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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–124737–19]

RIN 1545–BP57

Coordination of Extraordinary Disposition and Disqualified Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under sections 245A and 951A of the Internal Revenue Code (the ''Code'') that coordinate the extraordinary disposition rule under section 245A of the Internal Revenue Code (the ''Code'') with the disqualified basis rule under section 951A of the Code. This document also contains proposed regulations under section 6038 of the Code regarding information reporting to facilitate administration of the proposed regulations. The proposed regulations affect corporations that are subject to the extraordinary disposition rule and the disqualified basis rule.

DATES: Written or electronic comments and requests for a public hearing must be received by October 26, 2020. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–124737–19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG–124737–19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Logan M. Kincheloe, (202) 317–6937; concerning submission of comments or requests for a hearing, Regina Johnson, (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Overview

This document contains proposed amendments to 26 CFR part 1 under sections 245A, 951A, and 6038 (the ''proposed regulations''). Any terms used but not defined in this preamble have the meanings given to them in the proposed regulations.

II. Sections 245A and 954(c)(6)

Section 245A was added to the Code by the Tax Cuts and Jobs Act, Public Law 115–97, 131 Stat. 2054, 2189 (2017) (the ''Act''), which was enacted on December 22, 2017. Section 245A generally allows a domestic corporation that is a United States shareholder (as defined in section 951(b)) a 100-percent dividends received deduction (a ''section 245A deduction'') for the foreign-source portion of a dividend received after December 31, 2017, from a specified 10-percent owned foreign corporation (an ''SFC''). Section 245A(g) provides the Secretary with authority to prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 245A.

Section 954(c)(6) was added to the Code by the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222, 120 Stat. 345 (2006). Section 954(c)(6) generally provides that, for certain taxable years, dividends received or accrued by a controlled foreign corporation (as defined in section 957) (a ''CFC'') from another CFC that is a related person generally are excluded from the foreign personal holding company income (as defined in section 954(c)) (''FPHCI'') of the distributee CFC. Section 954(c)(6)(A) provides the Secretary with the authority to prescribe regulations as may be necessary or appropriate to carry out section 954(c)(6), including regulations as may be necessary or appropriate to prevent the abuse of its purposes. Section 954(c)(6) currently applies to taxable years of foreign corporations beginning before January 1, 2021, and to taxable years of United States shareholders with or within which those taxable years of the foreign corporations end.

On June 18, 2019, the Department of the Treasury (''Treasury Department'') and the IRS published temporary regulations (TD 9865, 84 FR 28398) and cross-referenced proposed regulations (REG–106282–18, 84 FR 28426) (together the ''2019 section 245A regulations'') under sections 245A, 954, and 6038. The 2019 proposed regulations are finalized, and the temporary regulations are removed, in the Final Rules section of this issue of the **Federal Register** (the proposed regulations as finalized, the ''final regulations''). The final regulations include rules that limit the amount eligible for the section 245A deduction and the amount eligible for the section 954(c)(6) exception by 50 percent of the extraordinary disposition amount or tiered extraordinary disposition amount, respectively (together, the ''extraordinary disposition rule''). *See* § 1.245A–5(b) and (d). In general, an extraordinary disposition amount is an amount of earnings and profits (''E&P'') distributed by an SFC that is attributable to an extraordinary disposition, which includes certain non-ordinary course asset sales between related parties during the selling SFC's disqualified period. In general, a tiered extraordinary disposition amount is a dividend received by an upper-tier CFC from a lower-tier CFC that would be an extraordinary disposition amount if received by a section 245A shareholder of the lower-tier CFC. The disqualified period is defined with respect to an SFC as the period beginning on January 1, 2018, and ending as of the close of the taxable year of the SFC, if any, that begins before January 1, 2018, and ends after December 31, 2017. *See* § 1.245A–5(c). The purpose of the extraordinary disposition rule is to prevent taxpayers from obtaining the benefits of the section 245A deduction or the section 954(c)(6) exception for E&P that were generated in certain non-ordinary course transactions occurring during the disqualified period and that were not subject to current U.S. tax solely because the transactions occurred during the disqualified period; these E&P are generally not intended to qualify for the section 245A deduction or the section 954(c)(6) exception. *See* 84 FR 28401.

III. Section 951A

Section 951A, added to the Code by the Act, requires a United States shareholder of any CFC for any taxable year to include in gross income the United States shareholder's global intangible low-taxed income (''GILTI inclusion amount'') for that year. On October 10, 2018, the Treasury Department and the IRS published in the **Federal Register** proposed regulations (REG–104390–18, 83 FR

51072) implementing section 951A. On June 21, 2019, the Treasury Department and the IRS published in the **Federal Register** final regulations (''GILTI final regulations'') (TD 9866, 84 FR 29288) that adopted, with revisions, the proposed regulations under section 951A.

The GILTI final regulations include a rule providing that a deduction or loss attributable to basis created by reason of a transfer of property from a CFC to a related person during the disqualified period (''disqualified basis'') is allocated and apportioned solely to residual CFC gross income (the ''disqualified basis rule''). *See* § 1.951A–2(c)(5)(i).[1] Residual CFC gross income is defined as gross income other than gross tested income, subpart F income, or income effectively connected with the conduct of a trade or business in the United States. *See* § 1.951A–2(c)(5)(iii)(B). The disqualified basis rule also provides that any depreciation, amortization, or cost recovery allowances attributable to disqualified basis are not properly allocable to property produced, or acquired for resale, under section 263, 263A, or 471. *See* § 1.951A–2(c)(5)(i). The purpose of the disqualified basis rule is to prevent taxpayers from obtaining the benefits of tax basis in the transferred asset (for example, depreciation or amortization deductions over time that reduce a CFC's tested income or increase a CFC's tested loss) that was created through related-party transactions effectuated at no U.S. tax cost solely because they occurred during the disqualified period. *See* 84 FR 29299. Thus, the rule creates symmetry between the categorization of non-taxed income created in the transaction generating disqualified basis during the disqualified period and the categorization of deductions generated after the disqualified period attributable to that disqualified basis. *See id.*

Further, recently proposed regulations under section 951A treat a deduction related to certain payments by a CFC to a related recipient CFC during the disqualified period in a manner similar to the treatment of disqualified basis under the GILTI final regulations (the ''disqualified payment rule''). *See* REG–106013–19, 85 FR 19858.

[1] Although the extraordinary disposition rule and the disqualified basis rule define ''disqualified period'' using different terminology, in application, a CFC that has a disqualified period under either rule has a disqualified period under the other rule. *Compare* § 1.245A–5(c)(3)(iii) with § 1.951A–3(h)(2)(ii)(C)(*1*). For this reason, references to a ''disqualified period'' in this preamble refer to the unified concept of a disqualified period under both the extraordinary disposition rule and the disqualified basis rule.

Explanation of Provisions

I. Overview

In certain cases, the extraordinary disposition rule and the disqualified basis rule, when applied together, may give rise to excess taxation as to a section 245A shareholder (or as to the section 245A shareholder and a related party). For example, consider a case in which a CFC that is wholly owned by a section 245A shareholder sells an item of specified property during the disqualified period to another CFC that is wholly owned by the section 245A shareholder. In this case, there is a single amount of gain (the gain that the transferor CFC recognizes upon the sale), which gives rise to both extraordinary disposition E&P of the transferor CFC (the E&P generated upon the sale) and disqualified basis in the item of specified property held by the transferee CFC (the basis step-up in the item of specified property resulting from the sale). The gain will in effect be subject to U.S. tax as to the section 245A shareholder when the extraordinary disposition E&P are distributed as a dividend by the transferor CFC. In addition, an amount (such as an amount of future gross tested income of the transferee CFC) equal to the gain might be indirectly taxed as to the section 245A shareholder as a result of not being offset or reduced by deductions or losses attributable to the disqualified basis (because, but for the disqualified basis rule, such deductions or losses would have offset or reduced the amount and sheltered it from U.S. tax). Moreover, the disqualified basis rule may in certain cases have the effect of reducing, in an amount equal to the gain, E&P of the transferee CFC that would otherwise have been eligible for the section 245A deduction when distributed as a dividend to the section 245A shareholder. This could occur because, in general, deductions or losses that are subject to the disqualified basis rule nevertheless reduce E&P.

The preamble to the 2019 section 245A regulations requested comments on whether and how to coordinate the extraordinary disposition rule and the disqualified basis rule. *See* 84 FR 28402. One comment was received, which recommended these rules be coordinated and suggested two approaches to that effect.

The first approach would permit taxpayers to effectively unwind the tax effect of an extraordinary disposition. Under this approach, a section 245A shareholder's extraordinary disposition account would be eliminated if, with respect to each item of specified property taken into account in determining the initial balance of the account, an election were made pursuant to § 1.951A–3(h)(2)(ii)(B)(*3*) to reduce the item's adjusted basis (and thus eliminate the item's disqualified basis), and provided that certain other requirements are met (for example, the person to which the item of specified property was transferred in the extraordinary disposition was a CFC, which remains a CFC for at least five years after the extraordinary disposition). The proposed regulations do not adopt this approach because the Treasury Department and the IRS have determined that it could give rise to inappropriate results, such as the elimination of an extraordinary disposition account in cases in which it is unlikely that the extraordinary disposition rule and the disqualified basis rule, when applied together, would result in excess taxation. In addition, the approach could be difficult to administer. For example, after the extraordinary disposition, the CFC to which the specified property was transferred might be transferred outside the U.S. taxing jurisdiction but remain a CFC due to the Act's repeal of section 958(b)(4), with the result that in effect there is no or little U.S. tax cost to the CFC having reduced the adjusted basis (and eliminated the disqualified basis) of the item of specified property. Furthermore, because the extraordinary disposition account with respect to the transferor CFC would have been eliminated, the E&P attributable to the extraordinary disposition could reduce gain that would otherwise be recognized on the disposition of stock of the transferor CFC as a result of the section 245A deduction. Moreover, there would be additional administrative and compliance burdens if the regulations adopted an approach pursuant to which an extraordinary disposition account is tentatively eliminated when elections are made pursuant to § 1.951A–3(h)(3) to reduce adjusted bases (and eliminate disqualified basis), but then the extraordinary disposition account is retroactively restored if the transferee CFC ceases to be a CFC or becomes a CFC only by reason of the repeal of section 958(b)(4).

The second approach recommended by the comment would adjust disqualified basis of an item of specified property to the extent that gain to which the disqualified basis is attributable is in effect subject to U.S. tax by reason of the extraordinary disposition rule. Similarly, an extraordinary disposition account of a section 245A shareholder would be adjusted to the extent that, with respect to disqualified basis attributable to gain to which the extraordinary disposition account is also attributable, the disqualified basis gives rise to deductions or losses that are allocated and apportioned to residual CFC gross income of a CFC by reason of the disqualified basis rule.

As discussed in parts II through IV of this Explanation of Provisions, the proposed regulations adopt a coordination mechanism that is broadly consistent with the second approach recommended by the comment. The coordination mechanism involves two operative rules, one that reduces disqualified basis in certain cases (the ''DQB reduction rule''), and another that reduces an extraordinary disposition account in certain cases (the ''EDA reduction rule'').

In addition, to reduce burden and facilitate compliance, the proposed regulations provide two versions of both the DQB reduction rule and the EDA reduction rule, similar to the approach taken in §§ 1.1248–2 and 1.1248–3 (providing rules for determining earnings and profits attributable to a block of stock in simple and complex cases). *See* proposed §§ 1.245A–7 and 1.245A–8. These versions achieve the same results. The first version (proposed § 1.245A–7) may be applied to simple cases, and the second version (proposed § 1.245A–8) applies to complex cases.

The version for simple cases may be applied when two conditions are satisfied, because those conditions eliminate the need for certain additional rules under the version for complex cases. *See* proposed § 1.245A–6(b). The first condition provides requirements related to the seller SFC with respect to which there is an extraordinary disposition account. *See* proposed § 1.245A–6(b)(1). The second condition provides requirements related to an item of specified property for which an extraordinary disposition occurred and the buyer CFC holding the item. *See* proposed § 1.245A–6(b)(2). As an example, the version for simple cases generally applies if (i) the seller SFC is wholly-owned (directly or indirectly, within the meaning of section 958(a)) by the section 245A shareholder at the time of the extraordinary disposition and remains wholly-owned by the section 245A shareholder, (ii) the seller SFC does not succeed to E&P of another SFC with respect to which there is an extraordinary disposition account, (iii) the items of specified property for which an extraordinary disposition occurred are acquired by a buyer CFC wholly-owned by the section 245A shareholder and certain related parties and the buyer CFC remains wholly-owned by the section 245A shareholder and certain related parties, and (iv) the buyer CFC retains the items of specified property it acquires in the extraordinary disposition and does not acquire items of specified property with disqualified basis that were transferred in another extraordinary disposition. *See* proposed § 1.245A–6(b)(1) and (2).

The determination as to whether the version for simple cases is available is made with respect to a taxable year of a section 245A shareholder. If the conditions for applying the version for simple cases are not satisfied for a taxable year, then the version for complex cases must be applied beginning with that taxable year and all subsequent taxable years. In addition, if the conditions for applying the version for simple cases are satisfied for a taxable year but the section 245A shareholder chooses not to apply the version for simple cases for that taxable year, then the version for complex cases applies to that taxable year. However, for a subsequent taxable year, the section 245A shareholder may apply the version for simple cases, provided that the conditions for applying the version for simple cases are satisfied for that taxable year and have been satisfied for all earlier taxable years.

Further, for purposes of determining whether the conditions for applying the version for simple cases are satisfied, any requirement that references a section 245A shareholder, an SFC, or a CFC does not include a successor of the section 245A shareholder, the SFC, or the CFC, respectively. *See* proposed § 1.245A–6(b) (last sentence). As a result, the version of the rules for simple cases is not available if the section 245A shareholder's extraordinary disposition account with respect to an SFC has been adjusted pursuant to the successor rules of § 1.245A–5(c)(4). Thus, for example, the version of the rules for simple cases is not available if the assets of the section 245A shareholder are acquired by another domestic corporation, or if the assets of the seller SFC are acquired by another SFC, in each case, in a transaction described in section 381 and subject to § 1.245A–5(c)(4)(i) or (ii), respectively.

Section II of this Explanation of Provisions discusses the versions of the DQB reduction rule and the EDA reduction rule that apply for simple cases. Section III of this Explanation of Provisions then discusses the versions of those rules for complex cases. Section IV of this Explanation of Provisions discusses other rules applicable to both simple and complex cases. Section V of this Explanation of Provisions discusses applicability dates, and Section VI of this Explanation of Provisions requests comments.

II. Rules for Simple Cases

A. The DQB Reduction Rule

1. In General

The DQB reduction rule provides that when an extraordinary disposition account of a section 245A shareholder gives rise to an extraordinary disposition amount or tiered extraordinary disposition amount, the disqualified bases of certain items of specified property are reduced by the same amount solely for purposes of § 1.951A–2(c)(5). *See* proposed § 1.245A–7(b)(1). This rule is intended to ensure that as the extraordinary disposition rule applies to cause gain to which extraordinary disposition E&P are attributable to in effect be subject to U.S. tax, the disqualified basis rule generally does not apply to the basis of an item of specified property attributable to that gain (because that basis is no longer generated at no U.S. tax cost) and, accordingly, items of deduction or loss attributable to that basis become eligible to offset income subject to U.S. tax.

More specifically, for a taxable year of a section 245A shareholder, the disqualified bases of items of specified property that ''correspond'' to the section 245A shareholder's extraordinary disposition account are generally reduced by the sum of the extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year. *See* proposed § 1.245A–7(b)(1); *see also* proposed § 1.245A–9(b)(1) (general rule providing that an item of specified property corresponds to an extraordinary disposition account if gain was recognized on the extraordinary disposition of the item and was taken into account in determining the initial balance of the account). This correspondence requirement ensures that the rule only reduces disqualified basis of an item of specified property that is attributable to gain that was taken into account in determining the initial balance of the account, and thus the rule does not reduce disqualified basis of an item of specified property that is attributable to other gain (for example, disqualified basis of an item of specified property that corresponds to an extraordinary disposition account of another section 245A shareholder or that does not correspond to an extraordinary disposition account).

The amount of the reduction under the DQB reduction rule is allocated pro rata across the disqualified basis of each item of specified property that corresponds to the section 245A shareholder's extraordinary disposition account, based on the item's disqualified basis relative to the aggregate disqualified bases of the items. *See* proposed § 1.245A–7(b)(1). The Treasury Department and the IRS have determined that a pro rata approach is appropriate because the initial balance of the extraordinary disposition account reflects an aggregate of the gain of each item of specified property that corresponds to the account (reduced by losses with respect to certain items of specified property). In addition, alternative approaches would be unduly complex, such as a stacking approach pursuant to which a reduction is applied first with respect to disqualified basis of a particular item of specified property, then with respect to another item of specified property, and so on.

2. Timing Rules for Determining and Reducing Disqualified Basis

For purposes of applying the DQB reduction rule for a taxable year of a section 245A shareholder, disqualified basis of an item of specified property is determined as of the beginning of the taxable year of the CFC holding the item that includes the date on which the section 245A shareholder's taxable year ends (and, to avoid circularity issues, without regard to any reductions to disqualified basis of the item of specified property pursuant to the DQB reduction rule for such taxable year of the CFC). *See* proposed § 1.245A–9(b)(2)(i). Then, disqualified basis of the item of specified property is reduced as of the beginning of the taxable year of the CFC. *See* proposed § 1.245A–9(b)(2)(ii). Thus, for example, disqualified basis of an item of specified property is reduced before any depreciation, amortization, or other cost recovery deduction allowances attributable to the basis of the item are determined for the CFC's taxable year.

B. The EDA Reduction Rule

1. In General

The EDA reduction rule provides that when items of deduction or loss attributable to disqualified basis of an item of specified property are allocated and apportioned to residual CFC gross income of a CFC and have the effect of reducing certain E&P of the CFC that could otherwise potentially qualify for the section 245A deduction when distributed, the extraordinary disposition account to which the specified property corresponds is reduced by up to the same amount. *See* proposed § 1.245A–7(c)(1). This rule is generally intended to ensure that as the application of the disqualified basis rule results in income of the CFC being indirectly taxed to a section 245A shareholder (or a related party that is a domestic corporation, a ''domestic affiliate'') and a reduction in the E&P of the CFC available to be distributed to the section 245A shareholder and any domestic affiliates as a dividend to which the section 245A deduction could be available if distributed, the extraordinary disposition rule no longer applies to E&P attributable to gain to which the disqualified basis is also attributable. Requiring reduction in the capacity to pay dividends for which the section 245A deduction could be available if the E&P were distributed ensures that the EDA reduction rule applies only once the disqualified basis rule has resulted in a tax detriment to the section 245A shareholder (or a domestic affiliate). To the extent that there has not been a reduction in the CFC's capacity to pay dividends for which the section 245A deduction could be available if the E&P were distributed, the disqualified basis rule might generally not give rise to a tax detriment to the section 245A shareholder (or a domestic affiliate). This is because the section 245A shareholder's (or domestic affiliate's) basis in its stock of the CFC is generally increased under section 961 by the amount of the income indirectly taxed to the section 245A shareholder (or a domestic affiliate). Such basis increase is, for example, available to reduce gain that would otherwise be recognized on a disposition of stock of the CFC (including gain that would be taxed at the full corporate tax rate even though, for instance, the basis increase is attributable to an inclusion under section 951A that in effect is taxed at a preferential rate).

More specifically, for a taxable year of a CFC, a section 245A shareholder's extraordinary disposition account is generally reduced by the lesser of two amounts. *See* proposed § 1.245A–7(c)(1). The first amount is intended to approximate in an administrable manner the extent to which the disqualified basis rule (by reason of the allocation and apportionment of items of deduction or loss to residual CFC gross income of the CFC) reduced the E&P of the CFC available to be distributed to the section 245A shareholder and any domestic affiliates as a dividend to which the section 245A deduction could be available. *See* proposed § 1.245A–7(c)(1)(i). In order to reduce administrative and compliance burdens, the proposed regulations disregard the holding period requirement of section 246(c) for purposes of determining if a section 245A deduction would be available if E&P were distributed. To compute the first amount, the CFC's E&P at the end of the taxable year are determined, taking into account distributions during the taxable year. Then, those E&P are adjusted, including by generally increasing the E&P by items of deduction or loss that are or have been allocated to residual CFC gross income of the CFC solely by reason of the disqualified basis rule (''adjusted earnings''). *See* proposed § 1.245A–7(c)(3). Lastly, the adjusted earnings are reduced by the sum of the previously taxed earnings and profits accounts with respect to the CFC under section 959 (taking into account any adjustments to the accounts for the taxable year) in order to reflect that an amount equal to such sum would not have been eligible for the section 245A deduction were it distributed by the CFC to the section 245A shareholder and any domestic affiliates. *See* proposed § 1.245A–7(c)(1)(i).

The second amount necessary to determine the reduction in a section 245A shareholder's extraordinary disposition account is the balance of the section 245A shareholder's residual gross income account (''RGI account'') with respect to the CFC. *See* proposed § 1.245A–7(c)(1)(ii). The balance of the RGI account generally reflects items of deduction or loss allocated and apportioned to residual CFC gross income of the CFC solely by reason of the disqualified basis rule, to the extent that the allocation and apportionment is likely to increase income of the CFC that is subject to U.S. taxation at the level of the section 245A shareholder and any domestic affiliates pursuant to section 951 or 951A. *See* proposed § 1.245A–7(c)(4)(i). Tracking such items of deduction or loss through an account mechanism allows for a reduction under, and facilitates compliance with, the EDA reduction rule in certain cases—for example, a case in which a CFC does not have any adjusted earnings for its taxable year in which items of deduction or loss are allocated and apportioned to residual CFC gross income (such that there cannot be a reduction under the EDA reduction rule to the section 245A shareholder's extraordinary disposition account that year) but in a later taxable year has sufficient adjusted earnings to allow for a reduction.

2. Timing Rules for Reducing an Extraordinary Disposition Account

A reduction to an extraordinary disposition account of a section 245A shareholder by reason of the application of the EDA reduction rule with respect to a taxable year of the CFC occurs as of the end of the taxable year of the section 245A shareholder that includes the date on which the CFC's taxable year ends (and, for example, after the determination of any extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year). *See* proposed § 1.245A–9(b)(3). Thus, a reduction to a section 245A shareholder's extraordinary disposition account under the EDA reduction rule occurs after the application of the DQB reduction rule for the taxable year of the section 245A shareholder. *See id.* Absent such an approach, there could be circularity issues because the computation of a reduction under one rule might depend on an amount that is potentially affected by the other rule, and it would be unclear which rule applies first. Applying the EDA reduction rule at the end of a taxable year also ensures that it applies after the full effect of the disqualified basis rule has been taken into account for the year.

III. Rules for Complex Cases

A. The DQB Reduction Rule

1. In General

The version of the DQB reduction rule for complex cases uses the same architecture as the version of the rule for simple cases but provides additional rules to address scenarios in which the conditions provided in proposed § 1.245A–6(b)(1) and (2) are not satisfied. *See* proposed § 1.245A–8. For example, the version for complex cases addresses scenarios in which, after the extraordinary disposition of an item of specified property, the item is transferred to another person (whether the transfer is taxable or non-taxable). *See* proposed § 1.245A–6(b)(2).

2. Ownership Requirement

To address the possibility that an item of specified property may have been transferred after the extraordinary disposition (with the result that the section 245A shareholder or a related party may not directly or indirectly own an interest in the item), the version of the DQB reduction rule for complex cases provides that an ownership requirement must be satisfied for disqualified basis of an item of specified property to be eligible for relief under the DQB reduction rule. *See* proposed § 1.245A–8(b)(1) and (3). The ownership requirement is intended to ensure that the DQB reduction rule applies with respect to an item of specified property only if it is likely that the section 245A shareholder (or the section 245A shareholder and a related party) would be meaningfully affected by the application of the disqualified basis rule as to the item of specified property, such that, absent the DQB reduction rule, the extraordinary disposition rule and the disqualified basis rule would, when applied together, result in meaningful excess taxation as to the section 245A shareholder (or the section 245A shareholder and a related party). In addition, the ownership requirement is intended to ensure that the DQB reduction rule takes into account only disqualified bases of items of specified property for which the section 245A shareholder can reasonably be expected to have or obtain the necessary information to accurately apply the DQB reduction rule.

The ownership requirement is satisfied with respect to an item of specified property if, on one or more days during the taxable year of the section 245A shareholder, the item is held by the section 245A shareholder, a related party, or a specified entity in which the section 245A shareholder or a related party owns directly or indirectly at least a 10-percent interest. *See* proposed § 1.245A–8(b)(3). As a result, the DQB reduction rule can apply to, for example, an item of specified property that is sold at a loss by a CFC of the section 245A shareholder to a third party on any day that falls within the taxable year of the section 245A shareholder, such that a reduced portion of the CFC's loss will be attributable to disqualified basis and thus subject to the disqualified basis rule for the CFC's taxable year. As an additional example, the DQB rule can also apply to an item of specified property that is held by a CFC of the section 245A shareholder all the stock of which is sold by the section 245A shareholder to a third party on any day that falls within the taxable year of the section 245A shareholder, such that a reduced portion of the CFC's amortization deductions with respect to the specified property for its taxable year that includes the sale and its subsequent taxable years will be subject to the disqualified basis rule.

3. Basis Benefit Amounts

i. In General

In certain cases in which an item of specified property with disqualified basis is transferred after the extraordinary disposition of the item, the extraordinary disposition rule and the disqualified basis rule, when applied together, do not give rise to excess taxation as to a section 245A shareholder (or as to the section 245A shareholder and a related party). This may occur, for example, if the section 245A shareholder ''benefits'' from the disqualified basis of the item of specified property pursuant to a transaction that is not subject to the disqualified basis rule, such as through a sale of the item by a CFC of the section 245A shareholder to an unrelated person at a gain (with the result that, but for the use of the disqualified basis, the CFC would have had a greater amount of gain that would have been taken into account in computing the CFC's tested income). In such a case, the DQB reduction rule need not apply to an amount of the section 245A shareholder's extraordinary disposition account equal to the amount of the disqualified basis benefit. *See* proposed § 1.245A–10(c)(2) (*Example 2*).

To address these situations, the proposed regulations provide that, for a taxable year of a section 245A shareholder, the amount of the reduction to disqualified bases under the DQB reduction rule is equal to the sum of the extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year, less the balance of the section 245A shareholder's ''basis benefit account'' with respect to the extraordinary disposition account. *See* proposed § 1.245A–8(b)(1). A basis benefit account with respect to an extraordinary disposition account generally reflects the extent to which the disqualified basis of one or more items of specified property that correspond to the extraordinary disposition account has been used to offset or reduce income subject to U.S. tax (the use of disqualified basis to such an extent, a ''basis benefit amount''). *See* proposed § 1.245A–8(b)(4)(ii).

For these purposes, the use of disqualified basis by a U.S. tax resident to offset or reduce taxable income, or the use of disqualified basis by a foreign person (including a CFC) to offset or reduce income effectively connected with a trade or business in the United States (''ECTI''), is always considered to offset or reduce income subject to U.S. tax. *See* proposed § 1.245A–8(b)(4)(ii). As an example, in the case of an item of specified property that is held by a U.S. tax resident and that has disqualified basis by reason of the application of § 1.951A–3(h)(2)(ii)(B)(*1*)(*ii*) to a previous transfer of the item of specified property by a related CFC to the U.S. tax resident, there is a basis benefit amount equal to the portion of the disqualified basis that gives rise to an item of depreciation or amortization of the U.S. tax resident for a taxable year of the U.S. tax resident.

However, the use of disqualified basis by a CFC to offset or reduce income taken into account in computing subpart F income, tested income, or tested loss is considered to offset or reduce income subject to U.S. tax only if the CFC is described in § 1.267A–5(a)(17) and thus a meaningful portion of the CFC's income is indirectly subject to current U.S. tax. *See id.*

Disqualified basis can be used to reduce or offset income subject to U.S. tax regardless of whether the disqualified basis is reduced or eliminated under § 1.951A–3(h)(2)(ii)(B)(*1*). For example, in a case in which a CFC sells an item of specified property with disqualified basis to a related CFC, the rule of § 1.951A–3(h)(2)(ii)(B)(*1*) generally does not prevent the disqualified basis from reducing or offsetting income subject to U.S. tax (for instance, income from the sale that but for the use of the disqualified basis would have been taken into account in computing the seller CFC's tested income), even though the buyer CFC succeeds to the disqualified basis under the rule. Thus, the proposed regulations provide that a basis benefit amount can be created from the use of disqualified basis regardless of whether the disqualified basis is reduced or eliminated as a result. *See* proposed § 1.245A–8(b)(4)(ii)(B); *see also* proposed § 1.245A–8(b)(4)(iii)(B) (anti-duplication rule to address cases in which disqualified basis gives rise a basis benefit amount but is not eliminated or reduced).

Further, the proposed regulations provide certain timing rules regarding when the use of disqualified basis gives rise to a basis benefit amount. *See* proposed § 1.245A–8(b)(4)(ii)(C). For example, if an item of deduction or loss arising from the use of disqualified basis is deferred under section 267(a)(2), then the determination of whether a basis benefit amount arises is made when, in a later taxable year, the deduction or loss is no longer deferred. Similarly, if an item of deduction or loss arising from the use of disqualified basis of an item of specified property is disallowed under section 267(a)(1), then a basis benefit amount would arise when and to the extent that gain is reduced on the sale of that specified property (or other property with basis determined by reference to that specified property) under section 267(d) in the hands of certain persons whose income is directly or indirectly subject to U.S. tax.

ii. Adjustments to a Basis Benefit Account

A basis benefit account is adjusted at the end of each taxable year of a section 245A shareholder. *See* proposed § 1.245A–8(b)(4)(i). Generally, the basis benefit account is increased by a basis benefit amount with respect to an item of specified property that corresponds to the extraordinary disposition account, provided that the basis benefit amount is assigned to the taxable year of the section 245A shareholder. *See* proposed § 1.245A–8(b)(4)(i)(A). However, in the case in which the extraordinary disposition ownership percentage with respect to the extraordinary disposition account is less than 100 percent (such that the initial balance of the extraordinary disposition account reflects only a portion of the gain from the extraordinary disposition of the item of specified property), only the same ratable portion of the basis benefit amount may increase the basis benefit account. *See id.*

A basis benefit amount with respect to an item of specified property is assigned to a taxable year of a section 245A shareholder if two conditions are satisfied. *See* proposed § 1.245A–8(b)(4)(iii). First, the ownership requirement described in part III.A.2 of this Explanation of Provisions must be satisfied with respect to the item of specified property. As a result of this first condition, a basis benefit amount is assigned to a taxable year of a section 245A shareholder (and thus only limits a potential reduction under the DQB reduction rule) only if the use of the disqualified basis giving rise to the basis benefit amount provides a meaningful benefit to the section 245A shareholder or a related party. This first condition is also intended to ensure that the section 245A shareholder can reasonably be expected to obtain information about the item of specified property necessary to accurately calculate and reflect the basis benefit amount. Second, the use of the disqualified basis must occur in the section 245A shareholder's taxable year (in a case in which the section 245A shareholder is the person that uses the disqualified basis) or a taxable year of a person ending with or within—or in certain cases, beginning with or within—the taxable year of the section 245A shareholder (in a case in which the section 245A shareholder is not the person that uses the disqualified basis). As a result of these assignment rules, in a case in which a CFC of a section 245A shareholder holds an item of specified property and the CFC sells the item of specified property (or the section 245A shareholder sells all of the stock of the CFC) to a third party on a day that falls within the taxable year of the section 245A shareholder, a use by the CFC of disqualified basis of the specified property to generate a basis benefit amount on a day that falls within the same taxable year of the section 245A shareholder is generally assigned to such taxable year of the section 245A shareholder.

Further, at the end of each taxable year of a section 245A shareholder, the balance of a basis benefit account is decreased to the extent that the basis benefit account limits a reduction under the DQB reduction rule. *See* proposed § 1.245A–8(b)(4)(i)(B).

4. Timing Rules for Determining and Reducing Disqualified Basis

To address the possibility that an item of specified property may be held by a person other than a CFC, the timing rules for purposes of the version of the DQB reduction rule for complex cases provide that disqualified basis of an item of specified property is generally determined and reduced as of the beginning of the taxable year of the ''specified property owner'' of the item. *See* proposed § 1.245A–9(b)(2)(i) and (ii). The specified property owner of an item of specified property is generally the person that held the item of specified property on at least one day during the taxable year of the person that includes the date on which the section 245A shareholder's taxable year ends. *See* proposed § 1.245A–9(b)(2)(iii).

In addition, to address cases in which, absent a special rule, two or more persons might be considered the specified property owner, a special rule provides that in such cases the specified property owner is the person that held the item of specified property on the earliest date that falls within the section 245A shareholder's taxable year. *See* § 1.245A–9(b)(2)(iii) (last sentence). Thus, for example, if a CFC (''CFC1'') transfers an item of specified property to another CFC (''CFC2'') on a date that falls within the taxable year of a section 245A shareholder and the taxable year of each of CFC1 and CFC2 includes the day of the close of the taxable year of the section 245A shareholder, then CFC1 (and not CFC2) would be the specified property owner for purposes of applying the DQB reduction rule for the taxable year of the section 245A shareholder.

B. The EDA Reduction Rule

1. In General

The version of the EDA reduction rule for complex cases uses the same architecture as the version of the rule for simple cases but provides additional rules to address scenarios in which the conditions provided in § 1.245A–6(b) are not satisfied. *See* proposed § 1.245A–8. For example, the version for complex cases addresses scenarios in which the CFC that holds an item of specified property that corresponds to an extraordinary disposition account of a section 245A shareholder is not wholly-owned by the section 245A shareholder and any domestic affiliates, or the CFC also holds an item of specified property that corresponds to another extraordinary disposition account. *See* proposed § 1.245A–6(b)(2).

2. Computing the Reduction in Certain Dividend-Paying Capacity of a CFC

As discussed in II.B.1 of this Explanation of Provisions, the EDA reduction rule depends in part on the extent to which the disqualified basis rule has, as to a CFC that holds items of specified property that correspond to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, reduced E&P of the CFC available to be distributed to the section 245A shareholder and any domestic affiliates as a dividend to which the section 245A deduction could be available. The EDA reduction rule for complex cases provides several additional rules for purposes of measuring this reduction to the CFC's capacity to pay dividends eligible for the section 245A deduction, to address the possibility that the section 245A shareholder and any domestic affiliates may not own all of the stock of the CFC (including because the section 245A shareholder or a domestic affiliate disposed of stock of the CFC during the CFC's taxable year) as well as other issues.

First, the version for complex cases provides an ownership requirement pursuant to which, for the section 245A shareholder's extraordinary disposition account to be reduced by reason of the application of the EDA reduction rule with respect to a taxable year of the CFC, the section 245A shareholder (or a domestic affiliate) must, on the last day of the CFC's taxable year, be a United States shareholder with respect to the CFC. *See* proposed § 1.245A–8(c)(1) and (3). The ownership requirement is measured on the last day of a CFC's taxable year because the EDA reduction rule depends on a section 245A shareholder's portion of the CFC's adjusted earnings, which are measured on an annual basis.

Second, the version for complex cases provides special rules for deficits of the CFC subject to § 1.381(c)(2)–1(a)(5). *See* proposed § 1.245A–8(c)(3). These rules generally provide that the CFC's adjusted earnings are determined by not taking into account these deficits in determining E&P because, in general, the deficits do not affect or limit the CFC's ability to distribute its other E&P as a dividend. In addition, for purposes of determining a CFC's adjusted earnings, the CFC's E&P are reduced by the amount of items of deduction or loss that are attributable to disqualified basis and that give or have given rise to a deficit subject to § 1.381(c)(2)–1(a)(5). This is because the application of the disqualified basis rule to these items has not affected or limited the CFC's ability to distribute certain earnings as a dividend and reducing the CFC's E&P by the amount of the items generally ensures that the application of the disqualified basis rule to these items does not give rise to relief under the EDA reduction rule. A CFC could have a deficit subject to § 1.381(c)(2)–1(a)(5) and comprised of items of deduction or loss attributable to disqualified basis if, for example, the CFC acquired in a transaction subject to section 381 the assets of another CFC that held items of specified property with disqualified basis.

Third, the version for complex cases provides a rule that allocates the CFC's adjusted earnings to the section 245A shareholder, based on the percentage of stock of the CFC that the section 245A shareholder and any domestic affiliates own. *See* proposed § 1.245A–8(c)(1)(i)(A). This allocation serves as a proxy for measuring the portion of the adjusted earnings of the CFC that the section 245A shareholder and any domestic affiliates would receive if the CFC were to distribute all of its adjusted earnings to its shareholders. The adjusted earnings as so allocated to a section 245A shareholder are further adjusted to reflect certain previously taxed earnings and profits accounts with respect to the CFC, certain hybrid deduction accounts with respect to shares of stock of the CFC, and the balance of any extraordinary disposition accounts with respect to the CFC (other than, in general and as illustrated in part III.B.6 of this Explanation of Provisions, the portion of the balance of an extraordinary disposition account with respect to the CFC that, by reason of a merger or similar transaction of the SFC into the CFC or vice versa, is attributable to an extraordinary disposition account with respect to the SFC). The end result is intended to measure the extent to which the disqualified basis rule has reduced E&P of the CFC available to be distributed to the section 245A shareholder and any domestic affiliates as a dividend to which the section 245A deduction could be available.

3. Computing the Increase to an RGI Account

As discussed in part II.B.1 of this Explanation of Provisions, the EDA reduction rule depends in part on the balance of a section 245A shareholder's RGI account with respect to a CFC. The EDA reduction rule for complex cases provides several additional rules for purposes of computing an increase to a section 245A shareholder's RGI account with respect to a CFC. *See* proposed § 1.245A–8(c)(4).

First, to address the possibility that the CFC may hold multiple items of specified property, some of which correspond to an extraordinary disposition account of the section 245A shareholder and others of which correspond to another extraordinary disposition account (or to no extraordinary disposition account), the rule for complex cases provides that the section 245A shareholder's RGI account can be increased only by items of deduction or loss (to which the disqualified basis rule applies) that are attributable to disqualified basis of an item of specified property that corresponds to the section 245A shareholder's extraordinary disposition account. *See* proposed § 1.245A–8(c)(4)(i)(A)(*1*)(*i*). In addition, in cases in which the section 245A shareholder owned less than all of the stock of the SFC when the SFC undertook an extraordinary disposition (such that the extraordinary disposition ownership percentage as to the section 245A shareholder's extraordinary disposition account with respect to the SFC is less than 100 percent), the section 245A shareholder's RGI account can be increased by only the same ratable portion of the items of deduction or loss. *See* proposed § 1.245A–8(c)(4)(i)(A)(*2*)(*ii*). These rules ensure that a reduction under the EDA reduction rule to the section 245A shareholder's extraordinary disposition account can occur only by reason of the application of the disqualified basis rule to the portion of disqualified basis of an item of specified property that is attributable to gain to which the extraordinary disposition account is also attributable.

Further, to address the possibility that the section 245A shareholder and any domestic affiliates may not own all of the stock of the CFC holding items of specified property that correspond to an extraordinary disposition account of the section 245A shareholder, a limit applies regarding the extent to which an item of deduction or loss (or portion thereof) may increase the section 245A shareholder's RGI account. *See* proposed § 1.245A–8(c)(4)(i)(A)(*2*). The limit is generally based on the portion of the CFC's subpart F income or tested income taken into account by the section 245A shareholders and any domestic affiliates under section 951 or 951A. *See* proposed § 1.245A–8(c)(4)(i)(A)(*2*)(*i*). This limit ensures that a reduction under the EDA reduction rule to the section 245A shareholder's extraordinary disposition account can occur only to the extent that the application of the disqualified basis rule has likely increased income of the CFC that is subject to U.S. taxation at the level of the section 245A shareholder and any domestic affiliates.

4. Allocating Certain Reductions Among Extraordinary Disposition Accounts

Because a reduction under the EDA reduction rule to an extraordinary disposition account may be a function of certain adjusted earnings of a CFC (that is, an amount that is not with respect to the extraordinary disposition account), absent a special rule in certain complex cases, the adjusted earnings could give rise to a reduction to two or more extraordinary disposition accounts that, in aggregate, exceeds the adjusted earnings. This could occur, for example, in a case in which a section 245A shareholder has two extraordinary disposition accounts (that is, an extraordinary disposition account with respect to two SFCs) and owns all the stock of a CFC, which, in turn, owns the items of specified property that correspond to each of the extraordinary disposition accounts. In that case the aggregate amount of reductions to the extraordinary disposition accounts could exceed the extent to which the application of the disqualified basis rule has, as measured by certain adjusted earnings of the CFC allocated to the section 245A shareholder, reduced the earnings of the CFC available to be distributed to the section 245A shareholder as a dividend to which the section 245A deduction could apply. To address these cases, the proposed regulations provide a rule that limits the aggregate reductions to extraordinary disposition accounts by reason of the application of the EDA reduction rule with respect to a taxable year of a CFC to certain adjusted earnings of the CFC. *See* proposed § 1.245A–8(c)(6). The proposed regulations also provide an example illustrating this rule. *See* proposed § 1.245A–10(c)(3)(iv).

Finally, the proposed regulations provide a rule that prevents an extraordinary disposition account from being reduced below the balance of the basis benefit account that relates to the extraordinary disposition account. *See* proposed § 1.245A–8(c)(7). This limitation may occur if extraordinary disposition E&P (and therefore the initial balance of the extraordinary disposition account) reflect losses recognized with respect to one or more items of specified property transferred in the extraordinary disposition.

5. Certain Items of Property Treated as Items of Specified Property That Correspond to an Extraordinary Disposition Account

In certain complex cases, an item of property may have disqualified basis even though the item itself was not transferred as part of an extraordinary disposition. For example, a share of stock may have disqualified basis if the share was received in exchange for an item of specified property with disqualified basis in a transaction to which section 351 applies. *See* § 1.951A–3(h)(2)(ii)(B)(*2*)(*ii*). Absent special rules, the share of stock would not correspond to an extraordinary disposition account of a section 245A shareholder and thus, for example, the disqualified basis of the share of stock could not be reduced under the DQB reduction rule.

The proposed regulations provide special rules to address this and similar issues. For instance, the proposed regulations provide that certain items of property that have disqualified basis by reason of § 1.951A–3(h)(2)(ii)(B)(*2*)(*i*) (increase corresponding to adjustments in other property), (*ii*) (exchanged basis property), or (*iii*) (increase by reason of section 732(d)) are generally treated as items of specified property that correspond to an extraordinary disposition account of a section 245A shareholder. *See* proposed § 1.245A–8(d). As a result, the disqualified basis of such items of property may be reduced under the DQB reduction rule, and items of deduction and loss attributable to such disqualified basis and allocated and apportioned to residual CFC gross income of a CFC may give rise to a reduction to an extraordinary disposition account under the EDA reduction rule.

The proposed regulations also include an anti-duplication rule to ensure that disqualified basis of an item of specified property, as well as disqualified basis of another item of property attributable to that disqualified basis (''duplicate DQB''), are not both taken into account for purposes of the DQB reduction rule, as taking into account both amounts of disqualified basis could inappropriately limit the reductions under the DQB reduction rule. *See* proposed § 1.245A–8(b)(5)(i)(A). In addition, to the extent that, pursuant to the anti-duplication rule, duplicate DQB is not taken into account for purposes of the DQB reduction, the duplicate DQB is generally reduced to the same extent that the disqualified basis of the item of specified property to which the duplicate DQB is attributable is reduced. *See* proposed §§ 1.245A–8(b)(5)(i)(B) and 1.245A–10(c)(5) (*Example 5*).

As an example of the application of these special rules, consider a case in which a single item of specified property (''Item A'') corresponds to an extraordinary disposition account of a section 245A shareholder, and Item A is transferred, in a transaction to which section 351 applies, in exchange for a share of stock (''Item B''). In addition, assume that the extraordinary disposition account gives rise to a $10x extraordinary disposition amount and that, at that time, Item A has $10x of disqualified basis and Item B also has $10x of disqualified basis (all of which is attributable to the disqualified basis of Item A). Here, Item B is considered an item of specified property that corresponds to the extraordinarily disposition account, but generally only the disqualified basis of Item A is taken into account for purposes of the DQB reduction rule, with the result that the entire $10x reduction under the DQB reduction rule is allocated to Item A (such that Item A's disqualified basis is reduced by $10x). However, pursuant to the special rule of proposed § 1.245A–8(b)(5)(i)(B), Item B's disqualified basis is then reduced by the same amount.

6. Extraordinary Disposition Account Adjusted Pursuant to Successor Rules Under § 1.245A–5(c)(4)

In certain complex cases, an extraordinary disposition account of a section 245A shareholder may be adjusted pursuant to the rules of § 1.245A–5(c)(4), with the result, for example, that another section 245A shareholder succeeds to a portion of the extraordinary disposition account or a portion of the extraordinary disposition account is attributed to another extraordinary disposition account. The proposed regulations provide two sets of special rules to address these cases.

First, in cases in which a portion of an extraordinary disposition account is attributed (the ''attributed account'') to another extraordinary disposition account (the ''successor account''), the proposed regulations ensure that the disqualified bases of the items of specified property that correspond to the attributed account are eligible to be reduced under the DQB reduction rule by reason of an amount in the successor account that gives rise to an extraordinary deposition amount or tiered extraordinary disposition amount, to the extent attributable to the attributed account. *See* proposed § 1.245A–8(e)(1). This rule also ensures that the successor account, to the extent attributable to the attributed account, may be reduced under the EDA reduction rule by reason of an allocation and apportionment of an item of deduction or loss attributable to disqualified basis of an item of specified property that corresponds to the attributed account. *See id.* This rule ensures these results by treating the attributed account and successor account as separate extraordinary disposition accounts for purposes of the proposed regulations. *See id.*

As an example of this rule, consider a case in which US1, a domestic corporation, owns all of the stock of CFC1, a CFC as to which US1 has an extraordinary disposition account with a $40x balance (the ''CFC1 EDA''), and CFC2, a CFC as to which US1 has an extraordinary disposition account with a $60x balance (the ''CFC2 EDA''). If CFC1 were to merge into CFC2 and thus under the rules of § 1.245A–5(c)(4) the $40x balance of the CFC1 EDA were attributed to the CFC2 EDA (such that the balance of the CFC2 EDA would become $100x), then $40x of the $100x balance of the CFC2 EDA would be treated for purposes of the proposed regulations as an extraordinary disposition account with respect to CFC1 (the CFC2 EDA to such extent, the ''deemed CFC1 EDA''), even though CFC1 would no longer be in existence. As a result, after the merger, the deemed CFC1 EDA would, by reason of the application of the EDA reduction rule to a taxable year of CFC2, generally be reduced by the lesser of (i) the adjusted earnings of CFC2, less the balance of (a) the previously taxed earnings and profits accounts with respect to CFC2, (b) the hybrid deduction accounts with respect to shares of stock of the CFC2, (c) the balance of the CFC2 EDA (but not including the portion of the balance of the CFC2 EDA that is treated as the deemed CFC1 EDA), to the extent taken into account as described in proposed § 1.245A–8(c)(1)(i)(B)(*3*), and (d) the balance of the deemed CFC1 EDA, to the extent taken into account as described in proposed § 1.245A–8(c)(1)(i)(B)(*3*); and (ii) the balance of the RGI account (if any) with respect to CFC2 that relates to the deemed CFC1 EDA.

Second, special rules address the extraordinary disposition ownership percentage. As discussed in parts III.A.3.i and III.B.3 of this Explanation of Provisions, the DQB reduction rule and the EDA reduction rule take into account the extraordinary disposition ownership percentage as to a section 245A shareholder's extraordinary disposition account, which generally represents the portion of gain on the extraordinary disposition of an item of specified property that is reflected in the initial balance of the extraordinary disposition account. Special rules ensure, after an extraordinary disposition account is adjusted pursuant to § 1.245A–5(c)(4), the extraordinary disposition ownership percentage continues to accurately reflect the portion of gain that is reflected in the (adjusted) balance of the extraordinary disposition account. *See* proposed § 1.245A–8(e)(1) and (2).

As an example of the application of these special rules regarding the extraordinary disposition ownership percentage, consider a case which the extraordinary disposition ownership percentage as to a section 245A shareholder's extraordinary disposition account with respect to an SFC (''EDA 1'') is 80 percent, and by reason of § 1.245A–5(c)(4)(i) another section 245A shareholder (that did not previously have an extraordinary disposition account with respect to the SFC) succeeds to a portion of EDA 1 equal to 40 percent of the balance of EDA 1 (the portion of EDA 1 to which the other section 245A shareholder succeeds, ''EDA 2''). Here, the extraordinary disposition ownership percentage as to EDA 1 is thereafter 48 percent for purposes of the proposed regulations (80%, less 80% multiplied by 40%), and the extraordinary disposition ownership percentage as to EDA 2 is 32 percent for purposes of the proposed regulations (80% multiplied by 40%). As an additional example, if in the example in the previous sentence the other section 245A shareholder instead had an extraordinary disposition account with respect to the SFC and the extraordinary disposition ownership percentage as to such extraordinary disposition account was 20 percent (''EDA 2''), then, pursuant to proposed § 1.245A–8(e)(1), the extraordinary disposition ownership percentage as to EDA 2 would become 52 percent for purposes of the proposed regulations (20%, plus the product of 80% and 40%).

IV. Other Rules

A. Coordination With Disqualified Payment Rule

The coordination mechanism of the proposed regulations also applies to cases in which a prepayment during the disqualified period gives rise to extraordinary disposition E&P of an SFC under the anti-avoidance rule of § 1.245A–5(h) and items of deduction or loss of a CFC are allocated and apportioned to residual CFC gross income under the disqualified payment rule. *See* proposed § 1.245A–5(j)(8) (*Example 7*). The coordination mechanism generally applies in the same manner as if the disqualified payment had given rise to disqualified basis of an item of specified property that corresponds to the extraordinary disposition account. *See id.*

B. Currency Translation Rules

Accounts created under the proposed regulations are maintained in the functional currency of the items to which they relate. *See* proposed § 1.245A–9(b)(4). Therefore, a basis benefit account is maintained in the same functional currency as the extraordinary disposition account to which it relates. Similarly, an RGI account is maintained in the functional currency of the CFC whose allocations to residual CFC gross income are being measured and tracked by that account.

The application of the DQB reduction rule and the EDA reduction rule may also require currency translation because these rules require amounts determined in the functional currency of one person to be applied to reduce attributes of another person that may have a different functional currency. In this regard, the proposed regulations provide that the disqualified basis of, and a basis benefit amount with respect to, an item of specified property that corresponds to an extraordinary disposition account are translated into the functional currency in which the extraordinary disposition account is maintained, using the spot rate on the date the extraordinary disposition occurred. *See* proposed § 1.245A–9(b)(4). Moreover, proposed § 1.245A–9(b)(4) provides that a reduction in disqualified basis of an item of specified property under the DQB reduction rule is translated into the functional currency in which the disqualified basis of the item of specified property is maintained, and reductions in an extraordinary disposition account are translated into the functional currency in which the extraordinary disposition account is maintained, in each case using the spot rate on the date the associated extraordinary disposition occurred.

C. Anti-Avoidance Rule

Proposed § 1.245A–9(b)(5) contains an anti-avoidance rule providing that appropriate adjustments are made if a transaction or arrangement is engaged in with a principal purpose of avoiding the purposes of these proposed regulations. As an example, the anti-avoidance rule applies if a section 245A shareholder causes its taxable year to end on a particular date with a principal purpose of avoiding a basis benefit amount from being assigned to that taxable year.

D. Existing Election To Eliminate Disqualified Basis

Taxpayers may have elected to reduce an item of specified property's adjusted basis (and thus eliminate the item's disqualified basis) pursuant to § 1.951A–3(h)(2)(ii)(B)(*3*) (a ''basis elimination election'') before the proposed regulations were issued. In certain cases, the proposed regulations once finalized may provide more favorable outcomes for taxpayers than a basis elimination election. Therefore, the proposed regulations permit taxpayers to revoke a basis elimination election during a transition period, which under the proposed regulations is 90 days after the proposed regulations are finalized. *See* proposed § 1.245A–9(c)(1). This transition period is intended to provide a taxpayer sufficient time to consider whether it would prefer a basis elimination election or to apply the rules of the proposed regulations. The proposed regulations set forth the procedures for revoking a basis elimination election. *See* proposed § 1.245A–9(c)(1) and (2). These procedures require a taxpayer to file a revocation statement, as well as amended returns reflecting the revocation of the election. *See id.*

V. Applicability Dates

The proposed regulations are proposed to apply to taxable years of foreign corporations beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register** (the ''finalization date''), and to taxable years of a U.S. person in which or with which such taxable years of foreign corporations end. *See* proposed § 1.245A–11(a). For taxable years beginning before the finalization date, a taxpayer may apply the rules set forth in the final regulations, provided that the taxpayer and all related parties consistently apply the rules to those taxable years. *See* proposed § 1.245A–11(b); *see* also section 7805(b)(7).

VI. Comment Requests

The Treasury Department and the IRS request comments on all aspects of the proposed regulations. In addition, comments are specifically requested on the issues discussed below.

A. The DQB Reduction Rule

The DQB reduction rule applies only if a distribution gives rise to an extraordinary disposition amount or a tiered extraordinary disposition amount. The Treasury Department and the IRS are considering whether the DQB reduction rule should apply by reason of a prior extraordinary disposition amount described in § 1.245A–5(c)(3)(D)(*i*) through (*iv*), such that disqualified basis of an item of specified property would be reduced to the same extent a reduction would occur under the DQB reduction rule were the prior extraordinary disposition amount an extraordinary disposition amount or tiered extraordinary disposition amount. For example, an investment in United States property subject to sections 951(a)(1)(B) and 956(a) and § 1.956–1(a)(2) may give rise to a prior extraordinary disposition amount under § 1.245A–5(c)(3)(i)(D)(*1*)(*iv*). As an additional example, prior dividends that would have been subject to § 1.245A–5(c) but failed to qualify for the section 245A deduction because they did not satisfy the requirement that the recipient domestic corporation be a United States shareholder with respect to the distributing may give rise to a prior extraordinary disposition amount under § 1.245A–5(c)(3)(i)(D)(*1*)(*i*). The Treasury Department and the IRS are studying whether applying the DQB reduction rule would be appropriate with respect to any of these prior extraordinary disposition amounts, including whether it would be necessary to prevent meaningful excess taxation or give rise to undue complexity. The Treasury Department and the IRS welcome comments on the matter.

B. The EDA Reduction Rule

Pursuant to section 952(c)(1)(A), the subpart F income of a CFC for any taxable year cannot exceed the CFC's E&P for the taxable year. In addition, any amount excluded from subpart F income under section 952(c)(1)(A) is recaptured under section 952(c)(2) in future taxable years to the extent the CFC would otherwise have E&P in excess of subpart F income. Although the disqualified basis rule prevents deductions or losses attributable to disqualified basis from reducing subpart F income, tested income, or ECTI, those deductions or losses still reduce E&P and may be used by a CFC to avoid current inclusions of subpart F income under section 952(c)(1)(A). The Treasury Department and the IRS are studying the extent to which the EDA reduction rule (for example, under the RGI account rules) should take into account this benefit derived from disqualified basis, and request comments on the matter.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The Executive Order 13771 designation for any final rule resulting from these proposed regulations will be informed by comments received. The preliminary Executive Order 13771 designation for this proposed rule is regulatory.

The proposed regulations have been designated by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. OIRA has determined that the proposed rulemaking is significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by OMB.

A. Background and Overview of the Proposed Regulations

The Tax Cuts and Jobs Act (''the Act'') enacted section 245A, which generally allows U.S. corporations a 100-percent deduction (the ''section 245A deduction'') for certain dividends received from 10-percent owned foreign corporations (''SFCs''). As a result of this deduction, certain types of foreign-source income earned by foreign corporations may not be subject to U.S. tax at the U.S. shareholder level. Section 245A applies only to dividends paid after December 31, 2017.

The Act also enacted section 951A, which subjects U.S. shareholders of controlled foreign corporations (''CFCs'') to current taxation under section 951A on their global intangible low-taxed income (''GILTI''). Generally, the U.S. shareholder calculates its GILTI by subtracting a routine return on tangible assets from ''tested income,'' which is essentially the income of the U.S. shareholder's CFCs (other than subpart F income, income effectively connected with the conduct of a U.S. trade or business (''ECTI''), and certain other excluded items of income). Section 951A applies for CFC tax years beginning after December 31, 2017, meaning that tested income of a fiscal year CFC is not subject to the GILTI regime until potentially as late as December 1, 2018.

The Act also enacted section 965, which imposed a new tax on the post-1986 earnings and profits of foreign corporations that had gone untaxed under the pre-Act international tax regime, measured as of no later than December 31, 2017. By subjecting post-1986 earnings and profits to a transition tax, section 965 generally ensured for calendar-year CFCs that only earnings first subjected to the anti-base erosion provisions of the Act could qualify for the section 245A deduction.

The difference in the dates for which sections 965 and 951A apply provides the context for the proposed regulations. For a CFC with a calendar taxable year, section 951A first applies on January 1, 2018, immediately after the final measurement date for section 965. However, a fiscal year CFC has a period from January 1, 2018, until the beginning of its first taxable year in 2018 (the ''disqualified period'') in which it could engage in transactions that generate income subject to neither section 965 nor 951A. These transactions could be used to create two types of tax benefits. First, earnings generated from transactions during the disqualified period could support tax-free distributions of cash or other assets to the United States using the section 245A deduction. Second, assets transferred to related CFCs during the disqualified period would have fair market value tax basis in the hands of the transferee, generating future depreciation deductions or other losses against U.S. taxable income such as GILTI. In many cases, these two benefits arise from the same transaction undertaken during the disqualified period because a transfer of low-basis assets can generate earnings eligible for the section 245A deduction for the seller and allow the buyer to take the assets with fair market value basis that generates future depreciation deductions (on assets that otherwise may have had no or low basis in the hands of the seller).

To address the earnings and profits created in these transactions, temporary and proposed regulations were published under section 245A on June 18, 2019 (the ''2019 section 245A regulations'') that limit the ability to obtain the section 245A deduction for certain earnings and profits generated during the disqualified period. The 2019 section 245A regulations are being finalized with certain changes alongside the issuance of the proposed regulations. To address the fair market value basis generated in these transactions, final regulations were published under section 951A (''GILTI final regulations'') on June 21, 2019, that allocate depreciation or amortization deductions resulting from basis generated in certain disqualified period transactions to income not subject to U.S. tax.

The 2019 section 245A regulations, as finalized, contain § 1.245A–5, which generally denies the section 245A deduction for 50 percent of the earnings generated from an SFC's disposition of property to a related party during the disqualified period. This denial applies if (i) the disposition was outside the SFC's ordinary course of business and (ii) the disposition generated earnings that would have been subject to tax under section 951A had the disposition not occurred during the disqualified period (an ''extraordinary disposition''). Section 1.245A–5 establishes an extraordinary disposition account for taxpayers to track the amount of earnings and profits generated from extraordinary dispositions. The section 245A deduction is limited for dividends out of that account.

Section 1.951A–2(c)(5) of the GILTI final regulations focuses on the consequences to the transferee in transactions that were generally extraordinary dispositions. It requires that deductions or losses attributable to the basis of an asset resulting from certain transfers during the disqualified period (''disqualified basis'') be allocated and apportioned to ''residual CFC gross income'' (that is, income other than tested income, subpart F income, or ECTI). As a result, the deductions or losses attributable to disqualified basis cannot reduce the CFC's income subject to U.S. tax. Instead, the deductions and losses reduce the untaxed earnings and profits of the CFC, including those earnings and profits that would otherwise be eligible for a section 245A deduction when distributed to a U.S. shareholder.

The 2019 section 245A regulations requested comments regarding options for coordinating § 1.245A–5 with § 1.951A–2(c)(5). After carefully considering the comments on this topic, the Treasury Department and the IRS are providing the proposed regulations, which coordinate § 1.245A–5 with § 1.951A–2(c)(5).

Generally, the proposed regulations provide relief from either § 1.245A–5 or § 1.951A–2(c)(5) to the extent that the other rule results in U.S. taxation on the same underlying transaction. Thus, to the extent that the section 245A deduction is limited with respect to distributions out of an extraordinary disposition account, a corresponding amount of disqualified basis attributable to the property that generated that extraordinary disposition account through an extraordinary disposition is converted to basis that is not subject to § 1.951A–2(c)(5). The Treasury Department and the IRS project that this situation is likely to be relatively rare in the near future, because of the rule in § 1.245A–5(c)(2)(i) specifying that distributions out of the extraordinary disposition account are made after all other E&P have been distributed. In the reverse scenario, to the extent that § 1.951A–2(c)(5) allocates a CFC's deductions or losses from property acquired during the disqualified period to residual CFC gross income and thereby causes an increase to the CFC's tested income, subpart F income, or ECTI while reducing its untaxed E&P, the extraordinary disposition account of the U.S. shareholder created from the transfer of that property during the disqualified period is reduced by a corresponding amount.

B. Need for the Proposed Regulations

The existence of two separate sets of rules governing the same types of income or transactions suggests that taxpayers would benefit from their coordination, and comments have requested this coordination. The proposed regulations respond to these comments and help to ensure proper functioning of the regulations governing the Act.

C. Economic Analysis of the Proposed Regulations

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations. Under the baseline, §§ 1.245A–5 and 1.951A–2(c)(5) can both apply as a result of the same transaction.

2. Economic Effects

i. Summary

The proposed regulations coordinate the treatment of extraordinary disposition accounts and disqualified basis. An example of how they do so is presented in part I.C.2.ii of this Special Analyses. Both extraordinary disposition accounts and disqualified basis were created during the disqualified period, which ended before the issuance of the proposed regulations; thus, the proposed regulations will not further economic activity. Thus, these provisions will largely not give rise to economic effects.

The Treasury Department and the IRS have, however, identified some circumstances under which the proposed regulations may affect business activity relative to the no-action baseline. In particular, the proposed regulations may affect the extent to which the basis of certain assets transferred during the disqualified period can reduce potentially taxable income. This means that for affected taxpayers who distribute dividends subject to the extraordinary disposition rule and thereby correspondingly reduce disqualified basis under the proposed regulations, the amount of deduction or loss allowed against potentially taxable income is generally higher under the proposed regulations than under the no-action baseline. This outcome leads to a lower effective tax rate for affected taxpayers on future income under the proposed regulations than under the no-action baseline.

The lower tax rate under the proposed regulations may lead to an increase in economic activity for affected taxpayers relative to the no-action baseline. This incentive for additional economic activity, relative to the no-action baseline, will generally persist for as long as the difference in effective tax rates exists (described in part I.C.2.ii of this Special Analyses).[2] The Treasury Department and the IRS project that the fact pattern leading to this situation will likely be relatively rare, however, because it relies on taxpayers distributing income from their extraordinary disposition accounts during the useful life of the asset, which is likely to be uncommon because of the ordering rule that requires that earnings from extraordinary disposition accounts be distributed after all other earnings and profits.

The Treasury Department and the IRS have not undertaken quantitative estimates of this economic effect. Data or models are not readily available to indicate (i) the amounts of potentially disqualified basis (which depends on the volume, value, and basis of assets transferred during the disqualified period; see related discussion in part I.C.2.iii of this Special Analyses) held by taxpayers and the amount of any corresponding extraordinary disposition accounts; (ii) differences in effective tax rates for affected taxpayers (taxpayers that have disqualified basis and a corresponding extraordinary disposition account) between the proposed regulations and the no-action baseline; (iii) the amount and period of the depreciation deductions related to the potentially disqualified basis to which the previous item applies; and (iv) the amount of additional economic activity that might be undertaken by these affected taxpayers as a result of the difference in effective tax rates. The combined effect of these four items gives rise to any potential economic effects of the proposed regulations.

The Treasury Department and the IRS also considered the effect of the regulations on compliance costs relative to the no-action baseline. The compliance costs arising from the proposed regulations stem only from those record-keeping, reporting, and related compliance activities that would not have been undertaken in the absence of the proposed regulations. However, because the final regulations in §§ 1.245A–5 and 1.951A–2(c)(5) already require collection of most of the information and record keeping necessary to implement these coordination rules, the Treasury Department and the IRS project that any additional costs of the proposed regulations, relative to the no-action baseline, will be modest. For example, to the extent that a U.S. taxpayer distributes a taxable dividend from its extraordinary disposition account, that taxpayer will already know the value of that dividend as well as the amount of disqualified basis generated in the transaction that created the extraordinary disposition account, such that any added burden generally lies only in identifying and reducing the corresponding disqualified basis by the amount of the dividend, as well as reporting such amounts to the extent required by the IRS.

Although the Treasury Department and the IRS have not undertaken quantitative estimates of the proposed regulations, it is projected that the proposed regulations could modestly enhance U.S. economic performance relative to the no-action baseline. The treatment of disqualified basis and the reduction in effective tax rates that it engenders for affected taxpayers will enhance economic activity.

The Treasury Department and the IRS solicit comments on the economic effects of the proposed regulations and particularly solicit data, models, or other evidence that could enhance the rigor of the analysis underlying the final regulations.

ii. Example

The potential difference in effective tax rates between the proposed regulations and the no-action baseline can be illustrated by an example.

Suppose CFC A (a wholly-owned foreign subsidiary of a U.S. parent) has $0 E&P and transfers assets worth $100x to CFC B (also a wholly-owned foreign subsidiary of the same U.S. parent) during the disqualified period in a transaction that is an extraordinary disposition, and suppose the transferred assets have basis of $0 immediately before the transfer. CFC A obtains $100x of earnings and profits of which, because of the final regulations under section 245A, only 50 percent qualifies for the section 245A deduction (if distributed to the U.S. parent as a dividend). Also, as a result of the sale of the asset during the disqualified period, CFC B obtains $100x of basis in the asset which, because of § 1.951A–2(c)(5), cannot be used to offset subpart F income, tested income for GILTI purposes, or ECTI as it is amortized or depreciated. Additionally, the amortization or depreciation deductions on this $100x of disqualified basis reduce CFC B's earnings that otherwise may have qualified for the section 245A deduction.

Thus, over the life of the amortization or depreciation of the asset with $100x basis, CFC B could, absent the proposed regulations, have $100x more tested income (potentially taxed at an effective rate of 10.5%, or $10.50x tax) than it would have had if the $100x of amortization or depreciation had been allowed to reduce tested income (assuming that CFC B has at least $100x of gross tested income in that period and neither it nor its U.S parent has any other attributes that can reduce GILTI). The amortization or depreciation deductions would also reduce CFC B's untaxed earnings and profits by $100x, potentially eliminating the ability to distribute $100x tax-free under section 245A.

Suppose that, in the same taxable year as the extraordinary disposition to CFC B, CFC A makes a dividend distribution to the U.S. parent of $100x out of the extraordinary disposition account. The section 245A deduction is limited to 50 percent of the earnings distributed

[2] The potential discrepancy in effective tax rates can exist for a period up to the remaining useful life of a depreciable or amortizable asset with (formerly) disqualified basis starting from the year that an amount is distributed out of an extraordinary disposition account and reduces that disqualified basis.

(under § 1.245A–5) and hence the U.S. parent pays $10.50x of tax (assuming CFC A's earnings and profits are solely attributable to the extraordinary disposition transaction). U.S. parent's extraordinary disposition account with respect to CFC A is reduced by $100x and subsequent income earned by CFC A can be repatriated tax free.

Under the proposed regulations, once CFC A makes that distribution of $100x out of its extraordinary disposition account subject to a $10.50x tax, the $100x of basis that CFC B has in the asset transferred during the disqualified period is no longer disqualified basis and can give rise to amortization or depreciation deductions that offset CFC B's gross tested income, potentially eliminating $10.50x tax on CFC B's tested income. This lowers the effective tax rate on CFC B's future income and may spur additional economic activity.

iii. Profile of Affected Taxpayers

The taxpayers potentially affected by the proposed regulations are direct or indirect U.S. shareholders of at least two related foreign corporations, one that has an extraordinary disposition account and the other that has assets with disqualified basis corresponding to the extraordinary disposition account. This means that the foreign corporation with the extraordinary disposition account has a fiscal year and engaged in a disposition of property (i) during the period between January 1, 2018, and the end of the transferor foreign corporation's last taxable year beginning before January 1, 2018; (ii) outside the ordinary course of the foreign corporation's activities; and (iii) generally, while the corporation was a CFC.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by the proposed regulations because data on the taxpayers that may have engaged in these particular transactions are not readily available. Based on tabulations of the 2014 Statistics of Income Study file, the Treasury Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. However, the number of potentially affected taxpayers is likely substantially smaller than the number of domestic corporations with at least one fiscal year CFC because a domestic corporation will not be affected unless it has a fiscal year CFC that engaged in a non-routine sale with a related party during the disqualified period that created an extraordinary disposition account and disqualified basis under §§ 1.245A–5 and 1.951A–2(c)(5), and the domestic corporation must then incur the type of cost (limitation of the section 245A deduction or allocation of deductions or losses to residual CFC gross income and reduction in untaxed earnings) that causes the proposed regulations to apply.

II. Paperwork Reduction Act

The collections of information in the proposed regulations are in § 1.6038–2(f)(17) and (18).

The collection of information in § 1.6038–2(f)(17) is mandatory for every U.S. shareholder of a CFC that holds an item of property that has disqualified basis within the meaning of § 1.951A–3(h)(2) during an annual accounting period and files Form 5471 for that period (OMB control number 1545–0123). The collection of information in § 1.6038–2(f)(17) is satisfied by providing information about the items of property with disqualified basis held by the CFC during the CFC's accounting period as Form 5471 and its instructions may prescribe. For purposes of the Paperwork Reduction Act, the reporting burden associated with § 1.6038–2(f)(17) will be reflected in the applicable Paperwork Reduction Act submission associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with § 1.6038–2(f)(17) is 7,500–8,500, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471	....	✓	7,500–8,500

The collection of information in § 1.6038–2(f)(18) is mandatory for every U.S. shareholder of a CFC that applies the rules of proposed §§ 1.245A–6 through 1.245A–11 during an annual accounting period and files Form 5471 for that period (OMB control number 1545–0123). The collection of information in § 1.6038–2(f)(18) is satisfied by providing information about the reduction to an extraordinary disposition account made pursuant to proposed § 1.245A–7(b) or § 1.245A–8(b) and reductions to an item of specified property's disqualified basis pursuant to proposed § 1.245A–7(c) or § 1.245A–8(c) during the corporation's accounting period as Form 5471 and its instructions may prescribe. For purposes of the Paperwork Reduction Act, the reporting burden associated with § 1.6038–2(f)(18) will be reflected in the applicable Paperwork Reduction Act submission associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with § 1.6038–2(f)(18) is 7,500–8,500, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471	....	✓	7,500–8,500

The current status of the Paperwork Reduction Act submissions related to the new revised Form 5471 as a result of the information collections in the proposed regulations is provided in the accompanying table. The reporting burdens associated with the information collections in § 1.6038–2(f)(17) and (18) are included in the aggregated burden estimates for OMB control number 1545–0123, which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of $58.148 billion

($2017). The overall burden estimates provided in 1545–0123 are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden of the tax forms that will be revised as a result of the information collections in the proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the temporary regulations. The Treasury Department and the IRS urge readers to recognize that these numbers are duplicates of estimates provided for informational purposes in other proposed and final regulatory actions and to guard against over-counting the burden that international tax provisions imposed before the Act.

No burden estimates specific to the proposed regulations are currently available. The Treasury Department and the IRS have not identified any burden estimates, including those for new information collections, related to the requirements under the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. Proposed revisions to these forms that reflect the information collections contained in these proposed regulations will be made available for public comment at *www.irs.gov/draftforms* and will not be finalized until after approved by OMB under the PRA.

Information collection	Type of filer	OMB No.(s)	Status
Form 5471	Business (new model).	1545–0123	Published in the **Federal Register** on 9/30/19. Public Comment period closed on 11/29/19. Approved by OMB through 1/31/2021.
	https://www.federalregister.gov/documents/2019/09/30/2019-21068/proposed-collection-comment-request-for-forms-1065-1066-1120-1120-c-1120-f-1120-h-1120-nd-1120-s		

III. Regulatory Flexibility Act

It is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). The small entities that are subject to § 1.245A–5 are small entities that are U.S. shareholders of certain foreign corporations that are otherwise eligible for the section 245A deduction on distributions from the foreign corporation. The small entities that are subject to § 1.951A–2(c)(5) are U.S. shareholders of certain foreign corporations that are subject to tax under section 951 with respect to subpart F income of those foreign corporations or section 951A with respect to tested income of those foreign corporations.

The taxpayers potentially affected by these proposed regulations are U.S. shareholders of at least two related foreign corporations, one that has an extraordinary disposition account and the other that has assets with disqualified basis corresponding to the extraordinary disposition account. This means that the foreign corporation with the extraordinary disposition account has or had a fiscal year and engaged in a disposition of property (i) during the period between January 1, 2018, and the end of the transferor foreign corporation's last taxable year beginning before 2018; (ii) outside the ordinary course of the foreign corporation's activities; and (iii) generally, while the corporation was a CFC.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged in these particular transactions are not readily available. Based on tabulations of the 2014 Statistics of Income Study file the Treasury Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. Previous estimates suggest that approximately half of domestic corporations with CFCs have less than $25 million in gross receipts. However, the number of potentially affected taxpayers is smaller than the number of domestic corporations with at least one fiscal year CFC because a domestic corporation will not be affected unless its fiscal year CFC engages in a non-routine sale with a related party that creates an extraordinary disposition account and disqualified basis, and the domestic corporation must then incur the type of cost (limitation of the section 245A deduction or allocation of deductions or losses to residual CFC gross income and reduction in untaxed earnings) that causes these proposed regulations to apply. There are several industries that may be identified as small even through their annual receipts are above $25 million or because they have fewer employees than the SBA Size Standard for that industry. The Treasury Department and the IRS do not have more precise data indicating the number of small entities that will be potentially affected by the regulations. The rule may affect a substantial number of small entities, but data are not readily available to assess how many entities will be affected. Nevertheless, for the reasons described below, the Treasury Department and the IRS have determined that the regulations will not have a significant economic impact on small entities.

The Treasury Department and the IRS have concluded that there is no significant economic impact on such entities as a result of the proposed regulations. To make this determination, the Treasury Department and the IRS calculated the ratio of estimated global intangible lowed-taxed income (''GILTI'') and subpart F income tax attributable to these businesses to aggregate total sales data. Bureau of Economic Analysis data on the activities of multinational enterprises report total sales of all foreign affiliates of U.S. parents of $7,183 billion in 2017 (accessed at this web address in December, 2018: *https://apps.bea.gov/iTable/iTable.cfm?ReqID=2&step=1*). Projections for GILTI and Subpart F tax revenues average $20 billion per year over the ten-year budget window (see Joint Committee on Taxation, Estimated Budget Effects of the Conference Agreement for H.R. 1, The ''Tax Cuts and Jobs Act, JCX–67–17, December 18, 2017), resulting in a less than 1 percent share of GILTI and Subpart F tax in total sales of U.S.—parented affiliates. Compliance costs for these regulations will be a small fraction of the revenue amounts. Thus, any tax regulation that affects the proceeds from GILTI and subpart F income would have an economic impact of less than 3 to 5 percent of ''receipts'' (as that term is defined in 13 CFR 121.104, the provision for calculating small business receipts, to mean sales and any other measure of gross income), an economic impact that the Treasury Department and IRS regard as the threshold for significant under the Regulatory Flexibility Act. This calculated percentage is furthermore an upper bound on the true expected effect of the proposed regulations because not all the GILTI and subpart F income estimated to be attributable to small entities will be affected by the proposed regulations. For example, GILTI and subpart F income that is not attributable to a CFC that holds property with disqualified basis (or property that would otherwise have disqualified basis in the absence of these regulations) is not affected by these proposed regulations. Consequently, the Treasury Department and the IRS have determined that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, these proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses.

Comments and Requests for Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020–4, 2020–17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of the proposed regulations are Logan M. Kincheloe and Shane M. McCarrick, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order for §§ 1.245A–6 through 1.245A–11 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.245A–6 through 1.245A–11 also issued under 26 U.S.C. 245A(g), 882(c)(1)(A), 951A, 954(b)(5), 954(c)(6), and 965(o).

* * * * *

■ **Par. 2.** Section 1.245A–5 is amended by:

■ 1. In the first sentence of paragraph (c)(3)(i)(A), adding immediately after the language ''by the prior extraordinary disposition amount'' the language ''and as provided in § 1.245A–7 or § 1.245A–8.''

■ 2. Revising paragraph (j)(8)(ii).

The revision reads as follows:

§ 1.245A–5 Limitation of section 245A deduction and section 954(c)(6) exception.

* * * * *

(j) * * *

(8) * * *

(ii) *Analysis.* Because the royalty prepayment was carried out with a principal purpose of avoiding the purposes of this section, appropriate adjustments are required to be made under the anti-abuse rule in paragraph (h) of this section. CFC1 is a CFC that has a November 30 taxable year, so under paragraph (c)(3)(iii) of this section, CFC1 has a disqualified period beginning on January 1, 2018, and ending on November 30, 2018. In addition, even though the intangible property licensed by CFC1 to CFC2 is specified property, CFC2's prepayment of the royalty would not be treated as a disposition of the specified property by CFC1 and, therefore, would not constitute an extraordinary disposition (and thus would not give rise to extraordinary disposition E&P), absent the application of the anti-abuse rule of paragraph (h) of this section. Pursuant to paragraph (h) of this section, the earnings and profits of CFC1 generated as a result of the $100x of prepaid royalty are treated as extraordinary disposition E&P for purposes of this section and, therefore, US1 has an extraordinary disposition account with respect to CFC1 of $100x. In addition, the prepaid royalty gives rise to a disqualified payment (as defined in § 1.951A–2(c)(6)(ii)(A)) of $100x. As a result, § 1.245A–7(b) or § 1.245A–8(b), as applicable, applies to reduce the disqualified payment in the same manner as if the disqualified payment were disqualified basis, and § 1.245A–7(c) or § 1.245A–8(c), as applicable, applies to reduce the extraordinary disposition account in the same manner as if the deductions directly or indirectly related to the disqualified payment were deductions attributable to disqualified basis of an item of specified property that corresponds to the extraordinary disposition account.

* * * * *

■ **Par. 3.** Sections 1.245A–6 through 1.245A–11 are added to read as follows:

Sec.

* * * * *

1.245A–6 Coordination of extraordinary disposition and disqualified basis rules.
1.245A–7 Coordination rules for simple cases.
1.245A–8 Coordination rules for complex cases.
1.245A–9 Other rules and definitions.
1.245A–10 Examples.
1.245A–11 Applicability dates.

* * * * *

§ 1.245A–6 Coordination of extraordinary disposition and disqualified basis rules.

(a) *Scope.* This section and §§ 1.245A–7 through 1.245A–11 coordinate the application of the extraordinary disposition rules of § 1.245A–5(c) and (d) and the disqualified basis rule of § 1.951A–2(c)(5). Section 1.245A–7 provides coordination rules for simple cases, and § 1.245A–8 provides coordination rules for complex cases. Section 1.245A–9 provides definitions and other rules, including rules of general applicability for purposes of this section and §§ 1.245A–7 through 1.245A–11. Section 1.245A–10 provides examples illustrating the application of this section and §§ 1.245A–7 through 1.245A–9. Section 1.245A–11 provides applicability dates.

(b) *Conditions to apply coordination rules for simple cases.* For a taxable year of a section 245A shareholder for which the conditions described in paragraphs (b)(1) and (2) of this section are satisfied, the section 245A shareholder may apply the coordination rules of § 1.245A–7 (rules for simple cases) to an extraordinary disposition account of the section 245A shareholder with respect to an SFC and disqualified basis of an item of specified property that corresponds to the extraordinary disposition account (as determined pursuant to § 1.245A–9(b)(1)). If the conditions are not satisfied, then the coordination rules of § 1.245A–8 (rules for complex cases) apply beginning with the first day of the first taxable year of the section 245A shareholder for which the conditions are not satisfied and all taxable years thereafter. If the conditions are satisfied for a taxable year of the section 245A shareholder but the section 245A shareholder chooses not to apply the coordination rules of § 1.245A–7 for that taxable year, then the coordination rules of § 1.245A–8 apply to that taxable year (though, for a subsequent taxable year, the section 245A shareholder may apply the coordination rules of § 1.245A–7, provided that the conditions described in paragraphs (b)(1) and (2) of this section are satisfied for such subsequent taxable year and have been satisfied for all earlier taxable years). For purposes of applying paragraphs (b)(1) and (2) of this section, a reference to a section 245A shareholder, an SFC, or a CFC does not include a successor of the section 245A shareholder, the SFC, or the CFC, respectively.

(1) *Requirements related to the SFC.* The condition of this paragraph (b)(1) is satisfied for a taxable year of the section 245A shareholder if the following requirements are satisfied:

(i) On January 1, 2018, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(ii) On each day of the taxable year of the section 245A shareholder, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(iii) On no day during the taxable year of the section 245A shareholder was the SFC a distributing or controlled corporation in a transaction described in a section 355, or did the SFC acquire the assets of a corporation as to which there is an extraordinary disposition account pursuant to a transaction described in section 381 (that is, taking into account the requirements of this paragraph (b)(1) and paragraph (b)(2) of this section, the section 245A shareholder's extraordinary disposition account with respect to the SFC has not been not been adjusted pursuant to the rules of § 1.245A–5(c)(4)).

(2) *Requirements related to an item of specified property that corresponds to an extraordinary disposition account and a CFC holding the item.* The condition of this paragraph (b)(2) is satisfied for a taxable year of a section 245A shareholder if the following requirements are satisfied:

(i) For each item of specified property with disqualified basis that corresponds to the extraordinary disposition account, the item of specified property is held by a CFC immediately after the extraordinary disposition of the item of specified property.

(ii) For each CFC described in paragraph (b)(2)(i) of this section—

(A) All of the stock (by vote and value) of the CFC is owned (within the meaning of section 958(a)) by the section 245A shareholder and any domestic affiliates of the section 245A shareholder immediately after the extraordinary disposition described in paragraph (b)(2)(i) of this section;

(B) For each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, there is no extraordinary disposition account with respect to the CFC, and the sum of the balance of the hybrid deduction accounts (as described in § 1.245A(e)–1(d)(1)) with respect to shares of stock of the CFC is zero (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year); and

(C) On each day of each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, and on each day of each taxable year of the CFC that begins with or within the taxable year of the section 245A shareholder—

(*1*) The CFC holds the item of specified property described in paragraph (b)(1)(i) of this section;

(*2*) The section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a)) all of the stock (by vote and value) of the CFC;

(*3*) The CFC does not hold any item of specified property with disqualified basis other than an item of specified property that corresponds to the extraordinary disposition account;

(*4*) The CFC does not own an interest in a partnership, trust, or estate (directly or indirectly through one or more other partnerships, trusts, or estates) that holds an item of specified property with disqualified basis; and

(*5*) The CFC is not engaged in the conduct of a trade or business in the United States and therefore does not have ECTI, and the CFC does not have any deficit in earnings and profits subject to § 1.381(c)(2)-1(a)(5).

§ 1.245A–7 Coordination rules for simple cases.

(a) *Scope.* This section applies for a taxable year of a section 245A shareholder for which the conditions of § 1.245A–6(b)(1) and (2) are satisfied and for which the section 245A shareholder chooses to apply this section (in lieu of § 1.245A–8).

(b) *Reduction of disqualified basis by reason of an extraordinary disposition amount or tiered extraordinary disposition amount*—(1) *In general.* If, for a taxable year of a section 245A shareholder, an extraordinary disposition account of the section 245A shareholder gives rise to one or more extraordinary disposition amounts or tiered extraordinary disposition amounts, then, with respect to an item of specified property that corresponds to the extraordinary disposition account, the disqualified basis of the item of specified property is, solely for purposes of § 1.951A–2(c)(5), reduced (but not below zero) by an amount (determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of—

(i) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account.

(2) *Timing rules regarding disqualified basis.* See § 1.245A–9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(c) *Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis*—(1) *In general.* If, for a taxable year of a CFC, the CFC holds one or more items of specified property that correspond to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, then the extraordinary disposition account is reduced (but not below zero) by the lesser of the amounts described in paragraphs (c)(1)(i) and (ii) of this section (each determined in the functional currency of the CFC).

(i) The excess (if any) of the adjusted earnings of the CFC for the taxable year of the CFC, over the sum of the previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year).

(ii) The balance of the section 245A shareholder's RGI account with respect to the CFC (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(ii) of this section for the taxable year).

(2) *Timing of reduction to extraordinary disposition account.* See § 1.245A–9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) *Adjusted earnings.* The term *adjusted earnings* means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC's taxable year (taking into account all distributions during the taxable year), and with the adjustments described in paragraphs (c)(3)(i) through (iii) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that is or was allocated and apportioned to residual CFC gross income of the CFC solely by reason of § 1.951A–2(c)(5)(i).

(ii) The earnings and profits are decreased by the amount by which an RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(ii) of this section for a prior taxable year of the CFC.

(iii) The earnings and profits are determined without regard to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(4) *RGI account.* For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder's RGI account with respect to the CFC:

(i) The balance of the RGI account is increased by the sum of the amounts of deductions and losses of the CFC that, but for § 1.951A–2(c)(5)(i), would have decreased one or more categories of the CFC's positive subpart F income or the CFC's tested income, or increased or given rise to a tested loss or one or more qualified deficits of the CFC.

(ii) The balance of the RGI account is decreased to the extent that, by reason of the application of paragraph (c)(1) of this section with respect to the taxable year of the CFC, there is a reduction to the extraordinary disposition account of the section 245A shareholder.

§ 1.245A–8 Coordination rules for complex cases.

(a) *Scope.* This section applies beginning with the first day of the first taxable year of a section 245A shareholder for which § 1.245A–7 does not apply and for all taxable years thereafter, or for a taxable year of a section 245A shareholder for which the section 245A shareholder chooses not to apply § 1.245A–7.

(b) *Reduction of disqualified basis by reason of an extraordinary disposition amount or tiered extraordinary disposition amount*—(1) *In general.* If, for a taxable year of a section 245A shareholder, an extraordinary disposition account of the section 245A shareholder gives rise to one or more extraordinary disposition amounts or tiered extraordinary disposition amounts, then, with respect to an item of specified property that corresponds to the extraordinary disposition account and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder, solely for purposes of § 1.951A–2(c)(5), the disqualified basis of the item of specified property is reduced (but not below zero) by an amount (determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of—

(i) The excess (if any) of—

(A) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; over

(B) The basis benefit account with respect to the extraordinary disposition account (determined as of the end of the taxable year of the section 245A shareholder, and without regard to the application of paragraph (b)(4)(i)(B) of this section for the taxable year); and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder.

(2) *Timing rules regarding disqualified basis.* See § 1.245A–9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(3) *Ownership requirement with respect to an item of specified property*—(i) *In general.* For a taxable year of a section 245A shareholder, the ownership requirement of this paragraph (b)(3)(i) is satisfied with respect to an item of specified property if, on at least one day that falls within the taxable year, the item of specified property is held by—

(A) The section 245A shareholder;

(B) A person (other than the section 245A shareholder) that, on at least one day that falls within the section 245A shareholder's taxable year, is a related party with respect to the section 245A shareholder (such a person, a *qualified related party* with respect to the section 245A shareholder for the taxable year of the section 245A shareholder); or

(C) A specified entity at least ten percent of the interests of which are, on at least one day that falls within the section 245A shareholder's taxable year, owned directly or indirectly through one or more other specified entities by the section 245A shareholder or a qualified related party.

(ii) *Rules for determining an interest in a specified entity.* For purposes of paragraph (b)(3)(i)(C) of this section, the phrase "*at least 10 percent of the interests*" means—

(A) If the specified entity is a foreign corporation, at least 10 percent of the stock (by vote or value) of the foreign corporation;

(B) If the specified entity is a partnership, at least 10 percent of the interests in the capital or profits of the partnership; or

(C) If the specified entity is not a foreign corporation or a partnership, at least 10 percent of the value of the interests in the specified entity.

(4) *Basis benefit account*—(i) *General rules.* The term *basis benefit account* means, with respect to an extraordinary disposition account of a section 245A shareholder, an account of the section 245A shareholder (the initial balance of which is zero), adjusted pursuant to the rules of paragraphs (b)(4)(i)(A) and (B) of this section on the last day of each taxable year of the section 245A shareholder. The basis benefit account must be maintained in the same functional currency as the extraordinary disposition account.

(A) The balance of the basis benefit account is increased to the extent that a basis benefit amount with respect to an item of specified property that corresponds to the section 245A shareholder's extraordinary disposition account is assigned to the taxable year of the section 245A shareholder. However, if the extraordinary disposition ownership percentage applicable to the section 245A shareholder's extraordinary disposition account is less than 100 percent, then, the basis benefit account is instead increased by the amount equal to the basis benefit amount multiplied by the extraordinary disposition ownership percentage.

(B) The balance of the basis benefit account is decreased to the extent that, for a taxable year that includes the date on which the section 245A shareholder's taxable year ends, disqualified basis of an item of specified property would have been reduced pursuant to paragraph (b)(1) of this section but for an amount in the basis benefit account.

(ii) *Rules for determining a basis benefit amount*—(A) *In general.* The term *basis benefit amount* means, with respect to an item of specified property that has disqualified basis, the portion of disqualified basis that, for a taxable year, is directly (or indirectly through one or more specified entities that are not corporations) taken into account for U.S. tax purposes by a U.S. tax resident, a CFC described in § 1.267A–5(a)(17), or a specified foreign person and—

(*1*) Reduces the amount of the U.S. tax resident's taxable income, one or more categories of the CFC's positive subpart F income, the CFC's tested income, or the specified foreign person's ECTI, as applicable; or

(*2*) Prevents a decrease or offset of the amount of the CFC's tested loss or qualified deficits.

(B) *Rules for determining whether disqualified basis of an item of specified property is taken into account.* For purposes of paragraph (b)(4)(ii)(A) of this section, disqualified basis of an item of specified property is taken into account for U.S. tax purposes without regard to whether the disqualified basis is reduced or eliminated under § 1.951A–3(h)(2)(ii)(B)(*1*).

(C) *Timing rules when disqualified basis gives rise to a deferred or disallowed loss.* To the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is deferred, then the determination of whether the item of deduction or loss gives rise to a basis benefit amount under paragraph (b)(4)(ii)(A) of this section is made when the item of deduction or loss is no longer deferred. In addition, to the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is disallowed under section 267(a)(1), then a basis benefit amount is treated as occurring in the taxable year when and to the extent that gain is reduced pursuant to section 267(d), and provided that the gain is described in paragraph (b)(4)(ii)(A) of this section.

(iii) *Rules for assigning a basis benefit amount to a taxable year of a section 245A shareholder*—(A) *In general.* For purposes of applying paragraph (b)(4)(i)(A) of this section with respect to a section 245A shareholder, a basis benefit amount with respect to an item of specified property is assigned to a taxable year of the section 245A shareholder if—

(*1*) With respect to the item of specified property, the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder; and

(*2*) The basis benefit amount occurs during the taxable year of the section 245A shareholder, or a taxable year of a U.S. tax resident (other than the section 245A shareholder), a CFC described in § 1.267A–5(a)(17), or a specified foreign person, as applicable, that—

(*i*) Ends with or within the taxable year of the section 245A shareholder; or

(*ii*) Begins with or within the taxable year of the section 245A shareholder, but only in a case in which but for this paragraph (b)(4)(iii)(A)(*2*)(*ii*) the basis benefit amount would not be assigned to a taxable year of the section 245A shareholder.

(B) *Anti-duplication rule.* For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Thus, for example, if the entire amount of disqualified basis of an item of specified property gives rise to a basis benefit amount for a particular taxable year of a CFC and is assigned to a taxable year of a section 245A shareholder but, pursuant to § 1.951A–3(h)(2)(ii)(B)(*1*)(*ii*), the disqualified basis is not reduced or eliminated in such taxable year of the CFC (because, for example, the buyer is a CFC that is a related party) and, as a result, the disqualified basis thereafter gives rise to an additional basis benefit amount, then no portion of the additional basis benefit amount is assigned to a taxable year of any section 245A shareholder.

(iv) *Successor rules for basis benefit accounts.* To the extent that an extraordinary disposition account of a section 245A shareholder is adjusted pursuant to § 1.245A–5(c)(4), a basis benefit account with respect to the extraordinary disposition account is adjusted in a similar manner.

(5) *Special rules regarding duplicate DQB of an item of exchanged basis property*—(i) *Adjustments to certain rules in applying paragraph (b)(1) of this section.* For purposes of paragraph (b)(1) of this section for a taxable year of a section 245A shareholder, the following rules apply with respect to duplicate DQB of an item of exchanged basis property:

(A) Duplicate DQB of the item of exchanged basis property with respect to an item of specified property to which the item of exchanged property relates is not taken into account for purposes of paragraph (b)(1) of this section if the disqualified basis of the item of specified property is taken into account for purposes of paragraph (b)(1) of this section. Thus, for example, if for a taxable year of a section 245A shareholder the ownership requirement of paragraph (b)(3) of this section is satisfied with respect to an item of specified property and an item of exchanged basis property that relates to the item of specified property, all of the disqualified basis of which is duplicate DQB with respect to the item of specified property, then only the disqualified basis of the item of specified property is taken into account for purposes of, and is subject to reduction under, paragraph (b)(1) of this section.

(B) If, pursuant to paragraph (b)(5)(i)(A) of this section, duplicate DQB of an item of exchanged basis property with respect to an item of specified property is not taken into account for purposes of paragraph (b)(1) of this section, then, solely for purposes of § 1.951A–2(c)(5), the duplicate DQB of the item of exchanged basis property is reduced (in the same manner as it would be if the disqualified basis were taken into account for purposes of paragraph (b)(1) of this section) by the product of the amounts described in paragraphs (b)(5)(i)(B)(*1*) and (*2*) of this section.

(*1*) The reduction, under paragraph (b)(1) of this section for the taxable year of the section 245A shareholder, to the disqualified basis of the item of specified property to which the item of exchanged basis property relates.

(*2*) A fraction, the numerator of which is the duplicate DQB of the item of exchanged basis property with respect to the item of specified property, and the denominator of which is the sum of the amounts of duplicate DQB with respect to the item of specified property of each item of exchanged basis property that relates to the item of specified property and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder. For purposes of determining this fraction, duplicate DQB of an item of exchanged basis property is determined pursuant to the rules of paragraph (b)(2)(i) of this section (by replacing the term ''paragraph (b)(1)'' in that paragraph with the term ''paragraph (b)(5)(i)(B)''). In addition, duplicate DQB of an item of exchanged basis property is excluded from the denominator of the fraction to the extent the duplicate DQB is attributable to duplicate DQB of another item of exchanged basis property that is included in the denominator of the fraction.

(ii) *Adjustments to certain rules in applying paragraph (b)(4) of this section.* For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter duplicate DQB attributable to such disqualified basis of the item of specified property gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Similarly, for purposes of paragraph (b)(4)(i)(A) of this section, to the extent that duplicate DQB attributable to disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis of the item of specified property (or duplicate DQB attributable to such disqualified basis of the item of specified property) gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder.

(c) *Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis*—(1) *In general.* For a taxable year of a CFC, if there is an RGI account with respect to the CFC that relates to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, and the section 245A shareholder satisfies the ownership requirement of paragraph (c)(5) of this section for the taxable year of the CFC, then, subject to the limitations in paragraphs (c)(6) and (7) of this section, the extraordinary disposition account is reduced (but not below zero) by the lesser of the following amounts (each determined in the functional currency of the CFC)—

(i) The excess (if any) of—

(A) The product of—

(*1*) The adjusted earnings of the CFC for the taxable year of the CFC; and

(*2*) The percentage of stock of the CFC (by value) that, in aggregate, is owned directly or indirectly through one or more specified entities by the section 245A shareholder and any domestic affiliates on the last day of the taxable year of the CFC; over

(B) The sum of—

(*1*) The sum of the balance of the section 245A shareholder's and any domestic affiliates' previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year);

(*2*) The sum of the balance of the hybrid deduction accounts (as described in § 1.245A(e)–1(d)(1)) with respect to shares of stock of the CFC that the section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a), and determined by treating a domestic partnership as foreign) as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year; and

(*3*) The sum of the balance of the section 245A shareholder's and any domestic affiliates' extraordinary disposition accounts with respect to the CFC (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year). However, if the section 245A shareholder or a domestic affiliate has an RGI account with respect to the CFC that relates to an extraordinary disposition account with respect to the CFC, then only the excess, if any, of the balance of the extraordinary disposition account over the balance of the RGI account that relates to the extraordinary disposition account (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year) is taken into account for purposes of this paragraph (c)(1)(i)(B)(*3*). In addition, for purposes of this paragraph (c)(1)(i)(B)(*3*), an extraordinary disposition account that but for paragraph (e)(1) of this section would be with respect to the CFC for purposes of this section is treated as an extraordinary disposition account with respect to the CFC and thus is taken into account for purposes of this paragraph (c)(1)(i)(B)(*3*).

(ii) The balance of the RGI account with respect to the CFC that relates to the section 245A shareholder's extraordinary disposition account with respect to the SFC (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year).

(2) *Timing of reduction to extraordinary disposition account.* See § 1.245A–9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) *Adjusted earnings.* The term *adjusted earnings* means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC's taxable year (taking into account all distributions during the taxable year, and not taking into account any deficit in earnings and profits subject to § 1.381(c)(2)–1(a)(5)) and with the adjustments described in paragraphs (c)(3)(i) through (iv) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that—

(A) Is or was attributable to disqualified basis of an item of specified property, but only to the extent that gain recognized on the extraordinary disposition of the item of specified property was included in the initial balance of an extraordinary disposition account;

(B) Is or was allocated and apportioned to residual CFC gross income of the CFC (or a predecessor) solely by reason of § 1.951A–2(c)(5)(i); and

(C) Does not or has not given rise to or increased a deficit in earnings and profits subject to § 1.381(c)(2)–1(a)(5), determined as of the end of the taxable year of the CFC.

(ii) The earnings and profits are decreased by the amount by which any RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(i)(B) of this section for a prior taxable year of the CFC.

(iii) The earnings and profits are determined without regard to earnings attributable to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(iv) The earnings and profits are decreased by the amount of any deduction or loss that, but for paragraph (c)(3)(i)(C) of this section, would be described in paragraph (c)(3)(i) of this section.

(4) *RGI account*—(i) *In general.* For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder's RGI account that is with respect to the CFC and that relates to an extraordinary disposition account of the section 245A shareholder with respect to an SFC:

(A) The balance of the RGI account is increased by the product of the amounts described in paragraphs (c)(4)(i)(A)(*1*) and (*2*) of this section for a taxable year of the CFC.

(*1*) The sum of the amounts of deductions and losses of the CFC that—

(*i*) Are attributable to disqualified basis of one or more items of specified property that correspond to the extraordinary disposition account; and

(*ii*) But for § 1.951A–2(c)(5)(i), would have decreased one or more categories of the CFC's positive subpart F income, the CFC's tested income, or the CFC's ECTI, or increased or given rise to a tested loss or one or more qualified deficits of the CFC.

(*2*) The lesser of—

(*i*) A fraction (expressed as a percentage), the numerator of which is the sum of the portions of the CFC's subpart F income and tested income or tested loss (expressed as a positive number) taken into account under sections 951(a)(1)(A) and 951A(a) (as determined under the rules of §§ 1.951–1(b) and (e) and 1.951A–1(d)) by the section 245A shareholder and any domestic affiliates of the section 245A shareholder and the section 245A shareholder's and any domestic affiliates' pro rata shares of the CFC's qualified deficits (expressed as a positive number), and the denominator of which is the sum of the CFC's subpart F income, tested income or tested loss (expressed as a positive number), and qualified deficits (expressed as a positive number), but for purposes of this paragraph (c)(4)(i)(A)(*2*)(*i*) treating ECTI (expressed as a positive number) as if it were subpart F income; and

(*ii*) The extraordinary disposition ownership percentage applicable as to the section 245A shareholder's extraordinary disposition account.

(B) The balance of the RGI account is decreased to the extent that, by reason of the application of paragraph (c)(1) of this section with respect to the taxable year of the CFC, there is a reduction to the extraordinary disposition account of the section 245A shareholder.

(ii) *Successor rules for RGI accounts.* To the extent that an extraordinary disposition account of a section 245A shareholder is adjusted pursuant to § 1.245A–5(c)(4), an RGI account of a CFC with respect to the extraordinary disposition account is adjusted in a similar manner.

(5) *Ownership requirement with respect to a CFC.* For a taxable year of a CFC, a section 245A shareholder satisfies the ownership requirement of this paragraph (c)(5) if, on the last day of the CFC's taxable year, the section 245A shareholder or a domestic affiliate is a United States shareholder with respect to the CFC.

(6) *Allocation of reductions among multiple extraordinary disposition accounts.* This paragraph (c)(6) applies if, by reason of the application of paragraph (c)(1) of this section with respect to a taxable year of a CFC (and but for the application of this paragraph (c)(6) and paragraph (c)(7) of this section), the sum of the reductions under paragraph (c)(1) of this section to two or more extraordinary disposition accounts of a section 245A shareholder or a domestic affiliate of the section 245A shareholder would exceed the amount described in paragraph (c)(1)(i)(A) of this section (the amount of such excess, the *excess amount*). When this paragraph (c)(6) applies, the reduction to each extraordinary disposition account described in the previous sentence is equal to the reduction that would occur but for this paragraph (c)(6) and paragraph (c)(7) of this section, less the product of the excess amount and a fraction, the numerator of which is the balance of the extraordinary disposition account, and the denominator of which is the sum of the balances of all of the extraordinary dispositions accounts described in the previous sentence. For purposes of determining this fraction, the balance of an extraordinary disposition account is determined as of the end of the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, that includes the date on which the CFC's taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, and adjustments to the extraordinary disposition account for prior extraordinary disposition amounts).

(7) *Extraordinary disposition account not reduced below balance of basis benefit account.* An extraordinary disposition account of a section 245A shareholder cannot be reduced pursuant to paragraph (c)(1) of this section below the balance of the basis benefit account with respect to the extraordinary disposition account (determined when a reduction to the extraordinary disposition account would occur under paragraph (c)(1) of this section).

(d) *Special rules for determining when specified property corresponds to an extraordinary disposition account*—(1) *Substituted property*—(i) *Treatment as specified property that corresponds to an extraordinary disposition account.* For purposes of this section, an item of substituted property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of substituted property relates, as described in paragraph (d)(1)(ii) of this section) corresponds. In addition, in a case in which an item of substituted property relates to an item of specified property that corresponds to a particular extraordinary disposition account and an item of specified property that corresponds to another extraordinary disposition account (such that, pursuant to this paragraph (d)(1)(i), the item of substituted property is treated as corresponding to multiple extraordinary disposition accounts), only the disqualified basis of the item of substituted property attributable to the first item of specified property is taken into account for purposes of applying this section as to the first extraordinary disposition account, and, similarly, only the disqualified basis of the item of substituted property attributable to the second item of specified property is taken into account for purposes of applying this section as to the second extraordinary disposition account.

(ii) *Definition of substituted property.* The term *substituted property* means an item of property the disqualified basis of which is, pursuant to § 1.951A–3(h)(2)(ii)(B)(*2*)(*i*) or (*iii*), increased by reason of a reduction under § 1.951A–3(h)(2)(ii)(*B*)(*1*) in disqualified basis of an item of specified property. An item of substituted property relates to an item of specified property if the disqualified basis of the item of substituted property was increased by reason of a reduction in disqualified basis of the item of specified property.

(2) *Exchanged basis property*—(i) *Treatment as specified property that corresponds to an extraordinary disposition account for certain purposes.* For purposes of this section, an item of exchanged basis property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of exchanged basis property relates) corresponds.

(ii) *Definition of exchanged basis property.* The term *exchanged basis property* means an item of property the disqualified basis of which, pursuant to § 1.951A–3(h)(2)(ii)(B)(*2*)(*ii*), includes disqualified basis of an item of specified property. An item of exchanged basis property relates to an item of specified property if the disqualified basis of the item of exchanged basis property includes disqualified basis of the item of specified property.

(iii) *Definition of duplicate DQB*—(A) *In general.* The term *duplicate DQB* means, with respect to an item of exchanged basis property and the item of specified property to which the exchanged basis property relates, the disqualified basis of the item of exchanged basis property that includes or is attributable to disqualified basis of the item of specified property.

(B) *Certain nonrecognition transfers involving stock or a partnership interest.* To the extent that an item of exchanged basis property that is stock or an interest in a partnership (*lower-tier item*) includes disqualified basis of an item of specified property to which the lower-tier item relates (*contributed item*), and another item of exchanged basis property that is stock or a partnership interest (*upper-tier item*) includes disqualified basis of the lower-tier item that is attributable to disqualified basis of the contributed item, the disqualified basis of the upper-tier item is attributable to disqualified basis of the contributed item and the upper-tier item is an item of exchanged basis property that relates to the contributed item. The principles of the preceding sentence apply each time disqualified basis of an item of exchanged basis property that is stock or an interest in a partnership is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.

(C) *Multiple nonrecognition transfers of an item of specified property.* To the extent that multiple items of exchanged basis property that are stock or interests in a partnership include disqualified basis of the same item of specified property (*contributed item*) to which the items of exchanged basis property relate, and the issuer of one of the items of exchanged basis property (*upper-tier successor item*) receives the other item of exchanged basis property (*lower-tier successor item*) in exchange for the contributed property, the disqualified basis of the upper-tier successor item is attributable to disqualified basis of the lower-tier successor item and the upper-tier successor item is an item of exchanged basis property that relates to the lower-tier successor item. The principles of the preceding sentence apply each time disqualified basis of an item of specified property to which an item of exchanged basis property that is stock or an interest in partnership relates is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.

(e) *Special rules when extraordinary disposition accounts are adjusted pursuant to § 1.245A–5(c)(4)*—(1) *Extraordinary disposition account with respect to multiple SFCs.* This paragraph (e)(1) applies if, pursuant to § 1.245A–5(c)(4)(ii) or (iii) (the transaction or transactions by reason of which § 1.245A–5(c)(4)(ii) or (iii) applies, the *adjustment transaction*), an extraordinary disposition account of a section 245A shareholder with respect to an SFC (such extraordinary disposition account, the *transferor ED account;* and such SFC, the *transferor SFC*) gives rise to an increase in the balance of an extraordinary disposition account with respect to another SFC (such extraordinary disposition account, the *transferee ED account;* such SFC, the *transferee SFC;* and such increase, the *adjustment amount*). When this paragraph (e)(1) applies, the following rules apply for purposes of this section:

(i) A ratable portion of the transferee ED account is treated as retaining its status as an extraordinary disposition account with respect to the transferor SFC and is not treated as an extraordinary disposition account with respect to the transferee SFC (the transferee ED account to such extent, the *deemed transferor ED account*), based on the adjustment amount relative to the balance of the transferee ED account (without regard to this paragraph (e)(1)) immediately after the adjustment transaction. Thus, for example, whether or not the transferor SFC is in existence immediately after the transaction, the items of specified property that correspond to the deemed transferor ED account are the same as the items of specified property that correspond to the transferor ED account. As an additional example, whether or not the transferor SFC is in existence immediately after the transaction the extraordinary disposition ownership percentage with respect to the deemed transferor ED account is the same as the extraordinary disposition ownership percentage with respect to the transferor ED account (except to the extent the extraordinary disposition ownership percentage is adjusted pursuant to the rules of paragraph (e)(2) of this section).

(ii) In the case of an amount (such as an extraordinary disposition amount or tiered extraordinary disposition amount) determined by reference to the transferee ED account (without regard to this paragraph (e)(1)), the portion of the amount that is considered attributable to the deemed transferor ED account (and not the transferee ED account) is equal to the product of such amount and a fraction, the numerator of which is the balance of the deemed transferor ED account, and the denominator of which is the balance of the transferee ED account (determined without regard to this paragraph (e)(1)). Thus, for example, if after an adjustment transaction the transferee ED account (without regard to this paragraph (e)(1)) gives rise to an extraordinary disposition amount, and if the fraction (expressed as a percentage) is 40, then, for purposes of this section, 40 percent of the extraordinary disposition amount is treated as attributable to the deemed transferor ED account and the remaining 60 percent of the extraordinary disposition amount is attributable to the transferee ED account, and the balance of each of the deemed transferor ED account and the transferee ED account is correspondingly reduced.

(2) *Extraordinary disposition accounts with respect to a single SFC.* If an extraordinary disposition account of a section 245A shareholder with respect to an SFC is reduced by reason of § 1.245A–5(c)(4), then, except as provided in paragraph (e)(1) of this section, for purposes of this section, the extraordinary disposition ownership percentage as to the extraordinary disposition account (as well as the extraordinary disposition ownership percentage as to any extraordinary disposition account with respect to the SFC that is increased by reason of the reduction) is adjusted in a similar manner.

§ 1.245A–9 Other rules and definitions.

(a) *In general.* This section provides rules of general applicability for purposes of §§ 1.245A–6 through 1.245A–10, a transition rule to revoke an election to eliminate disqualified basis, and definitions.

(b) *Rules of general applicability*—(1) *Correspondence.* An item of specified property corresponds to a section 245A shareholder's extraordinary disposition account if gain was recognized on the extraordinary disposition of the item and the gain was taken into account in determining the initial balance of the account. See § 1.245A–8(d) for additional rules regarding when an item of property is treated as corresponding to an extraordinary disposition account in certain complex cases.

(2) *Timing rules related to disqualified basis for purposes of applying §§ 1.245A–7(b) and 1.245A–8(b)*—(i) *Determination of disqualified basis.* For purposes of determining the fraction described in § 1.245A–7(b)(1)(ii) or § 1.245A–8(b)(1)(ii) when applying § 1.245A–7(b)(1) or § 1.245A–8(b)(1)(ii), respectively, for a taxable year of a section 245A shareholder, disqualified basis of an item of specified property is determined as of the beginning of the taxable year of the CFC that holds the item of specified property (in a case in which § 1.245A–7(b) applies) or the specified property owner (in a case in which § 1.245A–8(b) applies), in either case, that includes the date on which the section 245A shareholder's taxable year ends (and without regard to any reductions to the disqualified basis of

the item of specified property pursuant to § 1.245A–7(b)(1) or § 1.245A–8(b)(1) for such taxable year of the CFC or the specified property owner, as applicable). However, if disqualified basis of the item of specified property arose as a result of an extraordinary disposition that occurred after the beginning of the taxable year of the CFC or the specified property owner described in the preceding sentence, then the disqualified basis of the item of specified property is determined as of the date on which the extraordinary disposition occurred (and without regard to any reductions to the disqualified basis of the item of specified property pursuant to paragraph (b)(1) of this section for such taxable year of the CFC or the specified property owner).

(ii) *Reduction to disqualified basis of an item of specified property.* The reduction to disqualified basis of an item of specified property pursuant to § 1.245A–7(b)(1) or § 1.245A–8(b)(1) occurs on the date described in paragraph (b)(2)(i) of this section.

(iii) *Definition of specified property owner.* For purposes of applying § 1.245A–8(b)(1) and paragraphs (b)(2)(i) and (ii) of this section for a taxable year of a section 245A shareholder, the term *specified property owner* means, with respect to an item of specified property, the person that, on at least one day of the taxable year of the person that includes the date on which the section 245A shareholder's taxable year ends, held the item of specified property. However, if, but for this sentence, there would be more than one specified property owner with respect to the item of specified property, then the specified property owner is the person that held the item of specified property on the earliest date that falls within the section 245A shareholder's taxable year.

(3) *Timing rules for reducing an extraordinary disposition account under §§ 1.245A–7(c) and 1.245A–8(c).* For purposes of § 1.245A–7(c)(1) or § 1.245A–8(c)(1), as applicable, with respect to a taxable year of a CFC, the reduction to an extraordinary disposition account pursuant to § 1.245A–7(c)(1) or § 1.245A–8(c)(1) occurs as of the end of the taxable year of the section 245A shareholder that includes the date on which the CFC's taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary amounts, adjustments to the extraordinary disposition account for prior extraordinary disposition amounts, and the application of § 1.245A–7(b) or § 1.245A–8(b), as applicable, each for the taxable year of the section 245A shareholder).

(4) *Currency translation.* For purposes of applying §§ 1.245A–7(b) and 1.245A–8(b), the disqualified basis of (and, if applicable, a basis benefit amount with respect to) an item of specified property that corresponds to an extraordinary disposition account are translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, using the spot rate on the date the extraordinary disposition occurred. A reduction in disqualified basis of an item of specified property determined under § 1.245A–7(b)(1) or § 1.245A–8(b)(1) is translated (if necessary) into the functional currency in which the disqualified basis of the item of specified property is maintained, and a reduction in an extraordinary disposition account determined under § 1.245A–7(c) or § 1.245A–8(c) section is translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, in each case using the spot rate described in the preceding sentence.

(5) *Anti-avoidance rule.* Appropriate adjustments are made pursuant to this paragraph (b)(5), including adjustments that would disregard a transaction or arrangement in whole or in part, to any amounts determined under (or subject to application of) this section if a transaction or arrangement is engaged in with a principal purpose of avoiding the purposes of §§ 1.245A–6 through 1.245A–10.

(c) *Transition rule to revoke election to eliminate disqualified basis*—(1) *In general.* This paragraph (c)(1) applies to an election that is filed, pursuant to § 1.951A–3(h)(2)(ii)(B)(*3*), to eliminate the disqualified basis of an item of specified property. An election to which this paragraph (c)(1) applies may be revoked if, on or before [date 90 days after a Treasury decision adopting these rules as final regulations is published in the **Federal Register**]—

(i) All controlling domestic shareholders (as defined in § 1.964–1(c)(5)) of the CFC (or, in the case of an election made by a partnership, the partnership) each attach a revocation statement (in the manner described in paragraph (c)(2) of this section) to an amended return, for the taxable year to which the election applies, that revokes the election (or, in the case of a partnership subject to subchapter C of chapter 63 of the Internal Revenue Code, requests administrative adjustment under section 6227); and

(ii) The controlling domestic shareholders (or the partnership) each file an amended tax return, for any other taxable years reflecting the election to eliminate the disqualified basis, that reflects the election having been revoked (or, in the case of a partnership subject to subchapter C of chapter 63, requests administrative adjustment under section 6227).

(2) *Revocation statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, a revocation statement attached by a person to an amended tax return must include the person's name, taxpayer identification number, and a statement that the revocation statement is filed pursuant to paragraph (c)(1) of this section to revoke an election pursuant to § 1.951A–3(h)(2)(ii)(B)(*3*). In addition, the revocation statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(d) *Definitions.* In addition to the definitions in § 1.245A–5, the following definitions apply for purposes of §§ 1.245A–6 through 1.245A–11.

(1) The term *adjusted earnings* has the meaning provided in § 1.245A–7(c)(3) or § 1.245A–8(c)(3), as applicable.

(2) The term *basis benefit account* has the meaning provided in § 1.245A–8(b)(4)(i).

(3) The term *basis benefit amount* has the meaning provided in § 1.245A–8(b)(4)(ii).

(4) The term *disqualified basis* has the meaning provided in § 1.951A–3(h)(2)(ii).

(5) The term *domestic affiliate* means, with respect to a section 245A shareholder, a domestic corporation that is a related party with respect to the section 245A shareholder. *See also* § 1.245A–5(i)(19) (defining related party).

(6) The term *duplicate DQB* has the meaning provided in § 1.245A–8(d)(2)(iii).

(7) The term *ECTI* means, with respect to a taxable year of a specified foreign person, the taxable income (or loss) of the specified foreign person determined by taking into account only items of income and gain that are, or are treated as, effectively connected with the conduct of a trade or business in the United States (as described in § 1.882–4(a)(1)) and are not exempt from U.S. tax pursuant to a treaty obligation of the United States, and items of deduction and loss that are allocated and apportioned to such items of income and gain.

(8) The term *exchanged basis property* has the meaning provided in § 1.245A–8(d)(2)(ii).

(9) The term *qualified deficit* has the meaning provided in section 952(c)(1)(B)(ii).

(10) The term *qualified related party* has the meaning provided in § 1.245A–8(b)(3)(ii).

(11) The term *RGI account* means, with respect to a CFC and an extraordinary disposition account of a section 245A shareholder with respect to an SFC, an account of the section 245A shareholder with respect to an SFC (the initial balance of which is zero), adjusted at the end of each taxable year of the CFC pursuant to the rules of § 1.245A–7(c)(4) or § 1.245A–8(c)(4), as applicable. The RGI account must be maintained in the functional currency of the CFC.

(12) The term *specified foreign person* means a nonresident alien individual (as defined in section 7701(b) and the regulations under section 7701(b)) or a foreign corporation (including a CFC) that conducts, or is treated as conducting, a trade or business in the United States (as described in § 1.882–4(a)(1)).

(13) The term *specified property owner* has the meaning provided in § 1.245A–8(b)(2)(iii).

(14) The term *subpart F income* has the meaning provided in section 952(a).

(15) The term *substituted property* has the meaning provided in § 1.245A–8(d)(1)(ii).

(16) The term *tested income* has the meaning provided in section 951A(c)(2)(A).

(17) The term *tested loss* has the meaning provided in section 951A(c)(2)(B).

§ 1.245A–10 Examples.

(a) *Scope.* This section provides examples illustrating the application of §§ 1.245A–6 through 1.245A–9.

(b) *Presumed facts.* For purposes of the examples in the section, except as otherwise stated, the following facts are presumed:

(1) US1 and US2 are both domestic corporations that have calendar taxable years.

(2) CFC1, CFC2, CFC3, and CFC4 are all SFCs and CFCs that have taxable years ending November 30.

(3) Each entity uses the U.S. dollar as its functional currency.

(4) There are no items of deduction or loss attributable to an item of specified property.

(5) Absent the application of § 1.245A–5, any dividends received by US1 from CFC1 would meet the requirements to qualify for the section 245A deduction.

(6) All dispositions of items of specified property by an SFC during a disqualified period of the SFC to a related party give rise to an extraordinary disposition.

(7) None of the CFCs have a deficit subject to § 1.381(c)(2)–1(a)(5), and none of the CFCs are engaged in the conduct of a trade or business in the United States (and therefore none of the CFCs have ECTI).

(8) There is no previously taxed earnings and profits account with respect to any CFC for purposes of section 959. In addition, each hybrid deduction account with respect to a share of stock of a CFC has a zero balance at all times. Further, there is no extraordinary disposition account with respect to any CFC.

(9) Under § 1.245A–11(b), taxpayers choose to apply §§ 1.245A–6 through 1.245A–11 to the relevant taxable years.

(c) *Examples*—(1) *Example 1. Reduction of disqualified basis under rule for simple cases by reason of dividend paid out of extraordinary disposition account*—(i) *Facts.* US1 owns 100% of the single class of stock of CFC1 and CFC2. On November 30, 2018, in a transaction that is an extraordinary disposition, CFC1 sells two items of specified property, Item 1 and Item 2, to CFC2 in exchange for $150x of cash (the ''Disqualified Transfer''). Item 1 is sold for $90x and Item 2 is sold for $60x. Item 1 and Item 2 each has a basis of $0 in the hands of CFC1 immediately before the Disqualified Transfer, and therefore CFC1 recognizes $150x of gain as a result of the Disqualified Transfer ($150x − $0). After the Disqualified Transfer, CFC2's only assets are Item 1 and Item 2. On November 30, 2018, and thus during US1's taxable year ending December 31, 2018, CFC1 distributes $150x of cash to US1, and all of the distribution is characterized as a dividend under section 301(c)(1) and treated as a distribution out of earnings and profits described in section 959(c)(3). For CFC1's taxable year ending on November 30, 2018, CFC1 has $160x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year. CFC2 continues to hold Item 1 and Item 2. Lastly, because the conditions of § 1.245A–6(b)(1) and (2) are satisfied for US1's 2018 taxable year, US1 chooses to apply § 1.245A–7 (rules for simple cases) in lieu of § 1.245A–8 (rules for complex cases) for that taxable year.

(ii) *Analysis*—(A) *Application of §§ 1.245A–5 and 1.951A–2 as a result of the Disqualified Transfer.* As a result of the Disqualified Transfer, under § 1.951A–2(c)(5), Item 1 has disqualified basis of $90x, and Item 2 has disqualified basis of $60x. In addition, as a result of the Disqualified Transfer, under § 1.245A–5(c)(3)(i)(A), US1 has an extraordinary disposition account with respect to CFC1 with an initial balance of $150x. Under § 1.245A–5(c)(2)(i), $10x of the dividend is considered paid out of non-extraordinary disposition E&P of CFC1 with respect to US1, and $140x of the dividend is considered paid out of US1's extraordinary disposition account with respect to CFC1 to the extent of the balance of the extraordinary disposition account ($150x). Thus, the dividend of $150x is an extraordinary disposition amount, within the meaning of § 1.245A–5(c)(1), to the extent of $140x. As a result, the balance of the extraordinary disposition account is reduced to $10x ($150x − $140x).

(B) *Correspondence requirement.* Under § 1.245A–9(b)(1), each of Item 1 and Item 2 corresponds to US1's extraordinary disposition account with respect to CFC1, because as a result of the Disqualified Transfer CFC1 recognized gain with respect to Item 1 and Item 2, and the gain was taken into account in determining the initial balance of US1's extraordinary disposition account with respect to CFC1.

(C) *Reduction of disqualified basis of Item 1.* Because Item 1 corresponds to US1's extraordinary disposition account, the disqualified basis of Item 1 is reduced pursuant to § 1.245A–7(b)(1) by reason of US1's $140x extraordinary disposition amount for US1's 2018 taxable year. Paragraphs (c)(2)(ii)(C)(*1*) through (*3*) of this section describe the determinations pursuant to § 1.245A–7(b)(1).

(*1*) To determine the reduction to the disqualified basis of Item 1, the disqualified basis of Item 1, as well as the disqualified basis of Item 2, must be determined as of the date described in § 1.245A–9(b)(2)(i) (and before the application of § 1.245A–7(b)(1)). *See* § 1.245A–7(b)(1)(ii). For each of Item 1 and Item 2, that date is December 1, 2018. December 1, 2018, is the first day of the taxable year of CFC2 (the CFC that holds Item 1 and Item 2) beginning on December 1, 2018, which is the taxable year of CFC2 that includes December 31, 2018, the date on which US1's 2018 taxable year ends. *See* § 1.245A–9(b)(2)(i).

(*2*) Pursuant to § 1.245A–7(b)(1), the disqualified basis of Item 1 is reduced by $84x, computed as the product of—

(*i*) $140x, the extraordinary disposition amount; and

(*ii*) A fraction, the numerator of which is $90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of § 1.245A–7(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of § 1.245A–7(b)(1)). *See* § 1.245A–7(b)(1).

(*3*) The $84x reduction to the disqualified basis of Item 1 occurs on December 1, 2018, the date on which the disqualified basis of Item 1 is determined for purposes of determining the reduction pursuant to § 1.245A–7(b)(1). *See* § 1.245A–9(b)(2)(ii).

(D) *Reduction of disqualified basis of Item 2.* For reasons similar to those described in paragraph (c)(2)(ii)(C) of this section, on December 1, 2018, the disqualified basis of Item 2 is reduced by $56x, the amount equal to the product of $140x, the extraordinary disposition amount, and a fraction, the numerator of which is $60x (the disqualified basis of Item 2 on December 1, 2018, and before the application of § 1.245A–7(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of § 1.245A–7(b)(1)).

(2) *Example 2. Basis benefit amount and impact on reduction to disqualified basis*

under rule for complex cases—(i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that, on December 1, 2018, CFC2 sells Item 1 for $90x of cash to an individual that is not a related party with respect to US1 or CFC2 (such transaction, the ''Sale,'' and such individual, ''Individual A''). At the time of the Sale, CFC2's basis in Item 1 is $90x (all of which is disqualified basis, as described in § 1.951A–3(h)(2)(ii)(A)). CFC2 takes into the account the disqualified basis of Item 1 for purposes of determining the amount of gain recognized on the Sale, which is $0 ($90x − $90x); but for the disqualified basis, CFC2 would have had $90x of gain that would have been taken into account in computing its tested income. As a result of the Sale, the condition of § 1.245A–6(b)(2) is not satisfied, because on at least one day of CFC2's taxable year beginning on December 1, 2018 (which begins within US1's 2018 taxable year) CFC2 does not hold Item 1. *See* § 1.245A–6(b)(2)(ii)(C)(*1*). US1 therefore applies § 1.245A–8 (rules for complex cases) for its 2018 taxable year. *See* § 1.245A–6(b).

(ii) *Analysis*—(A) *Ownership requirement.* With respect to each of Item 1 and Item 2, the ownership requirement of § 1.245A–8(b)(3)(i) is satisfied for US1's 2018 taxable year. This is because on at least one day that falls within US1's 2018 taxable year, each of Item 1 and Item 2 is held by CFC2, and US1 directly owns all of the stock of CFC2 throughout such taxable year (and thus, for purposes of applying § 1.245A–8(b)(3)(i), US1 owns at least 10% of the interests of CFC2 on at least one day that falls within such taxable year). *See* § 1.245A–8(b)(3).

(B) *Basis benefit amount with respect to Item 1 as a result of the Sale.* Under § 1.245A–8(b)(4)(i), US1 has a basis benefit account with respect to its extraordinary disposition account with respect to CFC1. As described in paragraphs (c)(2)(ii)(B)(*1*) through (*3*) of this section, the balance of the basis benefit account (which is initially zero) is, on December 31, 2018, increased by $90x, the basis benefit amount with respect to Item 1 and assigned to US1's 2018 taxable year.

(*1*) By reason of the Sale, for CFC2's taxable year beginning December 1, 2018, and ending November 30, 2019, the entire $90x of disqualified basis of Item 1 is taken into account for U.S. tax purposes by CFC2 and, as a result, reduces CFC2's tested income or increases CFC2's tested loss. Accordingly, for such taxable year, there is a $90x basis benefit amount with respect to Item 1. *See* § 1.245A–8(b)(4)(ii)(A). The result would be the same if the Sale were to a related person and thus, pursuant to § 1.951A–3(h)(2)(ii)(B)(*1*)(*ii*), no portion of the $90x of disqualified basis were eliminated or reduced by reason of the Sale. *See* § 1.245A–8(b)(4)(ii)(B).

(*2*) The $90x basis benefit amount with respect to Item 1 is assigned to US1's 2018 taxable year. This is because the ownership requirement of § 1.245A–8(b)(3)(i) is satisfied with respect to Item 1 for US1's 2018 taxable year, and the basis benefit amount occurs in CFC2's taxable year beginning December 1, 2018, a taxable year of CFC2 that begins within US1's 2018 taxable year (and, but for § 1.245A–8(b)(4)(iii)(A)(*2*)(*ii*), the basis benefit amount would not be assigned to a taxable year of US1, such as the taxable year of US1 beginning January 1, 2019, given that, as result of the Sale, the ownership requirement of § 1.245A–8(b)(3)(i) would not be satisfied with respect to Item 1 for such taxable year). *See* § 1.245A–8(b)(4)(iii)(A).

(*3*) On December 31, 2018 (the last day of US1's 2018 taxable year), US1's basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is increased by $90x, the $90x basis benefit amount with respect to Item 1 and assigned to US1's 2018 taxable year. The basis benefit account is increased by such amount because Item 1 corresponds to US1's extraordinary disposition account with respect to CFC1, and the extraordinary disposition ownership percentage applicable to such extraordinary disposition account is 100. *See* § 1.245A–8(b)(4)(i)(A).

(C) *Basis benefit amount limitation on reduction to disqualified basis.* By reason of US1's $140x extraordinary disposition amount for US1's 2018 taxable year, the disqualified basis of Item 1 is reduced by $30x, and the disqualified basis of Item 2 is reduced by $20x, pursuant to § 1.245A–8(b)(1). *See* § 1.245A–8(b). Paragraphs (c)(2)(ii)(C)(*1*) through (*4*) of this section describe the determinations pursuant to § 1.245A–8(b)(1).

(*1*) For purposes of determining the reduction to the disqualified bases of Item 1 and Item 2, the disqualified bases of the Items are determined on December 1, 2018 (and before the application of § 1.245A–8(b)(1)). *See* § 1.245A–8(b)(1)(ii). The disqualified bases of the Items are determined on December 1, 2018, because that date is the first day of the taxable year of CFC2 beginning on December 1, 2018, which is the taxable year of CFC2 (the specified property owner of each of Item 1 and Item 2) that includes December 31, 2018, the date on which US1's 2018 taxable year ends. *See* § 1.245A–8(b)(2)(i). For purposes of applying §§ 1.245A–8(b)(1) and § 1.245A–9(b)(2) for US1's 2018 taxable year, CFC2 is the specified property owner of each of Item 1 and Item 2 because, on at least one day of CFC2's taxable year that includes the date on which US1's 2018 taxable year ends (that is, on at least one day of CFC2's taxable year beginning December 1, 2018), CFC2 held the Item. *See* § 1.245A–9(b)(2)(iii). CFC2 is the specified property owner of Item 1 even though Individual A also held Item 1 during Individual A's taxable year that includes the date on which US1's 2018 taxable year ends because CFC2 held Item 1 on an earlier date than Individual A. *See* § 1.245A–9(b)(2)(iii).

(*2*) Pursuant to § 1.245A–8(b)(1), the disqualified basis of Item 1 is reduced by $30x, computed as the product of—

(*i*) $50x, the excess of the extraordinary disposition amount ($140x) over the balance of the basis benefit account with respect to US1's extraordinary disposition with respect to CFC1 ($90x); and

(*ii*) A fraction, the numerator of which is $90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of § 1.245A–8(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of § 1.245A–8(b)(1)). *See* paragraph § 1.245A–8(b)(1).

(*3*) Pursuant to § 1.245A–8(b)(1), the disqualified basis of Item 2 is reduced by $20x, computed as the product of—

(*i*) $50x, the excess of the extraordinary disposition amount ($140x) over the balance of the basis benefit account with respect to US1's extraordinary disposition with respect to CFC1 ($90x); and

(*ii*) A fraction, the numerator of which is $60x (the disqualified basis of Item 2 on December 1, 2018, and before the application of paragraph (b)(1) of this section), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of § 1.245A–8(b)(1)). *See* § 1.245A–8(b)(1).

(*4*) The $30x and $20x reductions to the disqualified bases of Item 1 and Item 2, respectively, occur on December 1, 2018, the date on which the disqualified bases of the Items are determined for purposes of determining the reductions pursuant to § 1.245A–8(b)(1). *See* § 1.245A–9(b)(2)(ii).

(D) *Reduction of basis benefit account.* The balance of the basis benefit account with respect to US1's extraordinary disposition account with respect to CFC1 is decreased by $90x, the amount by which, for CFC2's taxable year beginning December 1, 2018, the disqualified bases of Item 1 and Item 2 would have been reduced pursuant to § 1.245A–8(b)(1) but for the $90x balance of the basis benefit account. *See* § 1.245A–8(b)(4)(i)(B). The reduction to the balance of the basis benefit account occurs on December 31, 2018, and after the completion of all other computations pursuant to § 1.245A–8(b). *See* § 1.245A–8(b)(4)(i)(B).

(3) *Example 3. Reduction in balance of extraordinary disposition account under rules for simple cases by reason of allocation and apportionment of deductions to residual CFC gross income*—(i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make a distribution to US1. In addition, during CFC2's taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 1 gives rise to a $6x amortization deduction, and the disqualified basis of Item 2 gives rise to a $4x amortization deduction, and each of the amortization deductions is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of § 1.951A–2(c)(5) (though, but for § 1.951A–2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further, as of the end of CFC2's taxable year ending November 30, 2019, CFC2 has $15x of earnings and profits. Lastly, because the conditions of § 1.245A–6(b)(1) and (2) are satisfied for US1's 2018 taxable year, US1 chooses to apply § 1.245A–7 (rules for simple cases) in lieu of § 1.245A–8 (rules for complex cases) for that taxable year.

(ii) *Analysis.* Pursuant to § 1.245A–7(c)(1), US1's extraordinary disposition account with respect to CFC1 is reduced by the lesser of the amount described in § 1.245A–7(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. *See* § 1.245A–7(c)(1). Paragraphs (c)(3)(ii)(A) through (D) of this section describe the determinations pursuant to § 1.245A–8(c)(1).

(A) *Computation of adjusted earnings of CFC2, and amount described in § 1.245A–7(c)(1)(i) with respect to US1.* To determine the amount described in § 1.245A–7(c)(1)(i) with respect to US1, the adjusted earnings of CFC2 must be computed for CFC2's taxable year ending November 30, 2019. *See* § 1.245A–7(c)(1)(i). Paragraphs (c)(3)(ii)(A)(*1*) and (*2*) of this section describe these determinations.

(*1*) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $25x, computed as $15x (CFC2's earnings and profits as of November 30, 2019, the last day of that taxable year), plus $10x (the sum of the $6x and $4x amortization deductions of CFC2 for that taxable year, which is the amount of all deductions or losses of CFC2 that is or was attributable to disqualified basis of items of specified property and allocated and apportioned to residual CFC gross income of CFC2 solely by reason of § 1.951A–2(c)(5)(i)). *See* § 1.245A–7(c)(3).

(*2*) For CFC2's taxable year ending November 30, 2019, the amount described in § 1.245A–7(c)(1)(i) with respect to US1 is $25x, computed as the excess of $25x (the adjusted earnings) over $0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2).

(B) *Increase to balance of RGI account.* Under § 1.245A–9(d)(11), US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. On November 30, 2019 (the last day of CFC2's taxable year), the balance of the RGI account (which is initially zero) is increased by $10x, the sum of the $6x and $4x amortization deductions of CFC2 for its taxable year ending November 30, 2019. *See* § 1.245A–7(c)(4)(i). Each of the amortization deductions is taken into account for this purpose because, but for § 1.951A–2(c)(5)(i), the deduction would have decreased CFC2's tested income or increased or given rise to a tested loss of CFC2. *See* § 1.245A–7(c)(4)(i).

(C) *Reduction in balance of extraordinary disposition account.* Pursuant to § 1.245A–7(c)(1), US1's extraordinary disposition account with respect to CFC1 is reduced by $10x, the lesser of the amount described in § 1.245A–7(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019 ($25x), and the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 ($10x, determined as of November 30, 2019, but without regard to the application of § 1.245A–7(c)(4)(ii) for the taxable year of CFC2 ending on that date). *See* § 1.245A–7(c)(1). The $10x reduction in the balance of US1's extraordinary disposition account occurs on December 31, 2019, the last day of US1's taxable year that includes November 30, 2019 (the last day of CFC2's taxable year). *See* § 1.245A–9(c)(3).

(D) *Reduction in balance of RGI account.* On November 30, 2019 (the last day of CFC2's taxable year), the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by $10x, the amount of the reduction, pursuant to § 1.245A–7(c)(1) section and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1. *See* § 1.245A–7(c)(4)(ii). Therefore, following that reduction, the balance of the RGI account is zero ($10x − $10x).

(iii) *Alternative facts in which the reduction is limited by earnings and profits.* The facts are the same as in paragraph (c)(3)(i) of this section (*Example 3*), except that CFC2 has a $5x deficit in its earnings and profits as of the end of its taxable year ending November 30, 2019. In this case—

(A) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $5x, computed as −$5x (CFC2's deficit in earnings and profits as of November 30, 2019) plus $10x (the sum of the $6x and $4x amortization deductions of CFC2), *see* § 1.245A–7(c)(3);

(B) The amount described in § 1.245A–7(c)(1)(i) with respect to US1 for CFC's taxable year ending November 30, 2019, is $5x, computed as the excess of $5x (the adjusted earnings) over $0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2), *see* § 1.245A–7(c)(1)(i);

(C) On December 31, 2019, US1's extraordinary disposition account with respect to CFC1 is reduced by $5x, the lesser of the amount described in § 1.245A–7(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019 ($5x), and the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 ($10x, determined as of November 30, 2019, but without regard to the application of § 1.245A–8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date), *see* §§ 1.245A–7(c)(1) and 1.245A–9(c)(3); and

(D) On November 30, 2019 (the last day of CFC2's taxable year), the balance of US1's RGI account with respect to CFC2 is decreased by $5x (the amount of the reduction, pursuant to § 1.245A–7(c)(1) and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1) and, therefore, following such reduction, the balance of the RGI account is $5x ($10x − $5x), *see* § 1.245A–7(c)(4)(ii).

(4) *Example 4. Reduction to extraordinary disposition accounts limited by § 1.245A–8(c)(6)*—(i) *Facts.* The facts are the same as in paragraph (c)(3)(iii) of this section (*Example 3,* alternative facts in which the reduction is limited by earnings and profits) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that US1 also owns 100% of the stock of US2, which owns 100% of the stock of CFC3, and on November 30, 2018, in a transaction that was an extraordinary disposition, CFC3 sold an item of specified property (''Item 3'') to CFC2 in exchange for $200x of cash. Item 3 had a basis of $0 in the hands of CFC3 immediately before the sale and, therefore, CFC3 recognized $200x of gain as a result of the sale ($200x − $0), Item 3 has $200x of disqualified basis under § 1.951A–2(c)(5), and US2 has an extraordinary disposition account with respect to CFC3 with an initial balance of $200x under § 1.245A–5(c)(3)(i)(A). Moreover, during CFC2's taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 3 gives rise to a $20x amortization deduction, which is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of § 1.951A–2(c)(5) (though, but for § 1.951A–2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further, as of the end of US1's 2018 taxable year, the balance of US1's basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is $0; similarly, as of the end of US2's 2018 taxable year, the balance of US2's basis benefit account with respect to its extraordinary disposition account with respect to CFC2 is $0. Because CFC2 holds items of specified property that correspond to more than one extraordinary disposition account (that is, Item 1 and Item 2 correspond to US1's extraordinary disposition account with respect to CFC2, and Item 3 corresponds to US2's extraordinary disposition account with respect to CFC2), the condition of § 1.245A–6(b)(2) is not satisfied. *See* § 1.245A–6(b)(2)(ii)(C)(*3*). US1 and US2 therefore apply § 1.245A–8 (rules for complex cases) for their 2018 taxable years.

(ii) *Analysis.* Pursuant to § 1.245A–8(c)(1), US1's extraordinary disposition account with respect to CFC1 is, subject to the limitation in § 1.245A–8(c)(6), reduced by the lesser of the amount described in § 1.245A–8(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. *See* § 1.245A–8(c)(1). Similarly, US2's extraordinary disposition account with respect to CFC3 is, subject to the limitation in § 1.245A–8(c)(6), reduced by the lesser of the amount described in § 1.245A–8(c)(1)(i) with respect to US2, and the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3. *See* § 1.245A–8(c)(1). Paragraphs (c)(4)(ii)(A) through (F) of this section describe the determinations pursuant to § 1.245A–8(c)(1).

(A) *Ownership requirement.* Each of US1 and US2 satisfy the ownership requirement of § 1.245A–8(c)(5) for CFC2's taxable year ending November 30, 2019, because on the last day of that taxable year each is a United States shareholder with respect to CFC2. *See* § 1.245A–8(c)(5).

(B) *Computation of adjusted earnings of CFC2, and amount described in § 1.245A–8(c)(1)(i) with respect to US1 and US2.* The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $25x, computed as −$5x (CFC2's deficit in earnings and profits as of November 30, 2019), plus $30x (the sum of the $6x, $4x, and $20x amortization deductions of CFC2). *See* § 1.245A–8(c)(3). For CFC2's taxable year ending November 30, 2019, the amount described in § 1.245A–8(c)(1)(i) with respect to US1 is $25x, computed as the excess of the product of $25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US1 and its domestic affiliate, US2, own), over $0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). *See* § 1.245A–8(c)(1)(i). Similarly, for CFC2's taxable year ending November 30, 2019, the amount described in § 1.245A–8(c)(1)(i) with respect to US2 is $25x, computed as the excess of the product of $25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US2 and its domestic affiliate, US1, own), over $0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). *See* § 1.245A–8(c)(1)(i).

(C) *Increase to balance of RGI account.* As described in paragraph (c)(3)(ii)(B) of this section, US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1, and the balance of the RGI account is $10x on November 30, 2019 (the last day of CFC2's taxable year). Similarly, US2 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3, and the balance of the RGI account is $20x on November 30, 2019 (reflecting a $20x increase to the balance of the account for the $20x amortization deduction of CFC2 for its taxable year ending November 30, 2019). *See* § 1.245A–8(c)(4)(i).

(D) *Reduction in balance of extraordinary disposition accounts but for § 1.245A–8(c)(6).* But for the application of § 1.245A–8(c)(6), US1's extraordinary disposition account with respect to CFC2 would be reduced by $10x, which is the lesser of $25x, the amount described in § 1.245A–8(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019, and $10x, the balance of the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 (determined as of November 30, 2019, but without regard to the application of § 1.245A–8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date). *See* § 1.245A–8(c)(1)(i) and (ii). Similarly, but for the application of § 1.245A–8(c)(6), US2's extraordinary disposition account with respect to CFC3 would be reduced by $20x, which is the lesser of $25x, the amount described in § 1.245A–8(c)(1)(i) with respect to US2 for CFC2's taxable year ending November 30, 2019, and $20x, the balance of the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 (determined as of November 30, 2019, but without regard to the application of § 1.245A–8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date). *See* § 1.245A–8(c)(1)(i) and (ii).

(E) *Application of limitation of § 1.245A–8(c)(6).* As described in paragraph (c)(4)(ii)(D) of this section, but for the application of § 1.245A–8(c)(6), there would be a total of $30x of reductions to US1's extraordinary disposition account with respect to CFC1, and US2's extraordinary disposition account with respect to CFC3, by reason of the application of § 1.245A–8(c)(1) with respect to CFC2's taxable year ending November 30, 2019. Because that $30x exceeds the amount described in § 1.245A–8(c)(1)(i) with respect to US1 and US2 ($25x)—

(*1*) US1's extraordinary disposition account with respect to CFC1 is reduced by $7.86x, computed as $10x (the reduction that would occur but for § 1.245A–8(c)(6)) less the product of $5x (the excess amount, computed as $30x, the total reductions that would occur but for the application of § 1.245A–8(c)(6), less $25x, the amount described in § 1.245A–8(c)(1)(i)) and a fraction, the numerator of which is $150x (the balance of US1's extraordinary disposition account with respect to CFC1) and the denominator of which is $350x ($150x, the balance of US1's extraordinary disposition account with respect to CFC1, plus $200x, the balance of US2's extraordinary disposition account with respect to CFC3), *see* § 1.245A–8(c)(6); and

(*2*) US2's extraordinary disposition account with respect to CFC3 is reduced by $17.14x, computed as $20x (the reduction that would occur but for § 1.245A–8(c)(6)) less the product of $5x (the excess amount, computed as $30x, the total reductions that would occur but for the application of § 1.245A–8(c)(6), less $25x, the amount described in § 1.245A–8(c)(1)(i)) and a fraction, the numerator of which is $200x (the balance of US2's extraordinary disposition account with respect to CFC3) and the denominator of which is $350x ($150x, the balance of US1's extraordinary disposition account with respect to CFC1, plus $200x, the balance of US2's extraordinary disposition account with respect to CFC3), *see* § 1.245A–8(c)(6) of this section.

(F) *Reduction in balance of RGI accounts.* On November 30, 2019 (the last day of CFC2's taxable year)—

(*1*) The balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by $7.86x (the amount of the reduction, pursuant to § 1.245A–8(c)(1) and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1) and, thus, following that reduction, the balance of the RGI account is $2.14x ($10x − $7.86x), *see* § 1.245A–8(c)(4)(i)(B); and

(*2*) The balance of US2's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 is decreased by $17.14x (the amount of the reduction, pursuant to § 1.245A–8(c)(1) and by reason of the RGI account, to US2's extraordinary disposition account with respect to CFC3) and, thus, following that reduction, the balance of the RGI account is $2.86x ($20x − $17.14x), *see* § 1.245A–8(c)(4)(i)(B).

(5) *Example 5. Computation of duplicate DQB*—(i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make any distribution to US1, and on November 30, 2018, immediately after the Disqualified Transfer, CFC2 transfers Item 1 to newly-formed CFC3 solely in exchange for the sole share of stock of CFC3 (the contribution, ''Contribution 1,'' and the share of stock of CFC3, the ''CFC3 Share'') and, immediately after Contribution 1, CFC3 transfers Item 1 to newly-formed CFC4 solely in exchange for the sole share of stock of CFC4 (the contribution, ''Contribution 2,'' and the share of stock of CFC4, the ''CFC4 Share''). Pursuant to section 358(a)(1), CFC2's basis in its share of stock of CFC3 is $90x, and CFC3's basis in its share of stock of CFC4 is $90x basis. As a result of Contribution 1, the condition of § 1.245A–6(b)(2) is not satisfied, because on at least one day of CFC2's taxable year ending on November 30, 2018 (which ends within US1's 2018 taxable year), CFC2 does not hold Item 1. *See* § 1.245A–6(b)(2)(ii)(C)(*1*). US1 therefore applies § 1.245A–8 (rules for complex cases) for its 2018 taxable year. *See* § 1.245A–6(b).

(ii) *Analysis*—(A) *Application of exchanged basis rule under section 951A to Contribution 1 and Contribution 2.* As a result of Contribution 1, pursuant to § 1.951A–3(h)(2)(ii)(B)(*2*)(*ii*), the disqualified basis of CFC3 Share includes the disqualified basis of Item 1 ($90x), and therefore the disqualified basis of CFC3 Share is $90x. Similarly, as a result of Contribution 2, pursuant to § 1.951A–3(h)(2)(ii)(B)(*2*)(*ii*), the disqualified basis of CFC4 Share also includes the disqualified basis of Item 1 ($90x), and therefore the disqualified basis of CFC4 Share is $90x.

(B) *Determination of duplicate DQB of CFC3 Share as a result of Contribution 1.* Because the disqualified basis of CFC3 Share includes the disqualified basis of Item 1, CFC3 Share is an item of exchanged basis property that relates to Item 1. *See* § 1.245A–8(d)(2)(ii). In addition, because CFC3 Share is an item of exchanged basis property that relates to Item 1 (which corresponds to US1's extraordinary disposition account with respect to CFC1), CFC3 Share is, for purposes of § 1.245A–8, treated as an item of specified property that corresponds to US1's extraordinary disposition account with respect to CFC1. *See* § 1.245A–8(d)(2)(i). Further, the duplicate DQB of CFC3 Share as to Item 1 is $90x, the portion of the disqualified basis of CFC3 Share that includes Item 1's disqualified basis of $90x. *See* § 1.245A–8(d)(2)(iii)(A).

(C) *Determination of duplicate DQB of CFC4 Share as a result of Contribution 2.* For reasons similar to those described in paragraph (c)(5)(ii)(B) of this section, CFC4 Share is an item of exchanged basis property that relates to Item 1, CFC4 is treated for purposes of § 1.245A–8 as an item of specified property that corresponds to US1's extraordinary disposition account with respect to CFC1, and the duplicate DQB of CFC4 Share as to Item 1 is $90x.

(D) *Determination of duplicate DQB of CFC3 Share as a result of Contribution 2.* Because the disqualified basis of CFC3 Share and the disqualified basis of CFC4 Share each includes $90x of the disqualified basis of Item 1 and CFC3 receives the CFC4 Share in Contribution 2, the $90x of disqualified basis of CFC3 Share is attributable to the $90x of disqualified basis of CFC4 Share, and CFC3 Share is an item of exchanged basis property that relates to CFC4 Share. *See* § 1.245A–8(d)(2)(i) and (d)(2)(iii)(C). In addition, the duplicate DQB of CFC3 Share as to CFC4 Share is $90x. *See* § 1.245A–8(d)(2)(iii)(A).

(E) *Application of duplicate basis rules in § 1.245A–8(b)(5).* For purposes of computing the fraction described in § 1.245A–8(b)(1)(ii), if US1's extraordinary disposition account with respect to CFC1 were to give rise to an extraordinary disposition amount or a tiered extraordinary disposition amount during US1's 2018 taxable year, then the duplicate DQB of CFC3 Share and the duplicate DQB of CFC4 Share would not be taken into account, because the disqualified basis of Item 1 (an item of specified property that corresponds to US1's extraordinary disposition account and as to which each of CFC3 Share and CFC4 share relates) would be taken into account. *See* § 1.245A–8(b)(1)(ii) and (b)(5)(i)(A). Accordingly, in such a case, for US1's 2018 taxable year, the numerator of the fraction described in § 1.245A–8(b)(1)(ii) would reflect only the disqualified basis of Item 1 or Item 2, as applicable, and the denominator would reflect only the sum of the disqualified basis of each of Item 1 and Item 2. *See* § 1.245A–8(b)(1)(ii) and (b)(5)(i)(A). Furthermore, to the extent there were to be a reduction under § 1.245A–8(b)(1) to the disqualified basis of Item 1, then the duplicate DQB of CFC4 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be $90x (the duplicate DQB of CFC4 Share), and the denominator of which would also be $90x (the duplicate DQB of CFC4 Share). *See* § 1.245A–8(b)(5)(i)(B). The $90x of duplicate DQB of CFC3 Share would be excluded from the denominator of the fraction described in the previous sentence because it is attributable to the $90x of duplicate DQB of CFC4 Share. *See* § 1.245A–8(b)(5)(i)(B)(*2*) (last sentence). For reasons similar to those described in this paragraph (c)(4)(ii)(E) with respect to the application of § 1.245A–8(b)(5)(i)(B) to CFC4 Share, the duplicate DQB of CFC3 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be $90x, and the denominator of which would also be $90x.

§ 1.245A–11 Applicability dates.

(a) *In general.* Sections 1.245A–6 through 1.245A–11 apply to taxable years of a foreign corporation beginning on or after [date a Treasury decision adopting these rules as final regulations is published in the **Federal Register**] and to taxable years of section 245A shareholders in which or with which such taxable years end.

(b) *Exception.* Notwithstanding paragraph (a) of this section, a taxpayer may choose to apply §§ 1.245A–6 through 1.245A–11 for taxable years of a foreign corporation beginning before [date a Treasury decision adopting these rules as final regulations is published in the **Federal Register**] and to taxable years of section 245A shareholders in which or with which such taxable years end, provided that the taxpayer and all persons bearing a relationship to the taxpayer described in section 267(b) or 707(b) apply §§ 1.245A–6 through 1.245A–11, in their entirety, and § 1.6038–2(f)(18) for all such taxable years.

■ **Par. 4.** Section 1.951A–2, as proposed to be amended at 85 FR 19858 (April 8, 2020), is further amended by:

■ 1. Redesignating paragraph (c)(5)(iv) as paragraph (c)(5)(v).

■ 2. Adding new paragraph (c)(5)(iv).

■ 3. In newly redesignated paragraph (c)(5)(v)(B)(*1*), removing the language ''(c)(5)(iv)(A)(*1*)'' and adding the language ''(c)(5)(v)(A)(*1*)'' in its place.

■ 4. In newly redesignated paragraph (c)(5)(v)(C)(*1*), removing the language ''(c)(5)(iv)(B)(*1*)'' and adding the language ''(c)(5)(v)(B)(*1*)'' in its place.

■ 5. Redesignating paragraph (c)(6)(iv) as paragraph (c)(6)(v).

■ 6. Adding new paragraph (c)(6)(iv).

■ 7. In newly redesignated paragraph (c)(6)(v)(B)(*1*), removing the language ''(c)(6)(iv)(A)(*1* and adding the language ''(c)(6)(v)(A)(*1*)'' in its place.

The additions read as follows:

§ 1.951A–2 Tested income and tested loss.

* * * * *

(c) * * *

(5) * * *

(iv) *Reductions to disqualified basis pursuant to coordination rules.* See § 1.245A–7(b) or § 1.245A–8(b), as applicable, for reductions to disqualified basis resulting from the application of § 1.245A–5.

* * * * *

(6) * * *

(iv) *Reductions to disqualified payments pursuant to coordination rules.* See § 1.245A–5(j)(8) and § 1.245A–7(b) or § 1.245A–8(b), as applicable, for reductions to disqualified payments resulting from the application of § 1.245A–5.

* * * * *

■ **Par. 5.** Section 1.6038–2, as proposed to be amended at 85 FR 44650 (July 23, 2020), is further amended by adding paragraphs (f)(17) and(18) and (m)(5) to read as follows:

§ 1.6038–2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(f) * * *

(17) *Reporting of disqualified basis and disqualified payments.* If for the annual accounting period of a corporation it holds an item of property having disqualified basis within the meaning of § 1.951A–3(h)(2)(ii) or § 1.951A–2(c)(5), or incurs an item of deduction or loss related to a disqualified payment (within the meaning of § 1.951A–2(c)(6)(ii)(A)), then Form 5471 (or successor form) must contain such information about the disqualified basis, or such information relating to the disqualified payment, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(18) *Adjustments to extraordinary disposition accounts and disqualified basis* If for the annual accounting period a section 245A shareholder of the corporation reduces its extraordinary disposition account pursuant to § 1.245A–7(c) or § 1.245A–8(c), as applicable, or the corporation reduces the disqualified basis in an item of specified property pursuant to § 1.245A–7(b) or § 1.245A–8(b), as applicable, then Form 5471 (or a successor form) must contain such information about the reduction to the extraordinary disposition account or disqualified basis, as applicable, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

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(5) *Special rule for paragraphs (f)(17) and (18) of this section.* Paragraphs (f)(17) and (18) of this section apply with respect to information for annual accounting periods beginning after [date a Treasury decision adopting these rules as final regulations is published in the **Federal Register**]. In addition, as provided in § 1.245A–11(b), paragraph (f)(18) of this section applies with respect to information for an annual accounting period that includes a taxable year for which a taxpayer has chosen to apply §§ 1.245A–6 through 1.245A–11 pursuant to § 1.245A–11(b).

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Sunita Lough,

Deputy Commissioner for Services and Enforcement.

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