded from stock basis for purposes of apportionment. We recommend that Treasury clarify that such basis is excluded.

B. Currency Translation

As discussed in Part III.B of this Report, the Notice provides that, if a taxpayer has not maintained section 961(c) basis in U.S. dollars, the taxpayer, as a condition to reliance, must translate such basis into U.S. dollars using a reasonable and consistently applied method. The Notice provides that a reasonable method must use an exchange rate that reflects the original U.S. dollar inclusion amounts of the U.S. shareholder that gave rise to the section 961(c) basis and the basis must be reduced to take into account PTEP distributions with respect to the stock. Any distribution of PTEP should be treated as reducing section 961(c) basis by the U.S. dollar basis of the PTEP.

As a general matter, any approach to translating section 961(c) basis into U.S. dollars should balance two priorities: (1) approximating the result under section 961(a) as if the CFC has always been held directly by the U.S. shareholder and (2) simplicity and administrability.

Given the lack of guidance in this area, the Notice's invitation to use a "reasonable method" is welcome. Nevertheless, the parameters regarding whether a method is reasonable should be further clarified. For example, the requirement to use "an exchange rate that reflects the original U.S. dollar inclusion amounts of the United States shareholder that gave rise to the section 961(c) basis" may mean that a domestic acquiring corporation must use the average exchange rate for the taxable year of the foreign corporation in which the CFC inclusion occurred to convert the section 961(c) basis maintained in foreign currency into U.S. dollars.[92] If that is the case, then the rule could be more simply expressed by simply requiring the conversion of the section 961(c) basis into U.S. dollars based on the original U.S. dollar amounts of the inclusion U.S. shareholder's CFC inclusions. That is generally the same result as if the acquired CFC were owned directly by the domestic acquiring corporation at the time of the CFC inclusion (*i.e.*, the hypothetical section 961(a) basis would match the section 961(c) basis).

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[91] Treas. Reg. § 1.861-12(c)(2)(i)(B)(1)(i). Treasury issued the regulation pursuant to a specific grant of regulatory authority under section 864(e)(4)(D), which provides that "proper adjustment shall be made to the earnings and profits of any corporation to take into account any earnings and profits included in gross income under section 951 or under any other provision of this title and reflected in the adjusted basis of the stock."

[92] This approach is analogous to that outlined in sections 986(b)(2) and 989(b)(3) for determining the amount of a subpart F inclusion.

Similarly, the Notice's requirement to reduce section 961(c) basis for distributions of PTEP "by the U.S. dollar basis of the PTEP" suggests that taxpayers should track PTEP with a U.S. dollar basis similar to the methodology outlined in Notice 2019-1[93] and that distributions of such PTEP should reduce section 961(c) basis by the associated average dollar basis associated with such PTEP. If these were the government's intended approaches, this should be clarified. Guidance should also specify what other approaches might be considered reasonable. That is, under the Notice, it appears that there is effectively only one reasonable method for calculating a taxpayer's adjusted basis attributable to section 961(c) basis. Proposed regulations should also highlight specific areas in which comments are needed.

C. Consistency Rule

As discussed in Part III.B.3 of this Report, taxpayers are permitted to rely on the rules described in the Notice for transactions completed "on or before the date of the proposed regulations," provided that "the taxpayer and its related parties . . . follow the rules [of the Notice] in their entirety and in a consistent manner" (the "**consistency rule**").[94] Nonetheless, the Notice also provides that "[n]o inference is intended with regard to the treatment of section 961(c) basis as a result of transactions other than covered inbound transactions" (the "**no inference language**").[95]

It is unclear if there was any particular concern necessitating the consistency rule or whether the insertion of the consistency rule was simply as part of the customary rule making practice. In particular, because of the no inference language, it appears that the consistency rule would permit a taxpayer and its related parties to rely on the Notice for all their covered inbound transactions while independently taking a position that section 961(c) basis is inherited in an inbound transaction that does not qualify as a covered inbound transaction within the meaning of the Notice because of one or more of the exceptions therein (*e.g.*, the BIL CFC exception or other transfer exception). If this was Treasury's intent, the consistency rule appears to serve no purpose, except perhaps to prevent taxpayers from relying on the Notice for some covered inbound transactions while *forgoing* section 961(c) basis in other covered inbound transactions. It does not seem likely that many taxpayers would be benefited from such inconsistency. If, alternatively, Treasury intended that the consistency rule would prevent taxpayers from relying on the Notice with respect to their covered inbound transactions while independently taking a position that section 961(c) basis is inherited in an inbound transaction that is not a covered inbound transaction, Treasury should clarify that intent.

Treasury should also clarify that the consistency rule applies only prospectively from the date of the Notice. The Notice's consistency rule applies to all transactions completed on or before the date of the proposed regulations and therefore appears to apply to all historic transactions, even those occurring before the date of the Notice. A retroactive consistency requirement may require taxpayers to diligence historic transactions and amend prior year returns to ensure consistency over prior, current, and future taxable years. We recommend that the proposed regulations clarify that

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[93] 2019-2 I.R.B. 275 (2018).

[94] Notice, §4.

[95] *Id.*

the consistency rule was not intended to require taxpayers to amend prior year returns and rather only contemplated prospective consistency.