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Report No. 1533
October 26, 2026

The Honorable Scott Bessent
Secretary of the Department of the Treasury, and Acting Commissioner of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Kevin Salinger
Acting Assistant Secretary (Tax Policy) of the Department of the Treasury, and Acting Chief Counsel of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: NYSBA Tax Section Report No. 1533 – Report on the Proposed Regulations Regarding the Pro Rata Share of Subpart F Income, Tested Income, or Tested Loss

Dear Secretary Bessent and Acting Assistant Secretary Salinger:

Please see attached Report No. 1533 of the Tax Section of the New York State Bar Association (the "Report") commenting on proposed regulations under sections 951 and 951A of the Internal Revenue Code concerning the determination of a United States shareholder's pro rata share of a controlled foreign corporation's subpart F income, tested income, or tested loss. The proposed regulations were published by the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") as REG-115646-25 on August 26, 2026, and implement amendments enacted by the One Big Beautiful Bill Act of 2025 that replaced the former last-day ownership framework with rules that take account of ownership of stock and changes thereto during the controlled foreign corporation's taxable year.

The Report recommends targeted revisions intended to align controlled foreign corporation income and related tax attributes more closely with the

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relevant ownership periods while preserving administrability. The Report principally recommends a deemed-disposition rule for partnership interests when a controlled foreign corporation's taxable year closes; earlier recognition of section 961(a) basis adjustments so that adjustments are made whenever stock basis becomes relevant; a broader elective closing rule for significant ownership changes that generally would apply upon an ownership variance of at least 25 percent; rules addressing indirect dispositions through certain transfers of domestic corporations owning CFCs; appropriate adjustments to the weighted-average-share-count rule for pro rata stock dividends, stock splits, and reverse stock splits; and further consideration of how the weighted-average-share-count rule should apply to same-day stock sales and redemptions involving appreciated property.

We appreciate the opportunity to comment on these important issues and thank Treasury and the IRS for considering the views of the Tax Section. If you have any questions or would like to discuss any aspect of the Report, please do not hesitate to contact us. We would be pleased to assist in any way.

Respectfully submitted,



Lawrence M. Garrett
Chair

Enclosure

cc:

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Report No. 1533

New York State Bar Association Tax Section

Report on the Proposed Regulations Regarding the Pro Rata Share of Subpart F Income, Tested Income, or Tested Loss

October 26, 2026

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

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I. INTRODUCTION

This report (the "Report") of the New York State Bar Association ("NYSBA") Tax Section[1] comments on Proposed Regulations under sections 951 and 951A concerning the determination of the pro rata share of a section 958(a) United States shareholder (a "U.S. Shareholder") of subpart F income, tested income, and tested loss of a controlled foreign corporation (a "CFC") (the "Proposed Regulations").[2] The Proposed Regulations implement amendments enacted by the One Big Beautiful Bill Act of 2025 (the "OBBBA"), which replaced the former last-day ownership framework with rules that take account of ownership during the CFC's taxable year.[3] Section 951(a)(4) expressly authorizes the Department of the Treasury ("Treasury," including, as applicable, the Internal Revenue Service, or "IRS") to issue guidance implementing that framework, including rules permitting or requiring a CFC's taxable year to close upon a direct or indirect disposition of its stock. The Proposed Regulations were published as REG-115646-25 on August 26, 2026.[4]

The Proposed Regulations generally implement the new framework through daily proration, mandatory closings upon specified changes in CFC status, and elective closings following certain significant ownership variances. Although that approach resolves important problems under prior law, several aspects of the proposal may assign income or related tax attributes to periods or taxpayers that do not correspond to the underlying economic activity. Other provisions may make an elective closing unavailable in transactions that present substantially the same information and compliance concerns as transactions covered by the Proposed Regulations.

This Report recommends targeted revisions intended to match CFC income and associated tax attributes more closely with the relevant ownership periods without contravening the Proposed Regulations' daily proration framework or imposing unnecessary information and compliance burdens.

II. SUMMARY OF PRINCIPAL RECOMMENDATIONS

1. Final Treasury Regulations should incorporate a deemed disposition rule for partnership interests under which, when a CFC is a partner in a partnership and that CFC's taxable year closes, the CFC is deemed to dispose of the partnership interest under section 706(c).

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[1] The principal authors of this Report are Laura Williams and Wade Sutton, with substantial assistance by Cade Pruitt. Helpful comments were received from Kim Blanchard, Kristen Gamboa, Lawrence Garrett, Steve Massed, Michael Molerus, Deborah Paul, Michael Schler, Eric Sloan, Shun Tosaka, and Gordon Warnke. This Report reflects solely the views of the Tax Section and not those of its individual members or any other party.

[2] Unless otherwise noted, references herein to "section" are to sections of the Internal Revenue Code of 1986 (the "Code"), as amended, references herein to "Prop. Treas. Regs. §" are to sections of proposed regulations ("Proposed Regulations") promulgated under the Code, and references herein to "Treas. Regs. §" are to sections of the regulations (the "Treasury Regulations") promulgated under the Code.

[3] Pub. L. No. 119-21, 139 Stat. 72 (2025).

[4] 91 Fed. Reg. 55,037 (Aug. 26, 2026).

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The closing should be limited to section 706 and related allocations of foreign income taxes.

2. Existing Treas. Reg. § 1.961-1 should be revised so that a section 961(a) basis increase attributable to section 951(a) and section 951A inclusions takes effect immediately before any transaction for which the basis of the relevant CFC stock or upper-tier property must be determined. If the inclusion is not then final, the taxpayer should be allowed to use a reasonable estimate subject to a later true-up and appropriate consistency and anti-duplication rules.

3. The controlling domestic shareholders of a CFC should be permitted to elect to close the CFC's taxable year upon an ownership variance affecting their ownership by at least 25 percent (a "25% Variance"), without regard to whether related transfers occur within a single taxable year. A targeted anti-abuse rule should also apply either to disregard a tax-year-closing election or to reallocate a CFC's items where a transaction is undertaken outside of the ordinary course of business with a principal purpose of reducing the U.S. tax liability of the U.S. Shareholders of the CFC by shifting the timing of its items of income, gain, loss, deduction, or taxes.

4. Final Treasury Regulations should treat certain transfers of stock of a domestic corporation that owns CFC stock as indirect dispositions for purposes of the elective-closing rule. Treasury should consider either treating an event that terminates the domestic corporation's taxable year as a deemed disposition of all its CFC stock or treating a transfer of domestic corporation stock as a proportionate indirect disposition of the CFC stock, with coordination rules if both approaches are adopted. For transactions entered into before August 26, 2026, Treasury should also provide a transition rule modeled on the tax-year-closing election in Treas. Reg. § 1.245A-5(e) where an ultimate third-party disposition of CFC stock is part of a plan with an initial transfer.

5. We recommend retaining the weighted-average-share-count rule when an issuance or redemption changes a CFC's assets or liabilities, but making appropriate adjustments for pro rata stock dividends, stock splits, and reverse stock splits in determining the weighted average share count. Treasury should further study the rule's operation for redemptions involving a distribution of appreciated property, including same-day stock sales and redemptions.

III. BACKGROUND

A. Statutory Framework

Before the OBBBA, section 951 generally determined a U.S. Shareholder's pro rata share of a CFC's subpart F income by reference to the stock owned on the last day of the CFC's taxable year on which the corporation was a CFC. Former section 951(a)(2)(B) reduced that share by certain dividends paid with respect to the stock to other persons during the portion of the year in which the U.S. Shareholder did not own the stock. When CFC stock changed ownership during the year,

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those rules could assign income to a shareholder that did not own the stock when the income arose and permit a dividend paid to the transferor to reduce the acquiror's inclusion.

Treasury adopted the extraordinary reduction rules in Treas. Reg. § 1.245A-5(e) and (f) against that statutory background. Those rules generally addressed transactions in which a controlling section 245A shareholder received a section 245A-eligible dividend and then transferred CFC stock, with the dividend reducing the transferee's pro rata share of subpart F income or tested income under former section 951(a)(2)(B).[5] In that circumstance, the related earnings could escape current U.S. taxation.

The OBBBA replaced the former last-day and dividend-reduction framework with an ownership-period attribution rule. For taxable years of foreign corporations beginning after December 31, 2025, section 951(a)(1)(A) generally requires an inclusion if a U.S. Shareholder owns CFC stock on any day during the CFC year. Revised section 951(a)(2) determines the shareholder's pro rata share by reference to the stock owned and the period during which the shareholder owned that stock while the shareholder was a U.S. Shareholder and the foreign corporation was a CFC.

Section 951A applies the revised section 951(a)(2) framework in determining a U.S. Shareholder's pro rata share of a CFC's tested income or tested loss. Section 951(a)(4) directs Treasury to issue guidance necessary or appropriate to implement the amended rules, including guidance permitting or requiring a CFC's taxable year to close upon a direct or indirect disposition of its stock. The amendments address concerns resulting from the former last-day rule, but they do not specify how a CFC's annual subpart F income, tested income, or tested loss should be attributed among ownership periods.

Consistent with the amended framework, Treasury concluded that the extraordinary reduction rules are no longer necessary for taxable years governed by revised section 951.[6] Prop. Treas. Reg. § 1.245A-5(k)(3) accordingly provides that Treas. Reg. § 1.245A-5(e) and (f) (i.e., the "extraordinary reduction" and "tiered extraordinary reduction" rules) would not apply to taxable years of foreign corporations beginning after December 31, 2025.

B. Prior Tax Section Recommendations

In Report No. 1518 (the "Prior Report"), the Tax Section recommended that Treasury permit taxpayers to allocate a CFC's annual income using either (i) a per diem method, subject to special treatment for extraordinary items or (ii) an interim closing-of-the-books method when ownership of CFC stock changes during the taxable year.[7] The recommendation drew on the analogous partnership framework in Treas. Reg. § 1.706-4.

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5 The regulations also addressed dividends subject to section 954(c)(6), which could produce similar results, under the tiered extraordinary reduction rules.

6 91 Fed. Reg. at 55,045.

7 N.Y. State Bar Ass'n Tax Section, Report No. 1518, *The Subpart F Pro Rata Share Rules and Merger and Acquisition Considerations* (Dec. 2, 2025).

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Under that approach, dispositions or abandonments of assets, accounting-method changes, cancellation-of-debt income, and other extraordinary items would be assigned to the portion of the CFC year in which they arose rather than prorated across the year. The Prior Report also recommended calendar-day, semi-monthly, or monthly conventions to reduce the administrative burden of an interim closing.

The Prior Report further recommended a relatively low threshold for an elective closing: either a person becoming or ceasing to be a U.S. Shareholder or a transfer of at least 10 percent of a CFC's stock during the taxable year. It also recommended consistent allocation methods for section 1248 earnings and profits and the section 951 pro rata share rules to reduce mismatches between income inclusions and section 1248 gain.

C. Prop. Treas. Reg. § 1.951-1

Prop. Treas. Reg. § 1.951-1 generally allocates a CFC's annual subpart F income, tested income, or tested loss ratably among the days of the CFC year.[8] Absent a closing of the foreign corporation's taxable year, a shareholder's pro rata share is determined by reference to the stock it owns during each period in which it is a U.S. Shareholder and the foreign corporation is a CFC during the CFC's taxable year. Ownership changes that do not close the CFC's taxable year divide the year into separate "CFC year blocks," and the shareholder's allocation is computed for each block.[9] The preamble states that these rules are intended to be consistent with the attribution of earnings and profits to foreign corporation stock under section 1248, while reserving possible amendments to the section 1248 Treasury Regulations for a separate project.[10]

Treasury considered, but did not adopt, a generally available closing-of-the-books method, a special-allocation rule for extraordinary items, or simplified timing conventions.[11] The preamble explains that subpart F income, tested income, and tested loss are annual net amounts determined at the CFC level and that assigning the items comprising those amounts to particular periods could be complex, especially when the section 952(c) earnings-and-profits limitation or other CFC-level rules apply.[12] The proposal instead uses daily proration as the default and permits or requires a closing of the foreign corporation's taxable year only in specified circumstances.

The preamble also requests comments on whether the Treasury Regulations under section 1248 should be revised to coordinate the attribution of earnings and profits with the revised section 951 pro rata share rules. This Report does not address that request.

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8 91 Fed. Reg. at 55,040.

9 Prop. Treas. Reg. § 1.951-1(e); 91 Fed. Reg. at 55043–44, 55052–56.

10 91 Fed. Reg. at 55,043.

11 91 Fed. Reg. at 55,040.

12 *Id.*

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A closing is mandatory when the foreign corporation's CFC status changes.[13] A closing is elective upon a "significant ownership variance," generally defined as an aggregate decrease of more than 50 percentage points in the ownership of U.S. Shareholders resulting from specified transfers pursuant to the same plan between unrelated persons.[14] Treasury selected that threshold on the ground that a greater-than-50-percent shift ordinarily reflects a transfer of control and may leave the seller without access to the CFC's information.[15] The threshold is materially higher than the one NYSBA previously recommended and excludes a transfer of exactly 50 percent, including a participant's disposition of its entire interest in a 50/50 joint venture.

A mandatory closing of a CFC's taxable year also may permit a U.S. acquiror of a foreign corporation to cause the foreign target to undertake a transaction that increases the basis of its assets before the acquisition—or, depending on the applicable stock-ownership convention, on the acquisition date—so that the resulting gain is taken into account in the target's pre-acquisition short taxable year. We do not view that consequence as materially problematic. A comparable asset-basis increase may be obtained through a section 338 election or through a step-up transaction completed in an earlier taxable year. The principal distinction is that a pre-acquisition step-up transaction generally does not cleanse the foreign target's earnings and profits, whereas a section 338 election treats the target as a new corporation following a deemed sale of its assets and thereby generally eliminates the old target's earnings and profits. We do not expect that difference, standing alone, to create material near-term planning opportunities.

If a mandatory or elective closing divides a foreign-law taxable year, Prop. Treas. Reg. § 1.951-1(d)(3) allocates certain foreign income taxes between the resulting U.S. taxable years under principles of Treas. Reg. § 1.1502-76(b) based on foreign taxable income. A closing of the CFC's taxable year generally does not, however, close the taxable year of a partnership in which the CFC is a partner. The CFC's distributive share for a partnership year spanning the closing date therefore generally falls entirely in the CFC's second short taxable year. Treasury requested comments on whether the CFC's closing instead should be treated as a deemed disposition of its partnership interest for purposes of section 706.[16]

For a CFC with multiple classes of stock, Prop. Treas. Reg. § 1.951-1(e) first allocates subpart F income among classes by reference to the earnings and profits that would be distributed to each class in a hypothetical distribution on the last day of the CFC year. The amount allocated to each class is then apportioned among shareholders under the daily-proration rules. The proposal includes additional rules for changes in the number of shares outstanding, preferred stock, redemption and liquidation rights, distribution restrictions, and transactions undertaken with a principal purpose of altering shareholders' pro rata shares.

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13 Prop. Treas. Reg. § 1.951-1(d)(1).

14 Prop. Treas. Reg. § 1.951-1(d)(2).

15 91 Fed. Reg. at 55,041.

16 *Id.* at 55,043.

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IV. RECOMMENDATIONS

A. Taxable Years of Partnerships Owned by Foreign Corporations

1. Recommendation

We recommend that, when a CFC is a partner in a partnership and the CFC's taxable year closes upon a status change event or a significant ownership variance for which an election is made, the CFC be treated as disposing of its entire partnership interest solely for purposes of section 706(c). The deemed disposition would close the partnership's taxable year with respect to the CFC and assign the CFC's distributive share of partnership items between its resulting short taxable years. The closing should apply consistently across CFCs whose taxable years close pursuant to the same plan and be limited to section 706(c) and the allocation of foreign income taxes under Prop. Treas. Reg. § 1.951-1(d)(3). To ease administrative burdens, Treasury should consider whether the deemed disposition of a partnership interest should be elective in the case of a de minimis partnership interest (e.g., a partnership interest of less than five percent of capital and profits and constituting less than five percent of the CFC's gross assets).

Under Prop. Treas. Reg. § 1.951-1, the taxable year of a partnership would not close solely because the CFC's taxable year closes upon a status change event or significant ownership variance (for which an election is made).[17] The foreign corporation would include its distributive share of partnership items arising in that partnership taxable year entirely in the foreign corporation's short taxable year following the status change event or significant ownership variance.[18] That result may assign items economically arising before the closing date to the post-closing period.

Treasury requested comments as to whether a closing of a foreign corporation's taxable year should be treated as a deemed disposition of the foreign corporation's entire interest in a partnership for purposes of section 706, thereby closing the partnership's taxable year with respect to the foreign corporate partner.[19] Any deemed disposition of a partnership interest upon a closing of the CFC's year would allow the parties to divide partnership items between the CFC's short taxable years. Any increased information and compliance burden should be outweighed by the benefits of consistency and accuracy.

2. Potential Distortions Under the Proposed Regulations

Example 1—Partnership taxable-year mismatch. To illustrate the issue raised by the preamble, assume USP is a domestic corporation that owns all the shares of CFC1. CFC1 owns 50 percent of Partnership A. USP, CFC1, and Partnership A all use the calendar year for tax purposes. Partnership A earns $1,000x of income ratably throughout Year 1.

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17 *Id.*

18 *Id.*

19 *Id.*

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On June 30, USP sells all its CFC1 stock to Buyer, a U.S. corporation, which qualifies as a significant ownership variance. USP makes an election to close CFC1's taxable year under Prop. Treas. Reg. § 1.951-1. Thus, CFC1's taxable year closes as of the end of the day on June 30. However, Partnership A's taxable year does not close as of that date. Instead, Partnership A's taxable year closes on December 31 since there has not been an event under section 706(c) that would trigger an interim closing with respect to CFC1.

Because CFC1 continues to own its 50-percent interest in Partnership A through December 31, Partnership A allocates $500x of income to CFC1 for its calendar taxable year. Under the proposed rule, that entire $500x distributive share falls in CFC1's short taxable year beginning on July 1. The result assigns no partnership income to CFC1's first short taxable year even though Partnership A may have earned income during such period.

3. Deemed Disposition Approach

A deemed disposition of the CFC's entire partnership interest upon a status change event or a significant ownership variance for which an election is made would close the partnership's taxable year with respect to the CFC under section 706(c)(2)(A). Partnership items would then be allocated between the CFC's two short taxable years under the applicable section 706 rules, rather than being assigned entirely to the second short taxable year.

The preamble to Prop. Treas. Reg. § 1.951-1 explains that the concurrent closing of the partnership's taxable year was not adopted because it requires the seller to obtain information from the buyer to determine the foreign corporation's distributive share of partnership items.[20] A deemed disposition rule may require the CFC and the partnership to determine partnership items through the closing date and may require the pre-closing U.S. Shareholders to obtain that information after control of the CFC has changed. The burden will vary with the CFC's rights to partnership information, the partnership's accounting systems, and the time available to prepare the relevant returns. These information concerns are not unique to partnership items, however.

Although partnership items may present an additional layer of complexity, particularly where the CFC is a minority partner in an unrelated partnership, that incremental burden does not justify always assigning all partnership items to the CFC's post-closing taxable year. Treasury should instead adopt rules that balance accuracy and administrability, including a general deemed disposition rule and potentially an elective deemed disposition rule for de minimis partnership interests.

A deemed disposition rule would follow established taxable-year-closing approaches found elsewhere. Section 706(c)(2)(A) and Treas. Reg. § 1.706-1(c)(2)(i) close a partnership's taxable year with respect to a partner whose entire interest terminates. Treas. Reg. § 1.1502-76(b)(2)(vi) similarly treats a consolidated-group member as disposing of its entire partnership interest immediately before a change in consolidated status solely to allocate partnership items between

[20] *Id.*

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the member's separate taxable years.[21] Those provisions provide a direct framework for coordinating a CFC-level closing with section 706.

4. Coordination if the Deemed Disposition Approach Is Adopted

If the deemed disposition approach is adopted, we recommend that it generally occur automatically with a mandatory or elective closing of the CFC partner's year. Specifically, upon a status change event or a significant ownership variance for which an election is made, the foreign corporation should be treated as having disposed of its entire interest in any partnership in which the foreign corporation is a partner for purposes of section 706(c)(1).[22]

B. Timing of Section 961(a) Basis Adjustments

1. Recommendation

We recommend that Treasury revise Treas. Reg. § 1.961-1 to provide that a section 961(a) basis increase attributable to a U.S. Shareholder's current-year inclusions under sections 951(a) and 951A is given effect immediately before any transaction for which the adjusted basis of the relevant CFC stock or upper-tier property must be determined.[23]

Section 961(a) generally increases a U.S. Shareholder's adjusted basis in the stock of a CFC, or in property through which the U.S. Shareholder is treated as owning such stock, by the amount included in the U.S. Shareholder's gross income under section 951(a) and section 951A with respect to that stock or property. The basis increase is permitted only to the extent the relevant amount is included in the U.S. Shareholder's gross income. This adjustment is integral to the statutory regime by preventing earnings that have already been taxed to a U.S. Shareholder under section 951(a) or section 951A from being taxed again when the shareholder disposes of its CFC stock or receives a distribution of previously taxed earnings and profits ("PTEP").

The timing rule under existing Treasury Regulations, however, may prevent section 961(a) from achieving that purpose in the case of a midyear transfer of CFC stock. In 1965, the Treasury promulgated Treas. Reg. § 1.961-1, which has not been amended since its issuance.[24] The Treasury Regulation generally provides that a section 961(a) basis increase is made as of the last day of the

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[21] *See also* Treas. Reg. §§ 1.1362-3(c)(1) and 1.1377-1(b)(3)(iv) (providing similar rules with respect to S corporations).

[22] Treasury should consider whether the deemed disposition of a *de minimis* partnership interest should be elective. For these purposes, *de minimis* may be defined by reference to the capital and profits of the partnership and with respect to the gross assets of the CFC. In such case, the election should be made by the controlling domestic shareholders of the CFC, within the meaning of Treas. Reg. § 1.964-1(c)(5).

[23] Treas. Reg. § 1.1502-32(b)(1)(i) similarly provides that "[a]djustments under this section are made as of the close of each consolidated return year, and as of any other time (an interim adjustment) if a determination at that time is necessary to determine a tax liability of any person."

[24] T.D. 6850, 30 FR 11,854 (Sept. 16, 1965).

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CFC's taxable year on which the corporation is a CFC.[25] The amount of the adjustment is determined by reference to the amount included in the U.S. Shareholder's gross income under section 951(a) for the U.S. Shareholder's taxable year in which or with which the CFC's taxable year ends.[26]

Treas. Reg. § 1.961-1's timing rule does not align with the amended pro rata share rules of section 951. Under section 951, a U.S. Shareholder that owns CFC stock, directly or indirectly, during any portion of the CFC's taxable year is required to include its allocable share of the CFC's subpart F income and tested income attributable to the period during which it owns the stock.[27] Accordingly, a U.S. Shareholder that disposes of CFC stock before the end of the CFC's taxable year may nevertheless be required to include amounts under section 951(a) or section 951A with respect to the transferred stock. Under the existing Treasury Regulations, however, the corresponding section 961(a) basis increase may not arise until the end of the CFC's taxable year after the shareholder has disposed of the stock and the basis of that stock has ceased to be relevant to the shareholder.[28]

For a transaction occurring before the amount of the U.S. Shareholder's section 951(a) and section 951A inclusions can be finally determined, we recommend that the Treasury Regulations permit the basis adjustment to be computed using a reasonable estimate of the inclusion attributable to the shareholder's pre-transaction ownership period, followed by an appropriate true-up when the final inclusion is determined.[29] Any such rule should also include appropriate consistency and anti-duplication provisions to ensure that the same section 951(a) inclusion does not increase basis more than once or benefit more than one shareholder. This approach would align the timing of the section 961(a) adjustment with the amended section 951 allocation rules and would further the statutory purpose of preventing multiple levels of U.S. federal income taxation on the same CFC earnings.

2. Potential Distortions Under the Proposed Regulations

The issue described above is illustrated by the following example.

Example 2—Timing of section 961(a) basis adjustment.

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25 Treas. Reg. § 1.961-1(a)(ii).

26 *Id.*

27 Section 951(a)(1)(A).

28 It is unclear whether a CFC-year-end basis adjustment could give rise to a loss under *Arrowsmith* principles, but that approach would be suboptimal relative to providing for the basis at the time of the original disposition under regulations, particularly given that the loss could be reported in a different tax year than the year of the disposition. *See Arrowsmith v. Comm'r,* 344 U.S. 6 (1952).

29 This reasonable estimate would be reflected in estimated tax payments and on the tax return for the year in which the disposition occurred and could be conditioned upon filing an amended return once the actual basis adjustment can be determined.

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Assume US1 and CFC1 are calendar-year taxpayers. US1, a domestic corporation, owns all the stock of CFC1 from January 1 through June 30, 2027. On June 30, US1 sells all of the CFC1 stock to an unrelated U.S. person for $500x. US1's adjusted basis in the CFC1 stock immediately before taking into account any current-year section 961(a) adjustment is $5x. CFC1 remains a CFC after the sale, and no election is made to close CFC1's taxable year on June 30. For 2027, CFC1 has $365x of tested income and $365x of subpart F income. For simplicity, assume that all CFC1's stock consists of a single class.

Under Prop. Treas. Reg. §§ 1.951-1(e) and 1.951A-1(d), US1's pro rata shares are determined under the daily-proration method. Under the holding-period convention in Prop. Treas. Reg. § 1.951-1(f), US1 owns the CFC1 stock through June 30, or for 181 days of CFC1's 365-day taxable year. US1 therefore is allocated $181x of CFC1's tested income and $181x of its subpart F income:

$$\$365x \times \frac{181}{365} = \$181x.$$

US1 consequently has aggregate gross-income inclusions of $362x under sections 951(a) and 951A with respect to the CFC1 stock. Section 961(a) is intended to increase US1's basis in that stock by the amount of those inclusions so that the same CFC earnings are not reflected both in US1's inclusions and in its gain from disposing of the stock.[30]

US1 sells the CFC1 stock on June 30, before CFC1's taxable year ends and before CFC1's annual subpart F income and tested income can be finally determined. Under the timing rule in Treas. Reg. § 1.961-1, the corresponding basis adjustment generally is made as of the last day of CFC1's taxable year on which CFC1 is a CFC. Read literally, that rule may not give effect to US1's current-year basis increase before the June 30 sale, when the basis of the CFC1 stock becomes relevant to the computation of US1's gain.

If US1 cannot take the current-year section 961(a) adjustment into account before the sale, its gain, before application of section 1248 and other potentially applicable provisions, is $495x:

$$\$500x \text{ sale price} - \$5x \text{ basis} = \$495x.$$

By contrast, if US1's $362x section 961(a) basis increase is given effect immediately before the sale, US1's adjusted basis is $367x, and its gain before application of section 1248 and other provisions is $133x: $500x sale price - $367x adjusted basis = $133x.

The $362x difference equals the amount of CFC1's current-year subpart F income and tested income allocated to US1. US1 is required to include $362x attributable to its pre-sale ownership period, but the existing timing rule may not increase the basis used to compute its gain on the disposition that ends that ownership period.

[30] Conceptually, these income amounts should be correlated with appreciation in the shares of CFC1.

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The ultimate tax consequences may be affected by sections 1248, 245A, 959, and other provisions. Those provisions, however, do not eliminate the need for a clear section 961 timing rule. Depending on the facts, the current rules in the Proposed Regulations may produce double taxation, a character mismatch, or an offsetting basis consequence that arises later or accrues to a different taxpayer. The appropriate result is to give effect to the section 961(a) adjustment when the basis of the stock or upper-tier property becomes relevant. A later section 961(a) basis increase might, in some circumstances, support a loss under *Arrowsmith* principles. Any such relief would be fact-dependent, uncertain, and incomplete, however, because the loss may arise in a different taxable year, may not be available to the same taxpayer, and may not match the character of the duplicated income.

Treas. Reg. § 1.961-2 presents a parallel timing problem on the basis-reduction side. Under the regulation, a U.S. Shareholder must reduce its adjusted basis in CFC stock at the time it receives a distribution of previously taxed earnings and profits excluded from gross income under section 959(a).[31] The reduction equals the sum of the excluded amount and any foreign income taxes imposed on or with respect to the attributable earnings and profits when those earnings were distributed through the chain of ownership.[32] Critically, to the extent the required reduction exceeds the shareholder's adjusted basis, the excess is treated as gain from the sale or exchange of property.[33] Because the basis reduction takes effect immediately upon receipt of the distribution, while the corresponding section 961(a) basis increase attributable to the current-year inclusion does not arise until the last day of the CFC's taxable year under Treas. Reg. § 1.961-1, a shareholder that receives a midyear distribution of current-year PTEP may lack sufficient basis to absorb the reduction. This anomaly triggers gain recognition even though the shareholder will also be subject to a section 951(a) or section 951A inclusion that caused the distributed earnings to constitute PTEP in the first place.

This asymmetry between the immediate timing of the section 961(b) basis decrease and the deferred timing of the section 961(a) basis increase creates a structural window for double taxation. The same CFC earnings may produce both recognized gain under section 961(b) at the time of the mid-year distribution and an income inclusion under section 951(a) or section 951A at year-end.

3. Historic Relief

Before the amendment to section 951 by the OBBBA, the timing issue of sections 951 and 951A inclusions and basis adjustments arose with respect to midyear PTEP distributions but not with respect to midyear dispositions of CFC stock. Under the prior pro rata share rules, a U.S. Shareholder generally was required to own CFC stock on the last relevant day of the CFC's taxable year to have an inclusion with respect to that stock. Thus, in the example above, the purchaser—

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31 Treas. Reg. § 1.961-2(a).

32 *Id.*

33 *Id.*

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not US1—generally would have borne the relevant subpart F and tested-income inclusions. US1 therefore would not have recognized both stock gain reflecting CFC1's current-year earnings and a section 951(a) inclusion attributable to its pre-sale holding period.

The IRS previously addressed the analogous timing problem arising under the "last-day" rule of Treas. Reg. § 1.961-1 with respect to midyear PTEP distributions. In Generic Legal Advice Memorandum AM 2023-002 (the "GLAM"), the IRS considered a CFC's midyear distribution of current-year earnings that constituted PTEP by reason of a subpart F or tested-income inclusion at the end of the CFC's taxable year. The GLAM concluded that the U.S. Shareholder should be permitted to take the corresponding section 961(a) basis increase into account when applying section 961(b) to the midyear PTEP distribution, notwithstanding that the CFC's taxable year had not yet ended.[34]

That conclusion was necessary to prevent inappropriate double taxation. Section 961(b) requires a U.S. Shareholder to reduce its basis when it receives a distribution excluded from gross income under section 959(a) and generally requires gain recognition to the extent the distribution exceeds the shareholder's basis. If the section 961(a) basis increase attributable to the current-year inclusion were not taken into account because the CFC's taxable year had not yet closed, a shareholder with insufficient preexisting basis could recognize gain upon the PTEP distribution. The shareholder would nevertheless remain subject, at year-end, to the section 951(a) or section 951A inclusion that caused the distributed earnings to constitute PTEP. The same earnings could therefore produce both gain on the distribution and an income inclusion under section 951(a) or section 951A, while the delayed basis increase could create a corresponding built-in loss (or reduce future gain) in the CFC stock. The GLAM appropriately concluded that the statutory provisions should not be applied to produce that anomalous result.

Treasury subsequently addressed this issue in the proposed PTEP regulations issued in 2024.[35] Those proposed Treasury Regulations generally would give certain section 961(a) basis adjustments retroactive effect as of the beginning of the relevant taxable year, subject to special rules for midyear transactions.[36] The proposed rules, however, were designed to operate in conjunction with the prior section 951 pro rata share rules, under which only a U.S. Shareholder that owned CFC stock on the relevant last day of the CFC's taxable year generally had an inclusion.[37] The section 961 Treasury Regulations therefore should be revised to account for the amended pro rata share rules, under which multiple U.S. Shareholders may have section 951(a) inclusions with respect to the same CFC stock for different portions of a single CFC taxable year.

Although the principles reflected in the GLAM may continue to provide support for taking section 961(a) basis increases into account in connection with midyear PTEP distributions, the GLAM

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34 AM 2023-002 at 3.

35 REG-105479-18, 89 Fed. Reg. 95,363, 95,376 (Dec. 2, 2024).

36 *Id.* at 95,378.

37 *Id.* at 95,389.

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does not address a midyear sale or other change in ownership of CFC stock. We therefore recommend that Treasury issue regulations providing that a section 961(a) basis increase is given effect immediately before the time at which the basis of the stock or property becomes relevant for U.S. federal income tax purposes. This rule should apply, for example, immediately before a sale, exchange, deemed disposition, distribution, or other transaction for which adjusted basis must be determined.[38]

Finally, we recommend that this narrow issue be addressed as part of the process of finalizing the Proposed Regulations, as it is already significant for transactions occurring in 2026 and thus should not wait to be addressed as part of a broader project to revise the proposed PTEP regulations.

C. Elective Closings of a CFC's Taxable Year Upon a Significant Ownership Variance

1. Recommendation

Section 951(a)(4), as added by the OBBBA, directs Treasury to issue guidance necessary or appropriate to implement the revised pro rata share rules, including guidance permitting or requiring the taxable year of a controlled foreign corporation (a "CFC") to close upon a direct or indirect disposition of its stock. The Proposed Regulations exercise that authority by permitting an elective closing only if a "significant ownership variance" occurs. A significant ownership variance generally requires specified transfers undertaken pursuant to the same plan during the same default taxable year of the CFC to result in an aggregate decrease of more than 50 percentage points in the CFC stock owned by one or more U.S. Shareholders.[39]

We recommend that Treasury broaden this rule to permit the controlling domestic shareholders of a CFC to elect to close the CFC's taxable year upon an ownership variance that affects their ownership by at least 25 percent (i.e., a 25% Variance), without regard to whether the transfers occur within a single default taxable year. For this purpose, an ownership variance generally would include any specified transfer described in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(B)—and any additional deemed or indirect transfer treated as a specified transfer under the recommendations in Part IV.D—that changes the percentage of CFC stock owned within the meaning of section 958(a) by one or more U.S. Shareholders.

This recommendation would not override the special rules in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C). Thus, a decrease would continue to be disregarded to the extent offset by an increase in the ownership of a related U.S. person, and the transferor and resulting corporation in a section 368(a)(1)(F) reorganization would continue to be treated as the same shareholder.

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[38] *See also* Treas. Reg. § 1.1502-32(b)(1)(i) (providing for basis adjustments when "necessary to determine a tax liability of any person").

[39] Section 951(a)(4), added by Pub. L. No. 119-21, § 70354(a) (2025); Prop. Treas. Reg. § 1.951-1(d)(2)(i)-(ii). A significant ownership variance occurs on the date of the last specified transfer during the taxable year that occurs as part of a plan, even if the greater-than-50-percentage-point threshold is crossed earlier in the year.

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The election should close the CFC's taxable year at the end of the day on which a 25% Variance occurs, consistent with the architecture of the Proposed Regulations. The election should be available with respect to each 25% Variance. Accordingly, a CFC could have more than one elective closing during what otherwise would have been its default taxable year. If more than one 25% Variance occurs on the same day, the CFC would have a single closing at the end of that day.

We recommend that the authority to make the election be vested in the CFC's "controlling domestic shareholders," determined under Treas. Reg. § 1.964-1(c)(5) immediately before each 25% Variance. The election would bind the CFC and all its shareholders. The controlling domestic shareholders should be required to file the prescribed election statement and to notify the other relevant U.S. shareholders, but the election should not require a written agreement from every U.S. shareholder that owned CFC stock during the relevant taxable year.

The existing procedural rules concerning the consistency of elections for CFCs involved in the same plan or series of related transactions, notice to affected shareholders, and the allocation of foreign income taxes should otherwise be retained. Where related transactions result in 25% Variances with respect to multiple CFCs, Treasury reasonably may require consistent elections for the affected CFCs.

As a condition to any elective closing, the controlling domestic shareholders should be required to maintain adequate books and records substantiating the CFC's subpart F income, tested income or tested loss, earnings and profits, foreign income taxes, and other relevant items for each resulting short taxable year. If this condition is not satisfied, the Commissioner should have the ability to allocate the CFC's items under the default daily proration convention or another reasonable method.

Regardless of whether Treasury adopts this principal recommendation, we also recommend two narrower changes. First, specified transfers undertaken pursuant to the same plan should be aggregated even if they span more than one default taxable year of the CFC. Second, final Treasury Regulations should clarify that, in measuring the decrease in ownership for purposes of the greater-than-50-percentage-point test, only the U.S. Shareholders whose ownership decreases are included in the relevant shareholder group, subject to the special rules in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C).

2. Importance of the Elective Closing Under the Proposed Allocation Rules

The revised section 951 rules determine a U.S. Shareholder's pro rata share by reference to the CFC stock owned by the shareholder and the portions of the CFC year during which the shareholder owns that stock while the shareholder is a U.S. Shareholder and the foreign corporation is a CFC. The Proposed Regulations implement this rule principally through daily proration. Subject to the rules for multiple classes of stock and changes in the number of outstanding shares, a CFC's annual subpart F income or tested income or loss is allocated among

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shareholders based on the number of shares held and the number of days for which those shares are held during the CFC year.[40]

Daily proration accounts for the duration of a shareholder's ownership but generally does not account for when the CFC economically earns income or incurs loss. If a CFC earns substantially all of its income before an ownership change, a ratable convention nevertheless treats that income as accruing throughout the CFC year. Conversely, losses incurred after an ownership change may reduce or eliminate income economically earned during the seller's ownership period. Under the framework of the Proposed Regulations, closing the CFC's taxable year is generally the only means of dividing the CFC's annual net amounts by reference to the periods in which the underlying items arise.[41]

The same concern can arise in connection with issuances and redemptions. Where the number of shares within a class changes during the CFC year, the Proposed Regulations generally use a weighted-average share count in applying the daily proration rules. Although that convention may be administrable, it can allocate income earned before an issuance to newly issued shares or otherwise cause the allocation to diverge from the parties' relative economic interests during particular portions of the year. An elective closing on the date of the issuance or redemption can isolate the items arising before and after the change and thereby mitigate this distortion.[42]

The Tax Section's 2025 report on the revised section 951 pro rata share rules recommended substantial taxpayer flexibility in selecting allocation methodologies for ownership changes.[43] The report observed that different allocation methods may be appropriate in different circumstances and recommended that taxpayers be permitted to select a method with respect to each ownership change. It also recommended allowing CFC's taxable year to close in connection with a sufficiently meaningful ownership change, while recognizing that closing has consequences beyond the allocation of subpart F income and tested items.

The Proposed Regulations accept the basic premise that an elective closing can produce a more accurate result. The preamble explains that the election available upon a significant ownership variance provides greater accuracy and certainty than applying daily proration to the entire CFC year.[44]

We propose expanding the circumstances under which an elective closing is available. A broad election also would make the operation of section 951 more comparable to other regimes

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40 Section 951(a)(2); Prop. Treas. Reg. §§ 1.951-1(e)(2), 1.951A-1(d).

41 One exception worth observing is that taxpayers may be able to avail themselves of self-help by structuring their CFC stock transfers as reorganizations that close the taxable year of the transferred CFC.

42 Prop. Treas. Reg. § 1.951-1(e)(2)(iii). Where the number of shares changes during a CFC year, the proposal generally substitutes a weighted-average share count for the number of shares outstanding.

43 Report No. 1518, *supra* note 7 at 18–21.

44 91 Fed. Reg. at 55,041–42. The preamble describes the elective closing as providing "accuracy, certainty, and reduced compliance burdens" in lieu of applying daily proration to the entire CFC year.

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governing changes in ownership during an entity's taxable year. Section 706 and the Treasury Regulations thereunder permit partnership items to be allocated using an interim closing method, and a partnership may have multiple segments during a single taxable year when partners' interests change.[45] Although the CFC rules are not completely analogous to subchapter K, an elective closing following a 25% Variance would apply the same basic principle: items arising during a period should, where adequately substantiated, be associated with the persons that economically own the entity during that period.[46]

3. Compliance, Administrability, and Potential for Abuse

The preamble states that the benefits of a closing for certain ownership variances may be outweighed by compliance and administrative burdens and that broader electivity could facilitate manipulation or abuse, particularly in connection with minor ownership changes or related-party transfers.[47] Those concerns warrant consideration, but they do not, in our view, justify limiting the election to changes exceeding 50 percentage points.

Some of the incremental compliance burden associated with an elective closing would be borne voluntarily by the taxpayers making the election. An elective closing may require the CFC and its shareholders to prepare short-period calculations, allocate foreign income taxes, maintain additional earnings and profits and previously taxed earnings and profits accounts, and satisfy additional reporting obligations. Taxpayers would be expected to elect a closing if the resulting accuracy or other benefits justify those costs.

Treasury nevertheless has a legitimate interest in ensuring that additional short-period determinations can be examined efficiently.[48] The substantiation condition described above would address that concern directly. The controlling domestic shareholders should be required to maintain records sufficient to establish the CFC's relevant items for each short taxable year. Those records could include interim financial statements, closing trial balances, schedules reconciling local books to U.S. tax accounting principles, and support for the allocation of foreign income taxes.

If the taxpayers cannot adequately substantiate the short-period determinations, the election should not be respected. The default consequence should be application of the daily proration convention, absent affirmative evidence supporting a different allocation. This rule would give

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45 Section 706; Treas. Reg. § 1.706-4.

46 Report No. 1518 treated the partnership interim-closing rules as a useful, although imperfect, analogy because subpart F and tested-item computations include entity-level netting not present in the same form under subchapter K.

47 91 Fed. Reg. at 55,041.

48 One inference from the preamble is that the reference to increased "administrative and compliance burden" refers to burdens imposed on the IRS. Elsewhere, the preamble notes that an elective closing may reduce compliance burdens for taxpayers: "[t]his election permits taxpayers to achieve the accuracy, certainty, and *reduced compliance burdens* afforded by closing the taxable year in lieu of applying the daily proration approach to the entire taxable year." *Id.*

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taxpayers access to a more precise method when the necessary information is available, while protecting the government from allocations that cannot be verified.

We also recognize that closing the CFC's taxable year can affect more than the division of an annual amount among shareholders. Because the closing applies for all purposes of the Code, it may affect annual netting, earnings and profits, the application of the high-tax rules, the allocation and timing of foreign income taxes, section 956, currency translation, and other provisions that operate by reference to a taxable year. Repeated closings therefore may alter the parties' aggregate U.S. tax consequences, rather than merely reallocating an otherwise fixed inclusion.

That consequence does not establish that broader electivity is abusive. Congress expressly authorized elective closings, and the Proposed Regulations already accept the broad consequences of a closing of the taxable year when an ownership shift exceeds 50 percentage points. The fact that an election may produce a lower aggregate tax liability for some U.S. Shareholders should not, standing alone, cause the election to be treated as abusive where the closing results in an allocation of items that corresponds to economic income and the resulting short-period items are adequately substantiated. Indeed, in many circumstances, more frequent closings should reduce opportunities to shift the allocation of economic income between shareholders. If a CFC's taxable year closed at the end of each day, the CFC's items generally would be associated with the persons owning its stock during the periods in which the items arose.

The special rules in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C) also address the circumstances presenting the most evident planning concerns. Transfers between related U.S. persons generally do not produce an eligible decrease to the extent the transferee's ownership increases, and an F reorganization is disregarded. The consistency rule for transactions involving multiple CFCs further limits selective elections within a related series of transactions. Those protections, together with the substantiation requirement and generally applicable anti-abuse principles, provide a more tailored response than denying an election whenever an otherwise genuine ownership change does not exceed 50 percentage points.

The Tax Section's Prior Report similarly recognized that some taxpayer planning is inherent in any elective allocation regime.[49] It recommended targeted scrutiny of related-party transactions but concluded that, outside that context, a reduction in the parties' aggregate tax liability should not by itself establish abuse.[50] That conclusion applies with greater force where the election associates income or loss with the period in which the electing shareholders actually owned the CFC stock.

Finally, to address any concerns regarding manipulation or abuse stemming from a lowered ownership variance threshold, Treasury should incorporate a targeted anti-abuse rule to either disregard the tax-year-closing election or reallocate a CFC's items in the event a transaction is undertaken outside of the ordinary course of business with a principal purpose of reducing the

49 Report No. 1518, *supra* note 7, at 32–33.

50 *Id.*

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U.S. tax liability of U.S. Shareholders by shifting the timing of items of income, gain, deduction, loss or taxes of the CFC.

4. Discontinuities Under the Significant Ownership Variance Standard

The definition of a significant ownership variance can produce materially different results for economically similar transactions. The following examples illustrate the principal discontinuities. Unless otherwise stated, the CFC has a single class of stock, the relevant persons are unrelated, and none of the special rules in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C) applies.

Example 3—Separate 40-percent dispositions. USP owns all the stock of CFC. In March, USP sells 40 percent of the CFC stock to an unrelated person. In July, USP sells an additional 40 percent to the same or another unrelated person.

If the two sales occur pursuant to the same plan, the sales result in an aggregate decrease of 80 percentage points and the Proposed Regulations permit an election to close CFC's taxable year at the end of the day on which the July sale occurs. If the sales do not occur pursuant to the same plan, neither sale independently exceeds 50 percentage points, and no election is available.

It is not apparent why the existence of a common plan should determine whether the CFC's items may be divided into short taxable years. The need to associate items with the relevant ownership periods is the same in either case. Under our recommendation, the controlling domestic shareholders could elect to close the taxable year at the end of the day of the March sale, the July sale, or both.

Example 4—Transfers spanning two default taxable years. USP owns all the stock of CFC, a calendar-year corporation. In December of Year 1, USP sells 25 percent of the CFC stock. Pursuant to the same plan, USP sells an additional 40 percent in July of Year 2.

The transfers do not produce a significant ownership variance under the Proposed Regulations because the aggregate decrease does not occur during the same default taxable year. That result follows even though the transfers are undertaken pursuant to a single plan and would have qualified if both transfers had occurred during Year 2.

Under our principal recommendation, each sale would qualify as a 25% Variance and independently could support a closing of the taxable year. If Treasury does not adopt that principal recommendation, the two sales at least should be aggregated for purposes of determining whether the percentage threshold has been met. Under this alternative, the Year 1 transaction would be taken into account solely in determining whether the later transaction makes an election available; it would not reopen Year 1 or produce a retroactive closing. If the cumulative ownership decrease first exceeds 50 percentage points as a result of the July sale, the election would close CFC's taxable year at the end of the day of that sale.

This approach would not be novel. Treas. Reg. § 1.245A-5 looks to a transfer occurring in the preceding taxable year when that transfer is part of a plan to reduce a controlling shareholder's

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interest.[51] Likewise, section 355(e)(2) does not limit its inquiry to acquisitions occurring in the same taxable year as the distribution. Instead, it aggregates the acquisitions occurring over a multi-year window when they are part of the same plan.[52] Section 302(b)(2)(D) also considers redemptions that are made pursuant to a plan. These rules demonstrate that a taxable-year condition need not prevent related ownership changes from being considered together.

Example 5—Threshold crossed before the final transfer under the plan. USP1 owns 75 percent of CFC and USP2 owns the remaining 25 percent. Pursuant to the same plan, USP1 sells its entire interest on July 1 and USP2 sells its interest on December 1.

The July sale, standing alone, produces a decrease exceeding 50 percentage points. Under the Proposed Regulations, however, the significant ownership variance occurs on December 1 because that is the date of the last specified transfer undertaken pursuant to the plan. An election therefore may close CFC's taxable year on December 1 but not on July 1, notwithstanding that the principal ownership change occurred five months earlier.[53]

Under our recommendation, each sale would be treated separately as a 25% Variance. The controlling domestic shareholders could elect to close the CFC's taxable year at the end of July 1 and could make a second election at the end of December 1. This treatment would retain the Proposed Regulations' end-of-day closing convention while eliminating the dependence of the closing date on the scope and duration of a transaction plan.

Example 6—Threshold crossed before the failed final transfer of the plan. USP1 owns 75 percent of CFC and USP2 owns the remaining 25 percent. USP1 sells its entire interest on February 1 and USP2 plans to sell its interest on December 31. However, USP2 is unable to consummate the sale.

The February sale produces a decrease exceeding 50 percentage points. Under the Proposed Regulations, however, the parties would not know as of the February sale whether the tax year closed on February 1 or December 31. This uncertainty affects tax compliance, deal making, and the economics of the transaction.

Under our recommendation, the February sale would be treated as a 25% Variance. The controlling domestic shareholder could elect to close the CFC's taxable year at the end of February 1. This treatment would retain the Proposed Regulations' end-of-day closing convention while eliminating the dependence of the closing date on a transaction plan.

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51 *See* Treas. Reg. § 1.245A-5(e)(2)(i)(B)(2) (taking into account the day before the first transfer in the preceding taxable year pursuant to a plan to reduce the shareholder's ownership percentage).

52 Section 355(e)(2).

53 Under the Proposed Regulations a significant ownership variance would occur on December 1, even if USP2 sold only 1 percent of its CFC shares, so long as that transaction occurred as part of an overall plan with USP1's disposition.

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Example 7—Sale to an existing U.S. Shareholder. USP1 owns 90 percent of CFC and USP2, an unrelated U.S. person, owns the remaining 10 percent. USP1 sells all its CFC stock to USP2.

One possible reading of the Proposed Regulations is that the test compares the aggregate ownership of all U.S. Shareholders before and after the sale. Under that reading, no decrease occurs because U.S. Shareholders collectively own 100 percent of CFC both before and after the transaction.[54]

An alternative reading is that the comparison takes into account only the U.S. Shareholders whose ownership decreases as a result of the specified transfer. This reading compares the post-transfer ownership of the transferring shareholders with the percentage owned by "those" shareholders immediately before the first specified transfer. The proposed definition of "controlling section 958(a) U.S. shareholders" (i.e., the person who technically elects to close the CFC's taxable year) similarly identifies the shareholders whose ownership decreases as part of the significant ownership variance.[55] Under this reading, USP1's ownership decreases by 90 percentage points and the sale results in a significant ownership variance. Final Treasury Regulations should confirm this second interpretation.

These examples illustrate that the significant ownership variance standard does not consistently distinguish transactions according to either their economic significance or the need for an accurate allocation. Any numerical threshold necessarily creates boundary cases, including under our proposed 25% Variance standard. The Proposed Regulations, however, add discontinuities based on whether transactions are part of a common plan and whether they occur within a single default taxable year. Permitting a closing election at each actual 25% Variance would reduce those discontinuities and make the election available for a broader range of meaningful ownership changes.

5. Persons Authorized to Make the Election

The Proposed Regulations generally require each controlling U.S. Shareholder to make the election and require all other U.S. Shareholders that owned CFC stock on any day of the CFC's taxable year through the date of the significant ownership variance to enter into a written, binding agreement consenting to the election.[56] The election therefore may be unavailable if a single affected U.S. Shareholder declines or is unable to execute the agreement.

This procedure follows the model in Treas. Reg. § 1.245A-5. The temporary and proposed section 245A regulations contemplated a bilateral election involving the seller and buyer. In finalizing those rules, Treasury acknowledged that commenters had questioned whether the election was

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54 "A significant ownership variance generally occurs if the specified transfers result in a decrease by more than 50 percentage points in *section 958(a) shareholder ownership*." 91 Fed. Reg. at 55042 (emphasis added).

55 Prop. Treas. Reg. § 1.951-1(d)(2)(iii)(B).

56 Prop. Treas. Reg. § 1.951-1(d)(2)(iv). The binding agreement generally must include the controlling U.S. Shareholders and each other U.S. Shareholder that owned CFC stock on any day of the CFC year through the date of the variance.

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unilateral and that some commenters had recommended a unilateral election. Treasury retained the bilateral requirement because a closing could have important tax consequences for both buyer and seller and concluded that one party should not be permitted to alter the other party's tax consequences without consent.[57]

Procedural difficulties can arise in obtaining timely consent for a tax-year-closing election. For example, in Private Letter Ruling 202226009, the taxpayer reported consistently with a section 1.245A-5 election but failed to attach the required election statement and failed to execute the prescribed binding agreement, necessitating a request for regulatory-election relief.[58] The ruling provides an example of the difficulties of the procedure's formal requirements.

There are important differences between the section 245A extraordinary reduction rules and the election authorized by section 951(a)(4). The section 245A election operated as an exception to an anti-abuse regime and was intended to place the parties in an alternative tax regime in lieu of denying a section 245A deduction. Section 951(a)(4), by contrast, expressly directs Treasury to issue guidance permitting or requiring CFC taxable-year closings. The question is principally how authority over an election made on behalf of a CFC should be allocated among its U.S. Shareholders.

Treas. Reg. § 1.964-1 provides a more appropriate model in this context. Under that regulation, the controlling domestic shareholders may make elections and adopt or change accounting methods or taxable years on behalf of a foreign corporation.[59] The controlling domestic shareholders generally are the U.S. Shareholders that, in the aggregate, own more than 50 percent of the voting power and undertake to act on behalf of the CFC. If the U.S. Shareholders do not collectively own more than 50 percent of the voting power, all U.S. Shareholders are treated as the controlling shareholders. An action properly taken by the controlling domestic shareholders binds the foreign corporation and its domestic shareholders, including a shareholder that did not receive the required notice.

A CFC year-closing election is comparable to the elections already entrusted to controlling domestic shareholders under Treas. Reg. § 1.964-1.[60] It determines the CFC's taxable periods and thereby affects the computation and timing of its items. Although those effects may be important, they are not categorically different from a change in taxable year or accounting method made on behalf of the CFC. The election generally affects the amount of subpart F income or tested items attributable to each ownership period; it does not restore the pre-OBBBA rule under which income could escape allocation to any U.S. Shareholder solely because the shareholder did not own stock on the last day of the CFC year.

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57 T.D. 9909, 85 Fed. Reg. 53,068, 53,080–81 (Aug. 27, 2020).

58 Priv. Ltr. Rul. 202226009 (July 1, 2022).

59 Treas. Reg. § 1.964-1(c)(3)-(5).

60 For example, the GILTI/NCTI high tax-exclusion election under Treas. Reg. § 1.951A-2(c)(7) is made by such persons.

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We recommend determining the controlling domestic shareholders immediately before the 25% Variance. A pre-variance determination would provide a fixed and administrable testing time where the transaction itself changes the persons that constitute the controlling group. It also generally would vest the election in the shareholders that controlled the CFC during the short period ending with the proposed closing and therefore are most likely to have access to the records needed to substantiate that period's items.

We recognize that this rule could permit a pre-transaction controlling shareholder to make an election that affects the tax consequences of an acquiring or minority shareholder. That consideration supports robust notice and consistency requirements but should not require unanimity. Buyers and sellers can address a potential closing in transaction documents, and continuing minority shareholders can address the authority to make elections in the CFC's organizational documents or a shareholders' agreement.

Our Prior Report recognized the need to protect minority shareholders but recommended a more flexible approach than mandatory transaction-by-transaction consent.[61] It suggested that authority concerning a year-closing election could be agreed or authorized in the CFC's constituent documents and that minority shareholders seeking to restrict such authority could do so through the corporate charter or a shareholders' agreement. The controlling-domestic-shareholder model would further simplify administration by supplying a regulatory default while leaving the parties free to allocate economic consequences and governance rights contractually.

Accordingly, final Treasury Regulations should require the controlling domestic shareholders, determined immediately before the 25% Variance, to make the election and file the required statement. The controlling domestic shareholders should provide notice under principles comparable to Treas. Reg. § 1.964-1(c)(3)(iii) to each other U.S. Shareholder that owned CFC stock during the short taxable year. A failure to provide notice should not invalidate an otherwise valid election, although Treasury could impose appropriate reporting consequences. All affected persons would remain required to report consistently with the election.

6. Alternative Recommendations

If Treasury does not permit an elective closing upon a 25% Variance, two changes to the significant ownership variance rules are particularly important.

First, specified transfers undertaken pursuant to the same plan should be aggregated even if they occur during different default taxable years of the CFC. The current same-year limitation creates different results based solely on whether related transactions occur before or after the end of the CFC's taxable year. That limitation is difficult to reconcile with the plan concept: if transactions are sufficiently related to be aggregated when they occur during one year, the intervening year-end should not, by itself, sever that relationship.

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[61] Report No. 1518, *supra* note 7, at 32–33.

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Final Treasury Regulations could provide that, in determining whether a transaction causes the cumulative decrease to exceed 50 percentage points, prior specified transfers under the same plan are taken into account regardless of whether they occurred in an earlier default taxable year. The closing would occur prospectively at the end of the day on which the later specified transfer causes the threshold to be satisfied. The rule would not reopen an earlier taxable year or cause a retroactive closing.

Second, final Treasury Regulations should clarify that the relevant shareholder group for purposes of measuring an ownership decrease comprises only those U.S. Shareholders whose ownership percentages decrease as a result of the specified transfers. Shareholders whose ownership percentages remain constant or increase should not be included in the measurement group merely because they are U.S. Shareholders before the transaction.

This clarification is consistent with the proposed definition of a controlling U.S. Shareholder and gives effect to the special related-person rule. Under that rule, an increase in ownership by a related U.S. person is taken into account specifically to offset the transferor's decrease. That offset frequently would be superfluous if the general rule already measured only the change in aggregate ownership of U.S. Shareholders as a single group.

These alternative changes would not provide the same accuracy or consistency as an election upon a 25% Variance. They would, however, eliminate significant discontinuities in the Proposed Regulations and would better align the availability of the election with actual changes in the ownership of CFC stock.

D. Indirect Dispositions of CFC Stock Through Domestic Corporations

1. Recommendation

New section 951(a)(4) directs the Secretary of the Treasury to issue guidance necessary or appropriate to implement the revised pro rata share rules, including guidance permitting or requiring the taxable year of a CFC to close upon a direct or indirect disposition of its stock. The Proposed Regulations exercise that authority, in part, by permitting an elective closing when a "significant ownership variance" occurs.[62] As explained above, a significant ownership variance generally requires an aggregate decrease of more than 50 percentage points in the CFC stock owned by one or more U.S. Shareholders as a result of "specified transfers" undertaken pursuant to the same plan during the same CFC taxable year.[63]

The definition of a specified transfer includes a disposition or issuance of foreign corporation stock and a disposition, issuance, or other change in a partnership interest.[64] It does not, however, include a disposition or issuance of stock of a domestic corporation that owns CFC stock. A

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62 Prop. Treas. Reg. § 1.951-1(d)(2).

63 Section 951(a)(4), added by Pub. L. No. 119-21, § 70354(a), 139 Stat. 72, 211–12 (2025); Prop. Treas. Reg. § 1.951-1(d)(2)(i)–(ii) (Aug. 26, 2026).

64 Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(B).

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transaction involving domestic corporation stock therefore may produce a substantial change in the indirect economic ownership of a CFC, or may terminate the taxable year of the domestic corporation that is the CFC's U.S. Shareholder, without producing a significant ownership variance under the Proposed Regulations. The domestic corporation remains the U.S. Shareholder before and after the transaction, and the transaction in its stock is not itself a specified transfer.[65]

We recommend that Treasury broaden the scope of indirect dispositions to include certain transfers of the stock of a domestic corporation that owns CFC stock and present two alternative approaches for consideration. We did not reach a clear consensus as to which of the alternatives below should be adopted, and we do not express a preference between them.

Under the first alternative, which we refer to as the "Deemed Transfer Approach," an event that terminates the taxable year of a domestic corporation that owns CFC stock would be treated, solely for purposes of the elective closing rule, as a disposition by that corporation of all of its CFC stock. This rule would not apply to the extent the year-closing event already results in an actual or deemed disposition of that stock.

Under the second alternative, which we refer to as the "Indirect Disposition Approach," a disposition or issuance of stock of a domestic corporation would be treated as a proportionate indirect disposition of the CFC stock owned by the domestic corporation, whether or not the transaction terminates the domestic corporation's taxable year.

The two approaches are not mutually exclusive. If Treasury adopts both, we recommend a coordination rule under which the Deemed Transfer Approach would control when the same transaction is subject to both approaches. We also recommend that final Treasury Regulations confirm the application of section 1373(a) to S corporations for purposes of determining whether a significant ownership variance (or, consistent with our recommendation above, a 25% Variance) has occurred.

The need to address indirect dispositions through domestic corporations is particularly acute for transactions entered into before August 26, 2026. During the period between the effective date of revised section 951 and publication of the Proposed Regulations, taxpayers had no guidance defining the circumstances in which Treasury would permit a CFC year-closing election under section 951(a)(4). Taxpayers reasonably could have looked to Treas. Reg. § 1.245A-5(e), the only then-existing regulatory framework for such an election, which applied substantially lower ownership-change thresholds and did not categorically disregard transfers between related U.S. persons. The Proposed Regulations instead generally require a decrease of more than 50 percentage points, disregard certain corresponding ownership increases by related U.S. persons, and do not treat a disposition of domestic-corporation stock as a specified transfer merely because the corporation owns CFC stock. Consequently, a pre-publication transaction involving a related-

[65] Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(B); Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C)(1) generally disregards decreases offset by increased ownership of a related U.S. person.

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party transfer of CFC stock to a domestic corporation followed by a sale of that domestic entity to an unrelated party may not permit a CFC year closing, even though taxpayers could reasonably have expected a more permissive framework when the transaction was negotiated and signed. Extending the elective-closing rules to appropriate indirect dispositions through domestic corporations would mitigate these unanticipated results while furthering section 951(a)(4)'s express focus on both direct and indirect dispositions. Specifically, in addition to the recommendations discussed herein, we recommend a transition rule modeled on Treas. Reg. § 1.245A-5(e)'s tax-year-closing election where there is an ultimate disposition of the CFC stock to an unrelated third party as part of a plan with an initial transfer.

2. Potential Issues Under the Proposed Regulations

The omission of domestic corporation stock transactions is significant when the transaction terminates the taxable year of the domestic corporation that owns the CFC stock. For example, under Treas. Reg. § 1.1502-76(b), a domestic corporation's taxable year generally ends for all federal income tax purposes when it joins or leaves a consolidated group. Unless the CFC's taxable year also closes, however, the revised section 951 rules may place all the domestic corporation's inclusion with respect to the CFC year in only one of the domestic corporation's two short taxable years.

Section 951(a)(3) generally assigns a section 951(a) inclusion for a CFC year to the U.S. Shareholder's taxable year that includes the last day on which the shareholder owns CFC stock during that CFC year. Where the same domestic corporation owns the CFC stock throughout the CFC year, the domestic corporation's ownership does not change for purposes of section 958(a), even though the domestic corporation itself has separate pre-change and post-change taxable years. The inclusion therefore generally falls in the domestic corporation's taxable year that includes the end of the CFC year. Daily proration does not address this issue because there has been no change in the identity or percentage ownership of the U.S. Shareholder. The relevant mismatch is between two taxable years of the same U.S. Shareholder, rather than between two different U.S. Shareholders.[66]

The Tax Section's 2015 report concerning Treas. Reg. § 1.1502-76 discussed a closely related issue. That report observed that allocating an item to a corporation's pre-change or post-change taxable year can affect not merely the timing of tax but also the parties' aggregate liability and the character of their income, including because of corresponding adjustments to the seller's basis in the corporation's stock. The 2015 report also identified as potentially anomalous the then-existing rule under which an entire year's subpart F and section 956 inclusions could be taken into account in the post-change year. The 2015 report did not recommend a special CFC rule, however, because

[66] *See* section 951(a)(3); Treas. Reg. § 1.1502-76(b)(1)(ii)(A)(1); Prop. Treas. Reg. § 1.951-1(b)(1).

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that result was consistent with the then-applicable last-day rule governing a direct sale of CFC stock.[67]

That premise has changed. The OBBBA replaced the former last-day approach for subpart F income and tested items with a time- and ownership-based rule and expressly authorized guidance permitting or requiring a CFC year to close upon a direct or indirect disposition. In our view, it is therefore appropriate to reconsider whether an indirect disposition through a domestic corporation, particularly one that also divides the domestic corporation's taxable year, should permit a corresponding closing of the CFC's taxable year.

3. Deemed Transfer Approach

Under the Deemed Transfer Approach, an event that terminates the taxable year of a domestic corporation that owns stock of one or more CFCs—a "Year-Closing Event"—would be treated as a disposition by the domestic corporation of all CFC stock it owns within the meaning of section 958(a). The deemed disposition would occur on the last day of the terminating taxable year and would apply solely for purposes of determining whether and when a significant ownership variance occurs under Prop. Treas. Reg. § 1.951-1(d)(2) (or, consistent with our recommendation above, when a 25% Variance occurs).

For purposes of the related-person rule in Prop. Treas. Reg. § 1.951-1(d)(2)(ii)(C)(1), the domestic corporation should be treated as making the deemed disposition to an unrelated U.S. person. Otherwise, the same continuing legal ownership of the CFC stock could cause the related-person rule to negate the deemed disposition.

Treasury also should provide conforming rules identifying the domestic corporation as a controlling U.S. Shareholder for purposes of making the election. Where the domestic corporation's terminating taxable year is included in a consolidated return, the common parent, acting as agent for that consolidated group, should make the election on the corporation's behalf, consistently with the election mechanics in the Proposed Regulations.

Year-Closing Events would principally include a domestic corporation's joining or leaving a consolidated group under Treas. Reg. § 1.1502-76(b). The rule also would extend to other events that divide a corporation's taxable year, including a midyear termination of an S corporation election that results in separate S and C short taxable years. The relevant principle is that the domestic corporation has two separate federal income taxable years to which the CFC's items potentially could relate, not that the year must end specifically under the consolidated return regulations.[68]

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[67] N.Y. State Bar Ass'n Tax Section, Report No. 1328, Proposed Amendments to Treas. Reg. § 1.1502-76, at 8–9, 31–33 (Aug. 20, 2015).

[68] *See* Treas. Reg. § 1.1502-76(b)(1)(ii)(A)(1)-(2); Section 1362(e); Treas. Reg. § 1.1362-3(a), (c)(3)(i) (treating the S and C short years as separate taxable years for generally all Code purposes).

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The Deemed Transfer Approach should not apply, however, if the Year-Closing Event already results in an actual or deemed disposition of the CFC stock. For example, if an election under sections 338 or 336(e) is made with respect to a domestic target that owns CFC stock, the target generally is treated as selling all of its assets to an unrelated person. The target's CFC stock therefore is already the subject of a deemed disposition and may be taken into account under the existing specified-transfer rules. Treating the target as making an additional deemed transfer of the same CFC stock would be duplicative. The same limitation should apply to any other transaction that both ends the domestic corporation's taxable year and independently results in an actual or deemed disposition of the CFC stock.[69]

Example 8—Deemed transfer upon departure from a consolidated group. S is a member of the P consolidated group and owns all the stock of CFC. P sells 21 percent of the stock of S to an unrelated person, causing S to cease to be a member of the P consolidated group. S's taxable year ends at the end of the day on which it leaves the group.

Under the Deemed Transfer Approach, S would be treated as disposing of all of its CFC stock to an unrelated U.S. person solely for purposes of Prop. Treas. Reg. § 1.951-1(d)(2). S's deemed disposition would represent a decrease of 100 percentage points in its ownership of CFC and therefore would constitute a significant ownership variance. The appropriate controlling shareholder or consolidated return agent could elect to close CFC's taxable year as of the end of the day on which S's taxable year ends.

Example 9—Deemed transfer combined with a direct CFC stock disposition. The facts are the same as in Example 8, except that S owns 50 percent of the stock of CFC and A, a domestic individual, owns the remaining 50 percent. As part of a plan, A sells 1 percent of the CFC stock to B, an unrelated domestic individual. B also purchases 21 percent of the stock of S from P, causing S to cease to be a member of the P consolidated group.

Under the Deemed Transfer Approach, S would be treated as disposing of its entire 50-percent interest in CFC to an unrelated U.S. person. That deemed disposition would be aggregated with A's actual disposition of 1 percent of the CFC stock. The resulting decrease of 51 percentage points would constitute a significant ownership variance, and an election could be made to close CFC's taxable year.

The principal policy justification for the Deemed Transfer Approach is that it coordinates the CFC's taxable year with the separate federal income taxable years of its domestic corporate shareholder. The consolidated return regulations follow a comparable approach for a member that owns a partnership interest. Solely for purposes of allocating partnership items between the member's pre-change and post-change taxable years, Treas. Reg. § 1.1502-76(b)(2)(vi)(A) treats the member as selling its entire partnership interest immediately before its change in consolidated

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[69] Treas. Reg. § 1.338-1(a)(1) treats old target as transferring all its assets to an unrelated person, and Treas. Reg. § 1.336-2(b)(1)(i)(A) similarly treats old target as selling its assets to an unrelated person in a section 336(e) transaction. If those assets include CFC stock, the stock is already the subject of a deemed disposition.

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status. The resulting application of section 706 allocates the partnership's items between the member's two taxable years. The current consolidated return rule expressly excludes deemed inclusions from foreign corporations, but the Deemed Transfer Approach would change this result through the newly granted authority in section 951(a)(4).[70]

The potential distortion under the Proposed Regulations can be illustrated by assuming that P acquires S from another consolidated group on December 30, that S's only asset is all of the stock of CFC, and that CFC's only asset is an interest-bearing debt instrument. If CFC uses the calendar year and its taxable year does not close, S's inclusion with respect to CFC's entire year generally would be taken into account in S's post-acquisition taxable year and thus by the P group, even though the P group owned S for only the final day of CFC's year.

At the same time, the seller group may recognize capital gain on its sale of S stock reflecting the increase in the value of S and CFC attributable to the interest accrued before the acquisition. The P group would take the corresponding CFC income into account as ordinary income. That inclusion would increase S's basis in its CFC stock under section 961(a) and ordinarily would increase P's basis in its S stock under Treas. Reg. § 1.1502-32. The basis adjustments may produce a future capital item, such as reduced capital gain or increased capital loss on a later disposition.[71] Thus, income economically accruing during the seller's ownership period may produce current capital gain to the seller, current ordinary income to the buyer, and a potential future capital benefit to the buyer. Closing CFC's taxable year when S's taxable year ends would allocate the CFC's income, tested items, and associated foreign taxes more closely to the periods in which they economically accrued.[72]

The Deemed Transfer Approach also would be administrable. Whether the domestic corporation's taxable year has ended can be determined under existing provisions, and the approach would not require taxpayers to trace each upper-tier change in economic ownership through multiple classes and tiers of domestic corporation stock. The Proposed Regulations themselves use the principles of Treas. Reg. § 1.1502-76(b) to allocate foreign income taxes when a CFC's year closes for U.S. federal income tax purposes but the relevant foreign taxable year remains open, which provides further support for using a year-closing framework here.[73]

The breadth of the approach may also be viewed as its principal drawback. A transaction that changes the ultimate ownership of a domestic corporation by a minuscule amount may be treated

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70 *See* section 706; Treas. Reg. §§ 1.706-4, 1.1502-76(b)(2)(vi)(A). Treas. Reg. § 1.1502-76(b)(2)(vi)(C) currently excludes foreign corporations generating deemed inclusions from the passthrough-entity rule. Report No. 1328 discussed the partnership rule and its exclusion for CFC inclusions.

71 Treas. Reg. § 1.1502-36 may limit future losses.

72 *See* section 961(a); Treas. Reg. §§ 1.961-1(a), 1.1502-32. Report No. 1328 observed that investment adjustments and differences between ordinary and capital treatment can cause the period allocation of an item to affect aggregate tax liability rather than merely timing.

73 Prop. Treas. Reg. § 1.951-1(d)(3)(i) allocates foreign income taxes across the U.S.-law closing date by applying the principles of Treas. Reg. § 1.1502-76(b), subject to specified modifications.

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as a disposition of 100 percent of its CFC stock if the transaction causes the domestic corporation to leave a consolidated group. The approach therefore would produce a discontinuity at the consolidated affiliation threshold and, in some cases, would permit a CFC year to close even though the change in the CFC's ultimate economic ownership is materially less than 50 percent.[74] A termination of S corporation status also may divide the corporation's taxable year without any substantial change in economic ownership.

Those results follow because the Deemed Transfer Approach treats the creation of separate shareholder taxable years, rather than the extent of the indirect ownership change, as the operative criterion. Treasury reasonably could conclude that this treatment is appropriate even where ultimate economic ownership does not significantly change because the purpose of the rule is to more accurately align the CFC's items with the shareholder's separate taxable year in which the items were accrued. Nevertheless, the difference between the deemed disposition and the actual change in economic ownership should be taken into account in evaluating this alternative, particularly because an elective closing applies to the CFC for all purposes of the Code and affects all of its shareholders, including shareholders that did not participate in the transaction.[75]

4. Indirect Disposition Approach

Under the Indirect Disposition Approach, a disposition of stock of a domestic corporation would be treated as a proportionate indirect disposition of each CFC interest owned by that corporation. Thus, a disposition of 10 percent of the stock of a domestic corporation that owns all of a CFC would be treated as an indirect disposition of 10 percent of the CFC stock. If the domestic corporation owned 50 percent of the CFC, the same domestic stock disposition would be treated as an indirect disposition of 5 percent of the CFC stock.

The same principle should apply to issuances, redemptions, and other changes in the relative ownership of a domestic corporation that are analogous to the transactions included in the Proposed Regulations' definition of a specified transfer. For tiered domestic structures, the proportionate disposition would be determined by multiplying the relevant ownership percentages through the domestic chain. The deemed disposition would apply solely for purposes of the elective closing rule and would be subject to the Proposed Regulations' plan-aggregation, related person, consent, and consistency requirements. A deemed disposition should not apply in cases of related party transfers. Treasury would need to prescribe rules for measuring indirect dispositions where either the domestic corporation or the CFC has multiple classes of stock with different voting and economic rights.

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[74] For example, a disaffiliating transfer of stock to a partnership controlled by members of a consolidated group would trigger a deemed transfer under this proposal.

[75] Prop. Treas. Reg. § 1.951-1(d)(2)(i). An elective closing applies for all purposes of the Code and to all shareholders of the CFC. *See also* Report No. 1518, *supra* note 7at 19–21 (Dec. 2, 2025) (discussing both the broader consequences of closing a CFC's taxable year and the procedural benefits of a closing following a meaningful ownership change).

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Applied to Example 9, the Indirect Disposition Approach would produce a different result from the Deemed Transfer Approach. P's disposition of 21 percent of S would be treated as an indirect disposition of 10.5 percent of the CFC stock—21 percent of S's 50-percent CFC interest. Together with A's actual disposition of 1 percent of the CFC stock, the aggregate disposition would be 11.5 percent. Because the decrease would not exceed 50 percentage points, no significant ownership variance would occur (moreover, the decrease would not equal at least 25% such that no 25% Variance would occur under our recommendation above). As a result, the CFC's taxable year could not be closed under the elective rule.

Example 10—Substantial indirect disposition without a domestic year-closing event. P acquires 51 percent of the stock of S from an unrelated person, and S owns all the stock of CFC. Because P acquires only 51 percent of S, S does not become a member of the P consolidated group, and its taxable year does not end under Treas. Reg. § 1.1502-76(b).

Under the Indirect Disposition Approach, the sale of 51 percent of S would be treated as an indirect disposition of 51 percent of the CFC stock. A significant ownership variance (or a 25% Variance under our recommendation above) therefore would occur, and an election could be made to close CFC's taxable year, notwithstanding that S's own taxable year remains open. The Deemed Transfer Approach, standing alone, would not apply because there is no Year-Closing Event.

The principal advantage of the Indirect Disposition Approach is that it measures the transaction by reference to the actual change in the CFC's indirect economic ownership. It would avoid the cliff effect inherent in the Deemed Transfer Approach and would place a sale of a domestic corporation that holds CFC stock on a more comparable footing with a direct sale of the CFC stock. It also would reach substantial indirect ownership changes, such as the transaction in Example 10, that do not produce a consolidated return status change or otherwise terminate the domestic corporation's taxable year. In that respect, it is a direct implementation of section 951(a)(4)'s reference to an "indirect disposition" of CFC stock.

The Indirect Disposition Approach would not, however, fully address the allocation problem that arises when the domestic corporation's taxable year ends. In Example 8, only 21 percent of the CFC stock would be treated as indirectly disposed of, even though S has separate pre-change and post-change taxable years. In Example 9, the aggregate 11.5-percent disposition similarly would be insufficient to permit a closing. The CFC's items therefore could remain concentrated in S's post-change taxable year despite the division of S's taxable year. The approach prioritizes the magnitude of the economic ownership change over coordination of the CFC's year with the taxable years of its legal U.S. Shareholder. This alternative also would require more extensive tracing rules. Changes in domestic corporation ownership can arise through issuances, redemptions, recapitalizations, options, multiple classes of stock, and transactions involving several tiers of domestic corporations. Because the domestic corporation remains the legal U.S. Shareholder, conforming rules also would be needed to identify the deemed transferor, the controlling U.S. Shareholders, and the persons required to make the election and enter into the binding agreement

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prescribed by the Proposed Regulations.[76] These issues appear manageable, but they make the Indirect Disposition Approach less mechanically straightforward than the Deemed Transfer Approach.

5. Coordination if Both Approaches Are Adopted

Treasury could adopt both approaches because they address different concerns. The Deemed Transfer Approach addresses the division of the domestic shareholder's taxable year. The Indirect Disposition Approach addresses substantial changes in the CFC's indirect economic ownership that do not necessarily divide the domestic shareholder's taxable year.

If both approaches are adopted, we recommend that final Treasury Regulations provide that the Deemed Transfer Approach controls when a transaction is subject to both rules. The proportionate deemed disposition otherwise arising under the Indirect Disposition Approach should be treated as subsumed within, rather than added to, the full deemed disposition under the Deemed Transfer Approach. Actual dispositions and deemed dispositions arising from other transactions undertaken pursuant to the same plan, would continue to be aggregated under the ordinary significant ownership variance (or 25% Variance) rules.

Thus, in Example 9, S would be treated as disposing of its full 50-percent CFC interest under the Deemed Transfer Approach, and A's separate 1-percent direct disposition would be added to that amount. The 10.5-percent proportionate disposition attributable to the sale of S stock under the Indirect Disposition Approach would not be counted separately. The aggregate disposition would be 51 percent, not 61.5 percent.

This coordination rule generally would produce the greater deemed disposition and therefore the greater likelihood that a closing election would be available. That result is appropriate where the transaction has already created separate taxable years for the domestic shareholder. Applying only the proportionate rule in those circumstances could deny the election precisely when the tax-year coordination rationale for a closing is strongest. The coordination rule would not indicate a general preference for the Deemed Transfer Approach; the Indirect Disposition Approach would continue to apply independently where, as in Example 10, the domestic corporation's taxable year does not end.

6. S Corporations

Finally, final Treasury Regulations should confirm that section 1373(a) applies in determining whether a significant ownership variance (or 25% Variance under our recommendation above) has occurred with respect to a CFC held through an S corporation. Section 1373(a) provides, for purposes of subpart F, that an S corporation is treated as a partnership and its shareholders are treated as partners. The Proposed Regulations' specified-transfer rules should therefore treat a disposition, issuance, redemption, or other change in S corporation stock in the same manner as

[76] To avoid complexity, consideration should be given to excluding ownership changes involving publicly traded corporations or small shareholders.

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the corresponding change in a partnership interest. The preamble already recognizes the application of section 1373(a) to certain S corporations in connection with the mandatory status-change closing and transition rules.[77]

Accordingly, a separate application of the Indirect Disposition Approach to an S corporation generally should be unnecessary and could result in double counting. The CFC ownership changes attributable to transfers of S corporation stock should instead be measured at the shareholder level under the principles of the applicable partnership rules.

This treatment should not preclude application of the Deemed Transfer Approach when the S corporation election itself terminates and the corporation has separate S and C short taxable years. This would align the CFC's items with the corporation's separate S and C taxable years while avoiding a duplicative indirect-disposition rule for ordinary transfers of S corporation stock.

As discussed in Part IV.D.1, both alternatives would expand the circumstances in which taxpayers may elect to close a CFC's taxable year. Subject to the existing consent, consistency, plan-aggregation, and related-person protections, such an expansion generally would permit subpart F income, tested items, and associated foreign taxes to be allocated more closely to the periods in which the relevant economic income accrues. The Deemed Transfer Approach and the Indirect Disposition Approach offer different methods of achieving that objective, and we recommend that Treasury consider each on its respective merits.

E. Changes in the Number of Outstanding Shares

1. Recommendation

Prop. Treas. Reg. § 1.951-1(e)(2)(iii) addresses changes in the number of shares of a class of CFC stock outstanding during a CFC year. If the number of shares changes, the Proposed Regulations apply the daily proration rules of Prop. Treas. Reg. § 1.951-1(e)(2)(i) using a "weighted average share count" in place of the number of shares outstanding. The weighted average share count equals the sum of the number of shares outstanding on each day of the CFC year divided by the number of days in the CFC year. A U.S. Shareholder generally applies that denominator separately to each CFC year block that it owns during the year.[78]

The weighted average share count is a reasonable means of addressing an issuance or redemption that changes the assets or liabilities of the CFC. In that circumstance, the change in the number of shares generally corresponds to a change in the CFC's capacity to earn income, and averaging

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[77] 91 Fed. Reg. at 55,041 (noting that the Proposed Regulations would provide special rules for "domestic partnerships (including certain S corporations treated as partnerships by operation of section 1373(a))" in determining whether a status change event occurs); *see also* Prop. Treas. Reg. § 1.951-1(d)(1)(iii); 91 Fed. Reg. at 55,046 (describing rules on partnerships and S corporations under the transition rule); Prop. Treas. Reg. § 1.951-4(d)(1).

[78] Prop. Treas. Reg. §§ 1.951-1(e)(2)(i)(B), (e)(2)(iii)(A). The Proposed Regulations define a "CFC year block" as a group of shares within a class of CFC stock that a U.S. Shareholder owns for the same period during a CFC year. Prop. Treas. Reg. § 1.951-1(e)(2)(i)(B)(2).

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the shares outstanding can align the allocation of the CFC's annual income with the economic interests represented by the shares.

However, upon a pro rata stock dividend, stock split, or reverse stock split, we recommend that final Treasury Regulations make appropriate adjustments in determining the weighted average share count so that the share count is stated on a consistent basis before and after the transaction.

We recommend the weighted average share count approach when an issuance or redemption changes the CFC's assets or liabilities. Specifically, we believe that approach reaches an economically accurate result when shares are issued for property and when property is distributed with basis equal to fair market value in the redemption of shares. However, in situations where appreciated property is distributed in redemption of shares, we do not recommend a specific substantive rule for this circumstance at this time. We instead recommend a study of the operation of the Proposed Regulations in cases involving a same-day stock sale and redemption in exchange for a distribution of appreciated property and confirm that Treasury believes that the resulting allocation is consistent with policies of sections 951 and 951A.

2. Pro Rata Stock Dividends, Stock Splits, and Reverse Stock Splits

The rule should not apply in the same manner to a pro rata stock dividend, stock split, or reverse stock split that merely changes the number of shares used to represent the same economic interests. Such a transaction does not change the CFC's assets or liabilities and generally does not change any shareholder's proportionate interest in the CFC. Applying the weighted average share count mechanically in that circumstance can inappropriately change the allocation of subpart F income.

The distortion can be illustrated by the following example. The example assumes that no election is made under Prop. Treas. Reg. § 1.951-1(d)(2) to close the CFC's taxable year.

Example 11—Pro rata stock dividend. CFC1 is a calendar-year CFC with one class of common stock. At the beginning of Year 1, CFC1 has 100 shares outstanding, all of which are owned by A, a U.S. individual. On June 30 of Year 1, A sells all 100 shares to B, an unrelated U.S. individual. Under Prop. Treas. Reg. § 1.951-1(f)(1), A is treated as owning the shares through June 30, a period of 181 days, and B is treated as owning the shares beginning July 1, a period of 184 days.

On July 1, CFC1 makes a distribution described in Section 305(a) of one additional share for each share outstanding. CFC1 earns $365x of subpart F income ratably during Year 1.

Under Prop. Treas. Reg. § 1.951-1(e)(2)(iii), CFC1's weighted average share count is 150.41:

$$\frac{(100 \times 181) + (200 \times 184)}{365} \approx 150.41.$$

A's pro rata share of CFC1's subpart F income is $120.34x:

$$\$365x \times \frac{100}{150.41} \times \frac{181}{365} \approx \$120.34x.$$

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B's pro rata share is $244.66x:

$$\$365x \times \frac{200}{150.41} \times \frac{184}{365} \approx \$244.66x.$$

Those amounts sum to CFC1's $365x of subpart F income, but they do not reflect the shareholders' economic ownership periods. Because CFC1 earns $1x per day and the stock dividend does not change its assets or liabilities, A's pro rata share should be $181x and B's pro rata share should be $184x. The Proposed Regulations instead weight each day of B's ownership twice as heavily as each day of A's ownership.

We recommend that final Treasury Regulations make appropriate adjustments for any pro rata stock dividend, stock split, or reverse stock split in determining the weighted average share count. One administrable method would be to restate the number of shares outstanding before the transaction, and the number of shares in each shareholder's relevant CFC year block, on a post-transaction-equivalent basis. In Example 11, the 100 shares outstanding before the stock dividend would be restated as 200 shares. The adjusted weighted average share count would therefore be 200 shares, and A and B would be allocated $181x and $184x, respectively.

This exception should be limited to transactions that do not alter any shareholder's proportionate economic interest, voting interest, distribution rights, or liquidation rights. It should not apply, for example, to the extent that a disproportionate stock distribution or a recapitalization changes relative economic rights. The general rule of Prop. Treas. Reg. § 1.951-1(e)(2)(iii), together with the anti-abuse rule in Prop. Treas. Reg. § 1.951-1(e)(3), would continue to apply to those transactions.

3. Issuances and Redemptions That Change the CFC's Assets or Liabilities

Different considerations apply where an issuance or redemption changes the CFC's assets or liabilities. In that case, the change in the number of shares corresponds to the CFC's balance sheet, which affects its net income. Although the operation of the weighted average share count may initially appear counterintuitive to some, we believe it generally produces economically appropriate results, as illustrated in the examples below.

The following examples assume that each CFC has one class of common stock and that no election is made under Prop. Treas. Reg. § 1.951-1(d)(2).

Example 12—Issuance of shares for property. CFC2 is a calendar-year CFC with 100 shares outstanding, all owned by A, a U.S. individual. CFC2 is worth $100x and owns assets that generate $8x of subpart F income per year. B, another U.S. individual, owns property worth $100x that would generate income at the same rate and that would constitute subpart F income if earned by CFC2.

At the close of July 1, B transfers the property to CFC2 in exchange for 100 newly issued shares. Under Prop. Treas. Reg. § 1.951-1(f)(1), B is treated as owning the newly issued shares from July

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2 through December 31, or 183 days. CFC2's original assets generate $8x during Year 1, and the contributed property generates $4.01x during the 183 days after the contribution:

$$\$8x \times \frac{183}{365} \approx \$4.01x.$$

CFC2 therefore has $12.01x of subpart F income for Year 1. Its weighted average share count is 150.14:

$$\frac{(100 \times 365) + (100 \times 183)}{365} \approx 150.14.$$

A's pro rata share is $8x:

$$\$12.01x \times \frac{100}{150.14} \times \frac{365}{365} \approx \$8x.$$

B's pro rata share is $4.01x:

$$\$12.01x \times \frac{100}{150.14} \times \frac{183}{365} \approx \$4.01x.$$

This is an economically appropriate result. A is allocated the amount that CFC2's original assets earn during Year 1, and B is allocated the amount earned after the contribution by the assets that B contributed. More generally, where the original and contributed assets generate equivalent rates of return, the weighted average share count preserves the income amounts economically associated with each shareholder's investment.

Example 13—Distribution of property with basis equal to fair market value in redemption of shares. CFC3 is a calendar-year CFC with 100 shares outstanding. A, a U.S. individual, owns 51 shares, and F, a nonresident alien individual, owns the remaining 49 shares. CFC3 is worth $100x and owns assets that generate $8x of subpart F income per year.

On July 1, after that day's operating income has accrued, A and F sell all their shares to B, an unrelated U.S. individual. Immediately after the sale, CFC3 distributes to B property worth $90x in redemption of 90 shares. CFC3 has an adjusted basis of $90x in the distributed property and therefore recognizes no gain under section 311(b). After the redemption, B owns CFC3's 10 remaining shares, and CFC3 owns assets worth $10x that generate income at an annual rate of $0.8x.

For purposes of the Proposed Regulations, A and F are treated as owning their shares through July 1, or 182 days, and B is treated as owning the 10 shares remaining after the redemption from July 2 through December 31, or 183 days. B has no days of ownership for purposes of Section 951 with respect to the 90 shares acquired and redeemed on July 1. CFC3 has 100 shares outstanding for 182 days and 10 shares outstanding for 183 days. Its weighted average share count is therefore 54.88:

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$$\frac{(100 \times 182) + (10 \times 183)}{365} \approx 54.88.$$

CFC3 earns $3.99x during the first 182 days and $0.40x during the remaining 183 days:

$$\left(\$8x \times \frac{182}{365}\right) + \left(\$0.8x \times \frac{183}{365}\right) \approx \$4.39x.$$

A's pro rata share of CFC3's subpart F income is $2.03x:

$$\$4.39x \times \frac{51}{54.88} \times \frac{182}{365} \approx \$2.03x.$$

B's pro rata share is $0.40x:

$$\$4.39x \times \frac{10}{54.88} \times \frac{183}{365} \approx \$0.40x.$$

The remaining $1.95x is attributable to the 49 shares held by F during the first 182 days.

A's $2.03x pro rata share equals 51 percent of the income earned by CFC3's $100x of assets during the 182-day pre-transaction period. The weighted average share count therefore produces the expected economic result when the property distributed in the redemption has an adjusted basis equal to fair market value and the CFC and distributed assets earn equivalent rates of return.

We recommend that final Treasury Regulations include an example along these lines. The example would address any concerns that the weighted average share count approach is distortive. Where the redemption removes a proportionate amount of income-producing property from the CFC, the reduction in the weighted average share count can be necessary to preserve the appropriate economic allocation.

Example 14—Distribution of appreciated property in redemption of shares. The facts are the same as in Example 13, except that CFC3 has an adjusted basis of $10x in the property worth $90x that it distributes to B in redemption of 90 shares. Assume that the property is of a type described in section 954(c)(1)(B), so that the gain deemed recognized under section 311(b) constitutes foreign personal holding company income, and that no exception or exclusion applies. CFC3 therefore has total subpart F income of $84.39x for Year 1.

Because the weighted average share count and the shareholders' ownership periods are unchanged, A's pro rata share is $39.11x:

$84.39x × (51 / 54.88) × (182 / 365) ≈ $39.11x.

B's pro rata share is $7.71x:

$84.39x × (10 / 54.88) × (183 / 365) ≈ $7.71x.

The remaining $37.57x is attributable to the shares held by F during the first 182 days and does not give rise to a Section 951 inclusion to F.

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There is a technical basis for this result. Section 951 and the Proposed Regulations allocate CFC3's net subpart F income for the CFC year by reference to shares and ownership periods. They generally do not trace a particular item of income to the shareholder that owned the CFC stock when the item was recognized. Thus, the fact that the section 311(b) gain arises in a transaction occurring after the stock sale is irrelevant as a technical matter.

The result nevertheless warrants further consideration. The $80x gain is triggered by a redemption undertaken immediately after B legally acquires all the CFC3 stock, and B receives the appreciated property. The annual allocation mechanics assign only approximately $7.31x of that gain to B's CFC year block, while approximately $37.07x is reflected in A's pro rata share and approximately $35.62x is attributable to F's pre-sale shares. The transaction thus can cause a substantial portion of gain triggered in connection with a buyer's post-acquisition transaction to affect the tax position of a former U.S. Shareholder, while another substantial portion is attributable to shares formerly held by a non-U.S. person, who is not subject to U.S. taxation.

The elective year-closing rule in Prop. Treas. Reg. § 1.951-1(d)(2) does not necessarily address this concern. Assuming A and B are unrelated, A's sale of its 51-percent interest results in a decrease of more than 50 percentage points in A's ownership and therefore constitutes a significant ownership variance. A may accordingly be able to elect to close CFC3's taxable year as of the end of July 1. But Prop. Treas. Reg. § 1.951-1(f)(1) treats A as owning its shares through July 1, and the elective closing occurs at the end of that day. Because the redemption and the resulting section 311(b) gain also occur on July 1, the gain remains in the short CFC year ending on the sale date rather than being shifted to a CFC year in which B is treated as owning the stock.

If the election is made, CFC3 has $83.99x of subpart F income for the short CFC year ending July 1, consisting of $80x of section 311(b) gain and $3.99x of operating income. A's pro rata share for that short CFC year is $42.83x:

$$51\% \times \left(\$80x + \$8x \times \frac{182}{365}\right) \approx \$42.83x.$$

B has no pro rata share for that short CFC year and includes the $0.40x earned by CFC3 during the second short CFC year beginning July 2. Thus, an election to close CFC3's taxable year would not assign the same-day section 311(b) gain to B and, in this example, would increase rather than reduce A's inclusion relative to the result under the default annual allocation rule.[79]

The seller would need to consider that consequence in negotiating the transaction. Depending on the circumstances, the parties could address the allocation of the resulting tax cost through the purchase price, covenants restricting post-closing transactions, tax indemnities, or other provisions in the acquisition agreement. Contractual protection, however, may be incomplete or

[79] Treasury should consider whether a next day rule would be appropriate in this context such that post-closing non-ordinary course transactions are allocated to the buyer's ownership period. Treas. Reg. § 1.338-1(d) could serve as an appropriate model.

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unavailable, and the parties may not anticipate every transaction that could trigger CFC-level income on the closing date.

We do not recommend a specific substantive rule for this circumstance at this time. We recommend, however, that Treasury studies the operation of the Proposed Regulations in cases involving a same-day stock sale and redemption in exchange for a distribution of appreciated property and confirm that Treasury is comfortable with the resulting allocation of CFC items.

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