DEPARTMENT OF THE TREASURY

Internal Revenue Service

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Limitation on Deduction for Dividends Received From Certain Foreign Corporations and Amounts Eligible for Section 954 Look-Through Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under sections 245A and 954 of the Internal Revenue Code (the ''Code'') that limit the deduction for certain dividends received by United States persons from foreign corporations under section 245A and the exception to subpart F income under section 954(c)(6) for certain dividends received by controlled foreign corporations. This document also contains final regulations under section 6038 of the Code regarding information reporting to facilitate administration of the final regulations. The guidance relates to changes made to the applicable law by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. This document finalizes proposed regulations published on June 18, 2019, and removes temporary regulations published on the same date.

DATES:

Effective date: These regulations are effective on August 27, 2020.

Applicability dates: For dates of applicability, see §§ 1.245A–5(k), 1.954(c)(6)–1(b), and 1.6038–2(m)(2).

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SUPPLEMENTARY INFORMATION:

Background

Added to the Code by the Tax Cuts and Jobs Act, Public Law 115–97, 131 Stat. 2054, 2189 (2017) (the ''Act''), section 245A provides a 100-percent deduction to domestic corporations for certain dividends received from foreign corporations after December 31, 2017 (the ''section 245A deduction''). Section 954(c)(6) provides that a dividend received by a controlled foreign corporation, as defined in section 957 (a ''CFC''), from a related CFC is not included in the recipient CFC's income subject to current tax under sections 951(a) and 954(c) if certain requirements are satisfied (the ''section 954(c)(6) exception''). On June 18, 2019, the Department of the Treasury (the ''Treasury Department'') and the IRS published temporary regulations (TD 9865) under sections 245A, 954(c)(6), and 6038 in the **Federal Register** (84 FR 28398, as corrected at 84 FR 38866) (the ''temporary regulations''). These temporary regulations limit the section 245A deduction and the section 954(c)(6) exception with respect to distributions supported by certain earnings and profits (''E&P'') not subject to the integrated international tax regime created by the Act. Also on June 18, 2019, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–106282–18) in the **Federal Register** (84 FR 28426, as corrected at 84 FR 38892) by cross-reference to the temporary regulations (the ''proposed regulations,'' and together with the temporary regulations, the ''2019 regulations''). A public hearing was held on November 22, 2019.

This Treasury decision finalizes the proposed regulations, and removes the temporary regulations, after taking into account and addressing comments received by the Treasury Department and the IRS with respect to the 2019 regulations. Some of the comments received are outside the scope of the topics addressed in the 2019 regulations and are thus generally not further addressed in this preamble. However, those comments may be considered in connection with any future guidance projects regarding the issues discussed therein. For example, the Treasury Department and the IRS anticipate taking into account comments received regarding the availability of the section 245A deduction for dividends received by a CFC when issuing relevant future guidance. Comments that relate solely to the temporary regulations, such as comments relating to the temporary regulations' compliance with the procedural requirements in 5 U.S.C. 553(b) and (d) of the Administrative Procedure Act, will not be further addressed, as these issues were discussed in the preamble to the 2019 regulations and are not relevant to this document finalizing proposed regulations for which a 90-day comment period was provided. *See* 84 FR 28398. All written comments received in response to the 2019 regulations are available at *www.regulations.gov* or upon request.

The preamble to the 2019 regulations solicits comments on whether and how to coordinate the rules in proposed § 1.245A–5(c) and (d) (regarding extraordinary dispositions) with the rules in § 1.951A–2(c)(5) (regarding the allocation of deduction or loss attributable to disqualified basis under the global intangible low-taxed income rules in section 951A (such income, global intangible lowed-taxed income or ''GILTI,'' and the rules, the ''GILTI regime'')).[1] In response to the comments received pursuant to this solicitation, the Treasury Department and the IRS have issued proposed regulations (REG–103470–19), the text of which is set forth in a notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register** (the ''proposed coordination rules'').

Terms used but not defined in this preamble have the meaning provided in the final regulations.

Summary of Comments and Explanation of Revisions

I. Overview

The final regulations retain the general approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions section discusses the revisions as well as relevant comments received.

II. Comments Relating to Authority To Issue the 2019 Regulations

Several comments recommended that the Treasury Department and the IRS withdraw the temporary regulations, and not finalize the proposed regulations, due to a claimed lack of statutory authority to issue the rules therein. These comments asserted that the extraordinary disposition and extraordinary reduction rules in the 2019 regulations are contrary to the statutory text of section 245A and are therefore not authorized by section 245A(g). Some comments also asserted that the extraordinary disposition rules are contrary to section 245A because they attempt to alter the effective dates of section 965, which imposed a transition tax on certain untaxed foreign earnings measured as of no later than December 31, 2017, and section 951A, which created GILTI, a new category of income that is subject to current U.S. taxation starting in the first taxable year of a CFC beginning on or after January 1, 2018. Other comments asserted that the 2019 regulations are not reasonable

[1] Section 1.951A–2(c)(5) was published in the **Federal Register** on June 21, 2019, as part of final and temporary regulations regarding the GILTI regime. *See* TD 9866, 84 FR 29288. This provision prevents any deduction or loss attributable to basis generated without U.S. tax cost during the disqualified period from being allocated to reduce tested income, subpart F income, or income effectively connected with a U.S. trade or business. *See* § 1.951A–2(c)(5)(i).

because the application of the rules may result in excess U.S. taxation in certain situations.

A. Authority

The 2019 regulations were issued and are now being finalized under several statutory grants of authority. First, section 245A(g) grants the Secretary the authority to ''prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of [section 245A].'' Second, section 954(c)(6)(A) provides the Secretary the authority to ''prescribe such regulations as may be necessary or appropriate to carry out [section 954(c)(6)], including such regulations as may be necessary or appropriate to prevent the abuse of the purposes of [section 954(c)(6)].'' Third, section 7805(a) of the Code generally provides the Secretary the authority to ''prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.''

As stated in the preamble to the 2019 regulations, the Treasury Department and the IRS determined that sections 245A(g), 954(c)(6), and 7805(a) provide authority for the 2019 regulations. After considering comments to the contrary, the Treasury Department and the IRS have determined that these provisions also provide authority to finalize the proposed regulations so that the section 245A deduction and section 954(c)(6) exception are appropriately limited as contemplated by sections 245A(g) and 954(c)(6)(A). The phrase ''necessary or appropriate'' is broad, and its use in sections 245A(g) and 954(c)(6)(A) reflects Congress's intent to confer extensive rulemaking authority upon the Treasury Department and the IRS with respect to those provisions. *See Michigan* v. *Environmental Protection Agency,* 135 S. Ct. 2705, 2707 (2015) (concluding that the words ''appropriate and necessary'' in a statutory grant of regulatory authority are ''capacious[ ]'' and noting that the term appropriate ''is the classic broad and all-encompassing term that naturally and traditionally includes consideration of all relevant factors,'' before going on to analyze the rulemaking at issue under the standard that the Court must ''accept an agency's reasonable resolution of an ambiguity in a statute that the agency administers''). This includes the authority to limit the availability of the section 245A deduction and the section 954(c)(6) exception when doing so is necessary or appropriate to the proper functioning of those provisions. Moreover, section 7805(a) provides additional rulemaking authority that may not be conferred in a specific statutory grant, including in cases where rules may be necessary due to alterations in law, such as those made by the Act. Under the authority of these provisions, the 2019 regulations and the final regulations are necessary and appropriate to the proper application of sections 245A and 954(c)(6) as components of the integrated international tax regime created by the Act.

As explained in the preamble to the 2019 regulations, the Act established a new system for the taxation of foreign income through the section 245A deduction, which is available to domestic corporations with respect to certain dividends received from specified 10-percent owned foreign corporations (''SFCs'') after December 31, 2017. E&P generated before the applicability of the section 245A deduction and not previously subject to U.S. tax were generally subject to the transition tax under section 965. For taxable years starting in 2018, the Act generally retained the rules under section 951 that subject certain income of CFCs to current U.S. tax (the ''subpart F regime''). The Act also introduced the GILTI regime, an expanded anti-base erosion measure that subjects certain income of CFCs to current U.S. tax in order to address heightened base erosion concerns arising from the enactment of section 245A and other provisions of the Act.

In a typical case, these provisions require E&P (or the income that gave rise to the E&P) to be tested for taxation under section 965 or the GILTI and subpart F regimes before the E&P can be distributed as dividends potentially eligible for the section 245A deduction. E&P that have been previously taxed by reason of section 965 or the subpart F or GILTI regimes are treated as being distributed before non-previously taxed E&P, and a distribution of previously taxed E&P is not treated as a distribution of a dividend for U.S. tax purposes and therefore would not be eligible for the section 245A deduction. *See* Sections 959(c) and (d). By contrast, section 245A applies to certain E&P when they are distributed as dividends (or deemed distributed under certain Code provisions). Understood together, this framework confirms that the section 245A deduction is intended to apply to residual E&P that is not subject to section 965 and properly determined to be exempt from current taxation under the GILTI and subpart F regimes.

The legislative history to the Act provides further relevant context to understanding how the section 245A deduction interacts with section 965 and the GILTI and subpart F regimes. Congress enacted section 245A to increase the competitiveness of U.S. companies and reduce incentives to keep funds offshore to avoid the U.S. residual tax on those earnings. *See* Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 353 (Comm. Print 2017). Congress recognized, however, that the enactment of section 245A presented a potential windfall, allowing taxpayers who had held E&P offshore to distribute all of those E&P to a United States shareholder without incurring tax. *See id.* Congress did not intend for section 245A to apply to such pre-Act E&P, and thus enacted section 965 ''to ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system.'' *Id.* at 358.

Congress was also aware that the section 245A deduction was susceptible to manipulation in other ways. In this regard, Congress recognized that section 245A could provide incentives to allocate income susceptible to base erosion to certain foreign corporations, including those located in low-taxed foreign jurisdictions or tax havens, ''where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.'' *See id.* at 365. To prevent these misuses, the Act implemented the GILTI regime and retained the subpart F regime.

The Treasury Department and the IRS interpreted the scope of the section 245A deduction based on this structure and context. The 2019 regulations and the final regulations ensure that the section 245A deduction appropriately operates within the statutory framework to complement, not contradict, the application of section 965 and the GILTI and subpart F regimes. The 2019 regulations limit the section 245A deduction in connection with extraordinary dispositions because E&P generated in those transactions are not subject to tax under section 965 or the GILTI and subpart F regimes and, as a result, are not of the residual type for which the section 245A deduction is intended to potentially be available. The 2019 regulations limit the section 245A deduction in connection with extraordinary reductions because the section 245A deduction can result in complete avoidance of U.S. tax with respect to subpart F income or tested income that, absent the extraordinary reduction, would have been included in income by the selling United States shareholder under the subpart F or GILTI regimes, respectively. Limitations on the section 245A deduction in the

2019 regulations and the final regulations are narrowly tailored to apply only in circumstances where allowing a section 245A deduction would conflict with Congress's intent to have the subpart F and GILTI regimes prevent base erosion. The 2019 regulations and the final regulations are therefore necessary and appropriate to ensure the proper application of the provisions of section 245A.

Similarly, the 2019 regulations and the final regulations limit the section 954(c)(6) exception where its application would otherwise allow E&P that had accrued after December 31, 2017 (the last measurement date for determining the amount of E&P subject to section 965), and that was generated by income that had never been tested under the subpart F and GILTI regimes, to inappropriately qualify for an exception to the subpart F regime. While section 954(c)(6) was added to the Code to allow certain CFCs to reinvest E&P attributable to active foreign activities without incurring current U.S. tax, the section 954(c)(6) exception was not intended to apply where the effect would be to permanently eliminate income from the U.S. tax base, which would constitute an abuse of section 954(c)(6). *See* Notice 2007–9, 2007–1 C.B. 401, at section 7(b). The 2019 regulations and the final regulations under section 954(c)(6) are designed to ensure that the section 954(c)(6) exception does not apply to permanently eliminate income from the U.S. tax base through certain transactions preventing the taxation of income that would otherwise be taxed under the subpart F regime when distributed to a CFC. Thus, these regulations are necessary and appropriate to prevent the abuse of the section 954(c)(6) exception.

B. Effective Dates

Comments asserted that the 2019 regulations are an attempt by the Treasury Department and the IRS to apply section 965 or the GILTI regime during the period beginning on January 1, 2018, and ending on the last day of the last taxable year of a CFC before the GILTI regime applies (the ''disqualified period''). In support of their position, some of these comments cite § 1.245A–5T(b) (and proposed § 1.245A–5(b)), which provides that 50 percent of extraordinary disposition E&P are ineligible for the section 245A deduction thereby subjecting extraordinary disposition amounts to tax at a 10.5 percent effective tax rate, rather than the general 21 percent corporate tax rate. The comments further alleged that the 2019 regulations contradict section 245A because Congress intentionally created the disqualified period and, therefore, intended section 245A to apply during this period to encourage repatriations. In support of this position, the comments cite a change to the effective date of section 245A in the final bill to align with the final E&P measurement date under section 965, rather than the applicability date of section 951A.

The Treasury Department and the IRS disagree with this characterization of the 2019 regulations. The 2019 regulations and the final regulations are not an attempt to change the effective dates of section 965 or the GILTI regime; rather, the regulations limit the availability of the section 245A deduction and the section 954(c)(6) exception in certain limited circumstances where the effect would be contrary to the appropriate application of those provisions in the context of the Act's integrated approach to the taxation of income, or E&P generated by income, of a CFC. Furthermore, the extraordinary disposition rules apply to a limited category of transactions—that is, transactions that take place outside the ordinary course of business, between related parties, and exceed the lesser of $50 million or 5 percent of the CFC's total income for the taxable year. These exceptions demonstrate that the extraordinary disposition rules do not change the effective dates of section 965 or the GILTI regime; rather, they ensure the proper coordination of multiple statutory provisions in circumstances in which there is a heightened risk of base erosion.

As explained in Part II.A of this Summary of Comments and Explanation of Revisions, section 245A must be read in context and in light of its role in the integrated international tax system created by the Act. Nothing in the statute or legislative history suggests that the change in effective date of section 245A during the drafting of the bill means that Congress intended for E&P generated through extraordinary dispositions during the disqualified period to qualify for the section 245A deduction. Moreover, such an interpretation would suggest, without support, that Congress purposefully amended the section 245A effective date to provide a tax benefit only to CFCs with a fiscal taxable year, giving them a significant advantage over CFCs with a calendar taxable year.

C. Excess Taxation

Several comments asserted that the 2019 regulations are unreasonable because they could result in excess U.S. taxation. For example, comments cited the potential for the extraordinary disposition rules and the disqualified basis rules in § 1.951A–2(c)(5) to apply to the same transaction. Comments also asserted that, due to the unavailability of foreign tax credits and other tax attributes (such as net deemed tangible income return as defined in section 951A(b)(2)), the extraordinary disposition rules impose a different tax cost on extraordinary disposition E&P than would have been imposed had the income or gain to which such E&P is attributable been subject to tax under the GILTI regime when it was generated. Another comment asserted that the extraordinary reduction rules are contrary to sections 1248(j) and 964(e)(4) because those provisions govern extraordinary reductions and the 2019 regulations in effect override those provisions. Finally, one comment stated that the extraordinary reduction rules result in excess U.S. taxation in the context of dividends that partially fail to qualify for the section 954(c)(6) exception because they are partly attributable to subpart F income. Each of these comments is addressed in turn.

First, and as noted in the Background section, the proposed coordination rules consider the application of the rules of §§ 1.245A–5(c) and (d) and 1.951A–2(c)(5) to the same transaction and, accordingly, address excess taxation concerns.

Second, the U.S. tax cost of an extraordinary disposition is not, and is not intended to be, equivalent to the cost of applying section 965 or the GILTI regime to the same transaction. Instead, the Treasury Department and the IRS determined that the extraordinary disposition E&P is not of the type that Congress intended to qualify for the section 245A deduction and the section 954(c)(6) exception. As an act of administrative grace, the 2019 regulations deny only 50 percent of the section 245A deduction and the section 954(c)(6) exception to approximate the tax rate that taxpayers may have expected to pay on similar E&P under section 965 or the GILTI regime. However, this is not intended to place taxpayers in an equivalent position as if they had been subject to those provisions. Instead, it is intended to prevent extraordinary disposition E&P from inappropriately qualifying for the section 245A deduction or the section 954(c)(6) exception.

Third, the 2019 regulations do not override the application of section 1248(j) or 964(e)(4). Both provisions impose taxation on built-in stock gain (to the extent of certain E&P of the CFC) as if it were a dividend, but neither one

expressly permits the section 245A deduction. To the contrary, both provisions envision that there will be contexts in which the deemed dividend under section 1248(j) or 964(e)(4) could fail to qualify for the section 245A deduction. The fact that the statutory text of these provisions ties their eligibility for tax-exemption to their ability to qualify for the section 245A deduction demonstrates that the same policies underlying the application of section 245A to actual dividends is also intended to apply to deemed dividends under section 1248(j) or 964(e)(4). Accordingly, the 2019 regulations further the policies underlying sections 1248(j) and 964(e)(4) by limiting the availability of the section 245A deduction for both actual and deemed dividends in the same manner.

Finally, one comment asserted that the interaction of the extraordinary reduction rules with the rules under § 1.245A–5T(f) (and proposed § 1.245A–5(f)) that limit the section 954(c)(6) exception, could result in subpart F income being subject to U.S. tax more than once in certain cases where a portion of the amount distributed would not otherwise qualify for the section 954(c)(6) exception. While not discussed in the comment, the same issue could arise in the context of tiered extraordinary disposition amounts. In response to this comment, the Treasury Department and the IRS have modified the rules in § 1.245A–5(d)(1) and (f)(1) and related provisions of § 1.245A–5 that limit application of the section 954(c)(6) exception.

III. Comments and Revisions Related to Extraordinary Dispositions

A. Exceptions to Extraordinary Dispositions

Under the 2019 regulations, an SFC is generally considered to have undertaken an extraordinary disposition with respect to an asset if the SFC (1) disposes of that asset outside of its ordinary course of activities to a related party during its disqualified period and (2) the sum of all extraordinary dispositions undertaken by the SFC exceeds the lesser of $50 million or 5 percent of the gross value of the SFC's assets. *See* proposed § 1.245A–5(c)(3)(ii). Determining whether the disposition of an asset is outside the ordinary course of the SFC's business is a facts and circumstances determination. *See* proposed § 1.245A–5(c)(3)(ii)(B). In addition, dispositions occurring with a principal purpose of generating E&P during the disqualified period and dispositions of intangible property (as defined in section 367(d)(4)) are per se outside the ordinary course of an SFC's activities. *See* proposed § 1.245A–5(c)(3)(ii)(C). This Part III.A of the Summary of Comments and Explanation of Revisions discusses comments requesting exceptions from the definition of an extraordinary disposition.

1. Post-Acquisition Integration Safe Harbor

Comments recommended that transactions occurring pursuant to a plan of integration after an acquisition of an unrelated group be excluded from the definition of extraordinary disposition. One comment suggested that any integration of an acquired group that was acquired within 12 months of January 1, 2018, should be excluded. The comments noted that post-acquisition integration, including through mergers and asset sales, may occur for a variety of non-tax business reasons, including consolidating ownership of certain assets, aligning business segments, creating synergies, and combining legal entities. Further, the comments noted that certain acquisitions and the related post-integration transactions were planned before the Act was enacted and would likely have occurred regardless of whether the Act was in effect at the time of the acquisition and post-acquisition integration. One comment acknowledged, however, that courts have typically found mergers to not be within the ordinary course of a business's activities.

The Treasury Department and the IRS have determined that recently acquired assets are indistinguishable from non-recently acquired assets for the purposes of determining whether an extraordinary disposition has occurred. First, an extraordinary disposition that occurs during the disqualified period implicates the policy concerns of the extraordinary disposition rule regardless of whether the taxpayer intended to avoid tax. That is, regardless of the taxpayer's subjective intent, such transactions, absent rules to address them, could give rise to inappropriate results, such as E&P that are not of the type for which the section 245A deduction was intended to be available giving rise to a section 245A deduction. Second, the regulations apply only to post-acquisition integrations occurring during the disqualified period. The Treasury Department and the IRS are aware that some taxpayers undertook extraordinary dispositions for the purpose of increasing the basis of an asset or generating E&P eligible for the section 245A deduction, without being subject to U.S. tax on the recognition of the built-in gain in the asset. There are a number of ways that an asset could be transferred within an organizational structure that, even in the absence of special rules, would not give rise to inappropriate tax results. The fact that an asset was recently acquired does not change this fact; the length of time that an asset was held does not impact the potential ways in which the asset can be transferred within a group of related entities. Therefore, the final regulations do not adopt this recommendation.

2. Intangible Property

a. Extraordinary Disposition Exception for Intangible Property

The comment requesting a general exception for transfers of intangible property asserted that (1) the rules as drafted would penalize the repatriation of intangible property to the United States, contrary to one of the Act's goals; and (2) other transfers of intangible property (that is, those between related CFCs) are addressed under § 1.951A–2(c)(5). The extraordinary disposition rules were issued in response to a concern regarding highly-structured transactions that took place during the disqualified period to create stepped-up basis for the transferee and generate E&P for the transferor. Such transactions are especially concerning when they occur outside the ordinary course of business, between related parties, and involve large amounts of gain. A transfer of intangible property often will fall within these criteria, and thus would raise the same concerns as other highly-structured asset dispositions during the disqualified period. Contrary to the argument in the comment, the concerns addressed by the extraordinary disposition rules are heightened when the property in question is highly mobile and highly valuable, as is generally true of intangible property (and less frequently true of tangible property). Accordingly, the final regulations do not adopt this comment and continue to treat transfers of intangible property as extraordinary dispositions subject to the per se rule (but see the exception discussed in Part III.A.2.b of the Summary of Comments and Explanation of Revisions).

b. Exception to the Per Se Rule for Inventory Property

A comment recommended that the final regulations adopt an exception to the per se rule for transfers of intangible property described in section 1221(a)(1). The comment noted that the disqualified basis rules, which similarly address transfers of property occurring during the disqualified period, provide

for an exception with respect to property described in section 1221(a)(1). *See* § 1.951A–2(h)(2)(ii). The comment further indicated that the facts and circumstances test in § 1.245A–5T(c)(3)(ii)(B) (and proposed § 1.245A–5(c)(3)(ii)(B)) would be sufficient to address any concerns of abuse.

The Treasury Department and the IRS agree that it is appropriate to except certain ordinary course transfers of intangible property ultimately sold to unrelated customers from the per se rule. However, the Treasury Department and the IRS have determined that the exception from the per se rule should not be based on whether such property is described in section 1221(a)(1). Accordingly, the final regulations provide that a disposition of certain types of intangible property defined in section 367(d)(4) is not per se treated as an extraordinary disposition if the intangible property is transferred to a related party during the disqualified period with a reasonable expectation that such property would be sold to an unrelated customer within one year of the transfer. *See* § 1.245A–5(c)(3)(ii)(C)(*2*)(*i*). This rule is intended to apply primarily to routine transfers of limited intangible property rights in furtherance of transactions with unrelated customers. Accordingly, transfers of intangible property described in section 367(d)(4)(C) or (F), such as trademarks and goodwill, are not eligible for this exception because, in general, these types of intangible property are not routinely transferred to unrelated customers. Additionally, transfers of copyright rights within the meaning of § 1.861–18 or intangible property described in section 367(d)(4)(A) that qualify for the exception to the per se rule are still subject to a presumption that they occur outside the ordinary course of the transferor SFC's activities. *See* § 1.245A–5(c)(3)(ii)(C)(*2*)(*ii*). This presumption can be rebutted only if the taxpayer shows that the facts and circumstances clearly establish that the disposition took place in the ordinary course of the SFC's activities. *See id.*

c. Platform Contribution Payments

A comment recommended that transfers of intangible property from a CFC to a related CFC that occur as a result of a platform contribution transaction under § 1.482–7 (a ''PCT'') be excluded from the per se rule. The comment noted that, when PCT payments represent payments from a United States shareholder to a CFC as consideration for a deemed transfer of intangible property, the result is that intangible property is effectively transferred into the United States from abroad. The comment described such transfers as broadly consistent with the policies of the Act and noted that PCT payments may not arise directly as a result of U.S. tax planning.

The final regulations do not adopt this recommendation. The ultimate destination of the intangible property transferred in an extraordinary disposition, and the motivations of the taxpayers involved in the transfer, are generally irrelevant in determining whether a transfer should be treated as an extraordinary disposition. Whether or not the intangible property is transferred to the United States or for non-tax business reasons, a transfer during the disqualified period generates E&P that have not been subject to U.S. tax, and an associated increase in the basis of the transferred property, to the benefit of a related person. Accordingly, the final regulations continue to treat transfers of intangible property as subject to the per se rule (subject to the exception discussed in Part III.A.2.b of this Summary of Comments and Explanation of Revisions) without regard to whether such transfers occur in connection with a PCT.

B. Extraordinary Disposition Accounts

1. In General

The 2019 regulations generally limit the section 245A deduction to the extent the dividend is paid out of the extraordinary disposition account of the section 245A shareholder. For this purpose, the 2019 regulations provide an ordering rule pursuant to which a dividend is considered paid out of non-extraordinary disposition E&P before it is considered paid out of the extraordinary disposition E&P account. *See* proposed § 1.245A–5(c)(2)(i). Similar rules apply with respect to the limitation on amounts eligible for the section 954(c)(6) exception. *See* proposed § 1.245A–5(d)(2)(i). The 2019 regulations generally define non-extraordinary disposition E&P based on the section 245A shareholder's share of the E&P of the SFC described in section 959(c)(3) in excess of the balance in the section 245A shareholder's extraordinary disposition account determined immediately before the distribution. *See* proposed § 1.245A–5(c)(2)(ii).

The 2019 regulations measure a section 245A shareholder's share of the E&P of an SFC described in section 959(c)(3) based on the percentage of stock (by value) of the SFC owned, directly or indirectly, by the section 245A shareholder after the distribution and all related transactions. *See* proposed § 1.245A–5(c)(2)(ii)(A)(*2*). Thus, in cases in which the section 245A shareholder sells all of its stock of the SFC, the section 245A shareholder's share of E&P described in section 959(c)(3) is considered to be zero with respect to any dividend that is related to the sale under the measurement rule. As a result, the measurement rule treats no portion of the dividend as being distributed from non-extraordinary disposition E&P even though, assuming that a dividend is first sourced from E&P other than E&P generated in an extraordinary disposition, none of the dividend may be sourced from E&P generated in an extraordinary disposition. The final regulations revise this rule to measure the section 245A shareholder's share of E&P described in section 959(c)(3) based on the percentage of stock of the SFC that the section 245A shareholder owns immediately before the distribution. *See* § 1.245A–5(c)(2)(ii)(A)(*2*).

2. Effect of Losses Incurred After Extraordinary Dispositions

One comment noted that a dividend will avoid being sourced from an extraordinary disposition account only to the extent the non-extraordinary disposition E&P equals or exceeds the amount of the dividend. The comment requested that regulations clarify the determination of non-extraordinary disposition E&P and the sourcing of dividends from an extraordinary disposition account to address cases involving losses generated after the extraordinary disposition and distributions giving rise to ''nimble'' dividends subject to section 316(a)(2).

This comment implicates two issues, the first of which is whether losses incurred after the disqualified period should reduce an extraordinary disposition account to the extent that such losses reduce E&P generated in an extraordinary disposition. The Treasury Department and the IRS have determined that losses incurred after the disqualified period should not reduce the extraordinary disposition account because extraordinary disposition E&P that are offset by losses provide a tax benefit to a section 245A shareholder. Specifically, extraordinary disposition E&P prevent offsetting losses from decreasing other E&P or creating a deficit that must be offset by future E&P that could give rise to future dividends. For every dollar of decreased E&P, an additional dollar distributed would be unable to qualify for the section 245A deduction and would instead reduce the distributee's basis in stock in the distributing corporation under section 301(c)(2) or constitute taxable gain to

the distributee under section 301(c)(3). In this way, extraordinary disposition E&P prevents post-extraordinary disposition losses from reducing the SFC's ability to pay dividends eligible for the section 245A deduction. Thus, the extraordinary disposition E&P provide the same benefit when offset by a loss as they do absent a loss: That E&P increases the SFC's ability to pay dividends otherwise eligible for the section 245A deduction. Accordingly, like the 2019 regulations, the final regulations do not reduce an extraordinary disposition account by reason of losses incurred after the disqualified period. *See* § 1.245A–5(c)(3)(i)(A).

The comment implicates a second issue, which is whether a nimble dividend should be considered paid out of extraordinary disposition E&P when the distributing SFC has an overall deficit in E&P, even factoring in the E&P supporting the nimble dividend. The Treasury Department and the IRS are studying the extent to which nimble dividends should qualify for the section 245A deduction generally and may address this issue in future guidance under section 245A.

3. Prior Extraordinary Disposition Amounts

A section 245A shareholder reduces the balance of its extraordinary disposition account with respect to an SFC by the prior extraordinary disposition amount. *See* proposed § 1.245A–5(c)(3)(i)(A). In general, the prior extraordinary disposition amount is intended to measure the extent to which the section 245A shareholder's extraordinary disposition account has disallowed the section 245A deduction or caused a subpart F inclusion due to prior dividends of an SFC. However, this amount also includes certain other prior dividends of an SFC to generally ensure that the extraordinary disposition account is reduced to the extent a dividend out of extraordinary disposition E&P does not give rise to a section 245A deduction under other provisions (such as under section 245A(e) for hybrid dividends). *See* § 1.245A–5(c)(3)(i)(D)(*1*).

A comment stated that the definition of a prior extraordinary disposition amount did not appropriately take into account section 956 and as a result, § 1.956–1(a)(2) can in effect deny the section 245A deduction with respect to the same extraordinary disposition E&P more than once. Section 1.956–1(a)(2) reduces a United States shareholder's section 956 amount to the extent that the United States shareholder's tentative amount determined under section 956(a) with respect to a CFC for a taxable year would be eligible for a section 245A deduction if the United States shareholder received that tentative amount as a distribution from the CFC. The comment recommended reducing the extraordinary disposition account by 200 percent of the amount included in the income of a section 245A shareholder under section 951(a)(1)(B) by reason of the application of § 1.245A–5T(b) (and proposed § 1.245A–5(b)) to the hypothetical distribution under § 1.956–1(a)(2).

The Treasury Department and the IRS generally agree with this comment. As a result, the final regulations modify the definition of a prior extraordinary disposition amount to take into account certain income inclusions under section 956. *See* § 1.245A–5(c)(3)(i)(D)(*1*)(*iv*). In addition, the final regulations add a new type of prior extraordinary disposition amount for 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 SFC. *See* § 1.245A–5(c)(3)(i)(C). Finally, the final regulations clarify that an extraordinary disposition account is maintained in the same currency as the extraordinary disposition E&P. *See* § 1.245A–5(c)(3).

C. Successor Rules for Extraordinary Disposition Accounts

1. In General

Under the 2019 regulations, § 1.245A–5T(c)(4) (and proposed § 1.245A–5(c)(4)) provides rules for the transfer of an extraordinary disposition account. Generally, when certain transactions occur (for example, a transfer of stock of an SFC for which a section 245A shareholder has an extraordinary disposition account), the 2019 regulations provide that the balance of the extraordinary disposition account is preserved by either transferring the account balance to another section 245A shareholder or requiring the section 245A shareholder to maintain the account with respect to a different SFC (''successor rules''). In general, the purpose of the successor rules is to ensure that a section 245A shareholder succeeds to (or is attributed) an extraordinary disposition account upon certain transactions to the extent, after the transaction, the section 245A shareholder would likely be able to access the E&P as to which the extraordinary disposition account relates. Absent these rules, an extraordinary disposition account could be separated from the E&P to which it relates, which could give rise to inappropriate results.

A comment recommended that extraordinary disposition accounts should terminate after a certain period. The Treasury Department and the IRS have concluded that it would be inappropriate to terminate the accounts when a dividend out of extraordinary disposition E&P can still give rise to a section 245A deduction (or the application of the section 954(c)(6) exception). Accordingly, this comment is not adopted. However, the proposed coordination rules, which are published in the Proposed Rules section of this issue of the **Federal Register**, alleviate the concerns raised by this comment by generally eliminating a section 245A shareholder's extraordinary disposition account in certain cases as the property that gave rise to the account is amortized or depreciated and those deductions reduce E&P otherwise potentially eligible for the section 245A deduction. Moreover, as discussed in Part III.C.5 of this Summary of Comments and Explanation of Revisions, the final regulations also alleviate these concerns by generally eliminating the extraordinary disposition account if no person is a section 245A shareholder of the SFC after certain transfers of stock of the SFC.

2. Nonrecognition Transactions

The successor rules under the 2019 regulations address certain nonrecognition transactions in order to carry out the purposes of the rules. Specifically, the 2019 regulations provide that upon certain distributions of stock under section 355 made pursuant to a reorganization described in section 368(a)(1)(D) a section 245A shareholder's extraordinary disposition account with respect to the distributing SFC is allocated between the distributing SFC and the controlled SFC. *See* proposed § 1.245A–5(c)(4)(iii). Other than this rule, the 2019 regulations do not provide any other special rules for transfers of extraordinary disposition accounts in nonrecognition transactions where a section 245A shareholder transfers stock of an SFC. In addition, proposed § 1.245A–5(c)(4)(i) provides that a transaction described in § 1.1248–8(a)(1) in which a section 245A shareholder transfers a share of stock of an SFC does not result in any transfer of the section 245A shareholder's extraordinary disposition account. This result arises because after the transfer the section 245A shareholder could access the E&P as to which the extraordinary

disposition account relates, by reason of section 1248 and § 1.1248–8.

A comment recommended that the rule addressing extraordinary disposition account transfers in reorganizations pursuant to sections 368(a)(1)(D) and 355 be extended to stand-alone section 355 distributions in which E&P of the distributing SFC are allocated to the controlled SFC. The Treasury Department and the IRS agree with this comment; as the comment noted, certain stand-alone section 355 distributions could otherwise potentially separate extraordinary disposition accounts from related extraordinary disposition E&P, which could give rise to inappropriate results. Thus, the final regulations provide that a section 245A shareholder's extraordinary disposition account with respect to a distributing SFC is allocated between the distributing SFC and the controlled SFC in any section 355 distribution in which E&P of the distributing SFC are decreased and the E&P of the controlled SFC are increased by reason of § 1.312–10. *See* § 1.245A–5(c)(4)(iii).

To address similar issues, the final regulations provide additional rules regarding the transfer of extraordinary disposition accounts in nonrecognition transactions. The final regulations provide that in a transaction described in § 1.1248–8(a)(1) where stock of an SFC is transferred to a foreign acquiring corporation in exchange for stock of a foreign corporation, any extraordinary disposition account with respect to the SFC remains with the pre-transaction section 245A shareholder. *See* § 1.245A–5(c)(4)(vi)(A). An exception to this rule applies in the case of a transaction described in § 1.1248(f)–1(b)(2) or (3); in this type of transaction, the extraordinary disposition account is transferred in the manner provided in § 1.245A–5(c)(4)(i), with certain adjustments, in order generally to ensure that a section 245A shareholder succeeds to an extraordinary disposition account to the extent that, after the transaction, the section 245A shareholder would likely be able to access the E&P as to which the extraordinary disposition account relates. *See* § 1.245A–5(c)(4)(vi)(B). Under the final regulations, other transactions described in § 1.1248–8(a)(1) cause the extraordinary disposition account to be transferred to the extent and in the manner provided under the general rule of § 1.245A–5(c)(4)(i).

Similarly, the final regulations also provide a rule addressing transactions in which an SFC acquires the assets of another SFC in a triangular asset reorganization and the section 245A shareholder of the target SFC receives stock of a domestic corporation that controls the acquiring SFC. In these triangular reorganizations, the domestic corporation whose stock was issued in the triangular reorganization succeeds to the extraordinary disposition account of the section 245A shareholder with respect to the target SFC. *See* § 1.245A–5(c)(4)(ii)(B).

3. Related Domestic Corporations

Although the 2019 regulations provide anti-abuse rules, the 2019 regulations do not provide explicit rules addressing issuances of stock of an SFC. For example, if a section 245A shareholder owns all the stock of an SFC and the SFC issues new stock to another section 245A shareholder, the second section 245A shareholder does not inherit any portion of the first section 245A shareholder's extraordinary disposition account with respect to the SFC under the successor rules of the 2019 regulations. However, in certain cases issuances raise the same policy concerns as those addressed by the successor rules and, absent rules to address, could facilitate the avoidance of the extraordinary disposition rules by separating an extraordinary disposition account from the E&P to which it relates.

Consider, for instance, a case in which FP, a foreign corporation, owns all the stock of US1 and US2, each of which is a domestic corporation, and US1 owns all the stock of CFC1, an SFC whose E&P is maintained in U.S. dollars and as to which US1 has an extraordinary disposition account of $100 ×. In such a case, if US2 contributes property to CFC1 in exchange for stock representing 99 percent of the stock of CFC1 and thereafter CFC1 pays $100 × of dividends pro rata to US1 and US2, only the $1 × dividend received by US1 would be an extraordinary disposition amount (US2's $99 × dividend would not, as US2 did not inherit any of US1's extraordinary disposition account), even though, as a factual matter, the entire $100 × of dividends may represent E&P generated by CFC1 in an extraordinary disposition. Moreover, for example, if US1 were to subsequently transfer all of its stock of CFC1 to a U.S. individual, the remaining balance of US1's extraordinary disposition account with respect to CFC1 may never give rise to an extraordinary disposition amount.

Rather than addressing such transactions solely through the anti-abuse rules in § 1.245A–5, the final regulations provide a rule that treats related domestic corporations as a single domestic corporation for purposes of determining the extent to which a dividend is an extraordinary disposition amount or a tiered extraordinary disposition amount. *See* § 1.245A–5(g)(7); *see also* § 1.245A–5(i)(19) (defining related based on a relationship described in section 267(b) or 707(b)). Thus, in the example above, the $100 × of dividends paid by CFC1 are extraordinary disposition amounts with respect to both US1 and US2 as a result of US1's extraordinary disposition account. The final regulations also treat related domestic corporations as a single domestic corporation for purposes of reducing a section 245A shareholder's extraordinary disposition account by prior extraordinary disposition amounts. *See id.*

4. Effect of Section 338(g) Election

The 2019 regulations do not address whether a section 245A shareholder of the new target succeeds to an extraordinary disposition account with respect to the old target when a section 338(g) election is made with respect to an SFC target. Because, in general, the new target does not inherit any of the E&P of the old target—and, as a result, no distributions by the new target could represent a distribution of E&P of the old target generated in an extraordinary disposition—the final regulations clarify that, in connection with an election under section 338(g), a section 245A shareholder of the new target generally does not succeed to an extraordinary disposition account with respect to the old target. *See* § 1.245A–5(c)(4)(v)(A). Special rules are provided for transactions in which a section 338(g) election is made and not all of the stock of the SFC target is subject to the qualified stock purchase. *See* § 1.245A–5(c)(4)(v)(B).

5. Elimination of Remaining Account Balance After Certain Stock Transfers

In general, the 2019 regulations do not provide rules addressing the treatment of the remaining balance of a section 245A shareholder's extraordinary disposition account with respect to an SFC when the section 245A shareholder directly or indirectly transfers all of its stock of the SFC and, following the transfer, no person is a section 245A shareholder of the SFC. However, under the 2019 regulations, if a section 245A shareholder ceases to be a section 245A shareholder with respect to a lower-tier CFC as a result of a direct or indirect transfer of stock of the lower-tier CFC by an upper-tier CFC, a special rule preserves the section 245A shareholder's remaining balance of its extraordinary disposition account with

respect to the lower-tier CFC. *See* proposed § 1.245A–5(c)(4)(iv). Under this rule, the section 245A shareholder's extraordinary disposition account is preserved by increasing the account with respect to the upper-tier CFC by the remaining balance. *See* proposed § 1.245A–5(c)(4)(iv).

The Treasury Department and the IRS have determined that proposed § 1.245A–5(c)(5)(iv) should be revised to address the treatment of the remaining balance of a section 245A shareholder's extraordinary disposition account with respect to an SFC when the section 245A shareholder directly or indirectly transfers all of its stock of an SFC (such section 245A shareholder, the ''transferor''). *See* § 1.245A–5(c)(4)(iv). In cases in which no related party with respect to the transferor is a section 245A shareholder of the SFC following the transfer, the transferor's remaining extraordinary disposition account balance is eliminated, to the extent not allocated or attributed to another extraordinary disposition account. *See* § 1.245A–5(c)(4)(iv)(A). In these cases, the remaining balance generally represents an individual's or a foreign (non-CFC) person's share of E&P of the SFC, such that, after the transfer, distributions of the E&P are unlikely to give rise to a dividend eligible for the section 245A deduction. Therefore, there is generally not a policy need to continue tracking such E&P.

The elimination rule does not apply, however, if a section 245A shareholder that is a related party with respect the transferor continues to own stock of the SFC after the transfer; instead the related section 245A shareholder succeeds to the remaining account balance. *See* § 1.245A–5(c)(4)(iv)(B). Moreover, transactions with a principal purpose of avoiding this limitation on the application of the elimination rule are disregarded. For example, if a U.S. individual acquires all of the stock of an SFC from a section 245A shareholder and subsequently, pursuant to a plan that included the acquisition, transfers all of the stock of the SFC to a domestic corporation that is a section 245A shareholder of the SFC, the transfer to the U.S. individual would be disregarded. *See* § 1.245A–5(c)(4)(vii). The final regulations add a rule that a transfer of stock of an SFC otherwise subject to § 1.245A–5(c)(4)(iv)(A) is deemed to have been undertaken with a principal purpose of avoiding the purposes described in this anti-abuse rule if stock of the SFC is transferred to a section 245A shareholder within one year after the transaction that would be subject to § 1.245A–5(c)(4)(vii). *See id.*

D. Tiered Extraordinary Disposition Amounts

The 2019 regulations limit the application of the section 954(c)(6) exception with respect to certain dividends attributable to extraordinary disposition E&P from a lower-tier CFC to an upper-tier CFC. *See* proposed § 1.245A–5(d). A comment noted that this limitation on the section 954(c)(6) exception gives rise to an incentive to avoid making a distribution (or otherwise generating a dividend to shareholders) to avoid subpart F income. Furthermore, the comment noted that, in certain cases, a dividend subject to this limitation on the section 954(c)(6) exception may nonetheless qualify for an exception under section 954(c)(3), permitting deferral with respect to distributed E&P. Accordingly, the comment recommended that the final regulations instead adopt a tracking approach, under which dividends from a lower-tier CFC attributable to extraordinary disposition E&P would be eligible for the section 954(c)(6) exception, and the extraordinary disposition account of an upper-tier CFC receiving a dividend attributable to extraordinary disposition E&P would be increased by the amount of the dividend attributable to extraordinary disposition E&P (while making corresponding downward adjustments to the extraordinary disposition account of the lower-tier CFC). In the alternative, the comment recommended that this approach apply solely with respect to lower-tier dividends paid before June 18, 2019 (the date on which the 2019 regulations were published), to provide relief with respect to dividends from lower-tier CFCs that were expected to qualify for the section 954(c)(6) exception.

Consistent with a statement in the preamble to the 2019 regulations, the Treasury Department and the IRS have concluded that limiting the application of the section 954(c)(6) exception in this context is necessary to prevent the inappropriate deferral of tax and minimizes the administrative and compliance burdens associated with a rule that would adjust upper-tier and lower-tier CFCs' extraordinary disposition accounts. The limitation on the section 954(c)(6) exception achieves the appropriate balance between preventing deferral of U.S. tax with respect to extraordinary disposition E&P and avoiding incentives to defer distributions. Similar to the rules limiting the application of the section 245A deduction to distributions attributable to extraordinary disposition E&P under § 1.245A–5(b), the incentive to defer distributions is mitigated by the fact that the limitation on the section 954(c)(6) exception generally applies only after other E&P (including E&P accumulated after the disqualified period and previously taxed E&P) are distributed.

Furthermore, failing to limit the application of the section 954(c)(6) exception would allow taxpayers to use extraordinary disposition E&P to defer U.S. tax on subsequent taxable transactions. For example, assume that USP owns 100 percent of the stock of CFC1, CFC1 owns 100 percent of the stock of CFC2, and CFC2's E&P is maintained in the U.S. dollar. USP has a $100 × extraordinary disposition account with respect to CFC2, which has no E&P other than $100 × of extraordinary disposition E&P. Finally, assume that CFC1 has $100 × of built-in gain with respect to its stock in CFC2. In the absence of the extraordinary disposition E&P, a sale of the stock of CFC2 by CFC1 generally would result in $100 × of capital gain that is subpart F income taken into account by USP in the year of sale pursuant to sections 954(c) and 951(a). With the extraordinary disposition E&P, however, CFC2 could (in the absence of any rule denying the section 954(c)(6) exception) distribute a $100 × dividend to CFC1 before the sale, and the dividend could be eligible for the section 954(c)(6) exception while eliminating the built-in gain in the stock of CFC2. If the rules only transferred the extraordinary disposition account from CFC2 to CFC1, the section 245A shareholder could effectively indefinitely defer recognizing the built-in gain in the stock of CFC2 until it causes CFC1 to pay a $100 × dividend. While similar benefits may be obtained in the case of same-country dividends under section 954(c)(3), the Treasury Department and the IRS have determined that such transactions are relatively infrequent.

For these reasons, the final regulations do not adopt this recommendation and, accordingly, continue to limit the application of the section 954(c)(6) exception with respect to certain dividends attributable to extraordinary disposition E&P from a lower-tier CFC to an upper-tier CFC. The final regulations also clarify that transactions structured to use section 954(c)(3) to avoid the purposes of the final regulations are subject to adjustments under the anti-abuse rule in § 1.245A–5(h). See § 1.245A–5(j)(10) for an example of the application of the anti-abuse rule to a transaction utilizing section 954(c)(3) to avoid the purposes of § 1.245A–5.

IV. Comments and Revisions Related to Extraordinary Reductions

A. Bilateral Election To Close Taxable Year

If an extraordinary reduction occurs with respect to a CFC and there is an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero, the controlling section 245A shareholder (or shareholders) of a CFC can elect to close the CFC's taxable year for all purposes of the Code and, as a result, be considered to not have undertaken an extraordinary reduction. *See* § 1.245A–5(e)(3)(i). As a condition for making the election, however, the controlling section 245A shareholders must enter into a written, binding agreement concerning the election with certain U.S. tax resident shareholders of the CFC. *See* proposed § 1.245A–5(e)(3)(i)(C). Because the election can only be made if there is an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero, the election cannot be made if the CFC only has a tested loss for the taxable year.

A comment stated that it was unclear who is required to enter into this agreement and that only the controlling section 245A shareholders at the time of the extraordinary reduction should be required to make such an election. The final regulations clarify that each controlling section 245A shareholder participating in the extraordinary reduction with an extraordinary reduction amount greater than zero, and each U.S. tax resident that is a United States shareholder of the CFC at the end of the day of the extraordinary reduction (thus including a person that becomes a United States shareholder of the CFC by reason of the extraordinary reduction), must enter into a binding agreement to close the taxable year of the CFC. This rule is reflected in the analysis in an example in proposed § 1.245A–5(j)(4)(iii), which is retained in the final regulations. This approach is not modified as requested by the comment because closing the taxable year of a CFC affects the tax consequences of both the transferors and transferees in an extraordinary reduction, and inconsistent treatment could give rise to inappropriate results (for example, both a transferor and transferee could claim to have income inclusions under section 951(a) or 951A(a) and claim deemed-paid foreign credits under section 960(a) or (d), with respect to the same income of the CFC).

The final regulations also allow a U.S. tax resident that owns its interest in the CFC through a partnership to delegate the authority to enter into the binding agreement on its behalf provided that the delegation is pursuant to a written partnership agreement (within the meaning of § 1.704–1(b)(2)(ii)(*h*)). *See* § 1.245A–5(e)(3)(i)(C)(*2*).

Finally, changes are made to clarify the scope of the reference to § 1.964–1(c) with respect to the election to close the taxable year for extraordinary reductions and to the consistency requirement of § 1.245A–5(e)(3)(i)(E).

B. Timing of Election To Close Taxable Year

Comments stated that it may not be clear in certain instances whether an election to close the taxable year is beneficial. Accordingly, the comments recommended that the final regulations provide additional flexibility as to when this election is required to be made. The final regulations do not adopt this recommendation. The election is timely made when filed with the controlling section 245A shareholder's timely filed (including extensions) original tax return for the taxable year in which the extraordinary reduction occurred; thus, taxpayers have considerable time to decide whether to make the election. Furthermore, permitting later elections would potentially result in amended tax returns and considerable administrative complexity.

C. Allocation of Subpart F Income and Tested Income Between Taxable Periods

If an election is made under § 1.245A–5(e)(3)(i) to close a CFC's taxable year for all purposes of the Code, then all United States shareholders that own (within the meaning of section 958(a)) stock of the CFC on such date compute and take into account their pro rata share of subpart F income or tested income earned by the CFC as of that date.

A comment recommended modifying the ''closing-of-the-books'' approach under § 1.245A–5T(e)(3)(i) (and proposed § 1.245A–5(e)(3)(i)) because of administrative complexity for the CFC, and because the closing-of-the-books method may provide inconsistent results. The comment also suggested that this approach would provide tax planning opportunities and traps for the unwary because an extraordinary item of income (for example, gain from the disposition of a capital asset) might arise pre- or post-sale, but the item would only be allocated to the period in which it arises when an election under § 1.245A–5(e)(3)(i) is in place. The comment instead recommended adopting principles similar to those in § 1.1248–3 to allocate subpart F income and tested income of a CFC between the pre- and post-sale portions of the year based on a daily proration. The comment acknowledged, however, that this approach could delay restructuring or commercial decisions and suggested allowing a taxpayer to elect to allocate extraordinary items to the period in which they arise, similar to an approach under § 1.1502–76(b).

The final regulations do not adopt this comment for several reasons. First, the election under § 1.245A–5(e)(3)(i) is provided to allow controlling section 245A shareholders and U.S. tax residents to agree to close the CFC's taxable year and take into account their pro rata share of subpart F or tested income earned by that date in lieu of being subject to the extraordinary reduction rules. The Treasury Department and the IRS have determined that closing the taxable year provides a more precise method for determining the amount of subpart F income and tested income attributable to each owner. Second, the rule provides taxpayers with flexibility, given that controlling section 245A shareholders may choose not to make the election (or U.S. tax residents may choose not to agree to make the election) when it would not provide the preferred outcome. Finally, the comment's recommended approaches present administrative complexities and may delay commercial transactions.

D. Reporting on U.S. tax Residents' pro Rata Shares

The 2019 regulations provide that, for purposes of determining a controlling section 245A shareholder's extraordinary reduction amount, the shareholder's pre-reduction pro rata share of subpart F income or tested income is reduced by certain amounts taken into account by transferee shareholders. *See* § 1.245A–5(e)(2)(ii)(B). A comment indicated that it may be difficult for a controlling section 245A shareholder to determine a transferee's pro rata share of subpart F income or tested income and recommended that the final regulations provide that a controlling section 245A shareholder may make this determination by relying on information provided by a transferee pursuant to IRS forms and instructions.

While the Treasury Department and the IRS may consider whether information reporting would be appropriate in this context in future guidance, the final regulations do not adopt this recommendation. Parties to an extraordinary reduction transaction can negotiate to share the needed information, however. Furthermore, in some instances, parties to an extraordinary reduction transaction are

related, and therefore readily have access to such information.

E. Nonrecognition Transactions

The 2019 regulations and the final regulations do not contain special rules for extraordinary reductions occurring as a result of nonrecognition transactions such as reorganizations or transfers subject to section 351(a) or 721(a). The Treasury Department and the IRS continue to study these transactions and the potential to use them to avoid the purposes of the extraordinary reduction rules. For example, the Treasury Department and the IRS are concerned that taxpayers may avail themselves of partnerships to attempt to shift the tax liability, in whole or in part, with respect to E&P of a CFC attributable to subpart F income or tested income to a related foreign partner that is not owned by a United States shareholder. The Treasury Department and the IRS request comments on this matter and other cases in which nonrecognition transactions could be used to avoid the purposes of the extraordinary reduction rules.

V. Anti-Abuse Rule

The 2019 regulations include a general anti-abuse rule that provides that the Commissioner may make appropriate adjustments to any amounts determined under proposed § 1.245A–5 if a transaction is entered into with a principal purpose of avoiding the purposes of such section. *See* proposed § 1.245A–5(h).

One comment appreciated the desire to use a principles-based backstop to mechanical rules, and recognized the legitimate concerns of the government, but nevertheless asserted that the anti-abuse rule is vague and overly broad. The comment stated that although the policies underlying the extraordinary disposition rules and the extraordinary reduction rules are related, the origins of the transactions giving rise to the concerns and the focus of the two rules differ. Accordingly, the comment recommended that the final regulations clarify the purposes of § 1.245A–5 and include examples regarding the applicability of the anti-abuse rule and the scope of the adjustments that may be made pursuant to the rule.

In response to this comment, the final regulations include examples illustrating the application of the anti-abuse rule. *See* § 1.245A–5(h) and (j)(8)–(10). In addition, the Treasury Department and the IRS have determined that the anti-abuse rule should be self-executing, rather than applicable under the discretion of the Commissioner. Accordingly, the anti-abuse rule is modified to this effect.

VI. Applicability Date

The proposed regulations incorporated the applicability date of the temporary regulations by cross-reference. The temporary regulations apply to distributions made after December 31, 2017, consistent with the applicability date of section 245A. The temporary regulations were issued under sections 7805(b)(2), which permits the Treasury Department and the IRS to issue retroactive regulations within 18 months of the enactment of the statutory provision to which the regulations relate.

The final regulations apply to tax periods ending on or after June 14, 2019, the date the proposed regulations were filed with the **Federal Register**. *See* section 7805(b)(1)(B). This formulation of the applicability date is consistent with numerous other regulations. *See, e.g.,* §§ 1.59A–10; 1.960–7. It differs from the one incorporated in the proposed regulations because the final regulations are not being issued within 18 months of the enactment of the provisions to which the regulations relate.

In a case where both the temporary regulations and the final regulations could apply, only the final regulations apply. *See* § 1.245A–5(k)(1). For example, if a CFC has a tax period ending on November 30, 2019, and it made a distribution during that period on December 1, 2018, a portion of which would be an ineligible amount, the final regulations apply to the distribution. Distributions made after December 31, 2017, and before the final regulations apply, continue to be subject to the rules set forth in the temporary regulations. *See* T.D. 9865. However, a taxpayer may choose to apply the final regulations to distributions made during this period, provided that the taxpayer and all related parties consistently apply the final regulations in their entirety. *See* § 1.245A–5(k)(2).

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 this regulation is regulatory.

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

A. Background

The Tax Cuts and Jobs Act (the ''Act'') transitioned the United States from a primarily deferral-based international tax system (subject to the immediate taxation of generally mobile or passive income under the subpart F regime) to a participation exemption system coupled with immediate taxation of certain offshore earnings (in some cases, at a reduced rate of tax).[2] This transition was effected through several interlocking provisions of the Code—sections 245A, 951A, and 965. The three provisions have different effective dates, and thus it was possible, absent these regulations, for certain transactions to gain the benefits of section 245A without the potential imposition of U.S. tax as a result of the application of sections 951A and 965. The new system operates alongside the pre-Act subpart F regime that taxes certain offshore earnings using a longstanding rule for attributing pro rata shares of a foreign corporation's earnings to its U.S. shareholders.

1. Background: Dividends Received Deduction (Section 245A)

The Act included section 245A, which provides a deduction for U.S. taxpayers for dividends received out of certain offshore earnings (the ''section 245A deduction''). Prior to the Act, dividends paid by foreign corporations to their U.S. shareholders were

[2] A deferral-based system is a system in which taxable foreign-source income generally is taxed only when it is repatriated to the United States. A participation exemption system is one in which foreign-source income is generally not taxed by the resident country of the shareholder (in this case, the United States). As explained further below, in the United States the participation exemption system is coupled with immediate taxation of certain types of earnings to reduce incentives for erosion of the U.S. tax base. These taxed foreign earnings can then be repatriated to the United States without further tax.

generally taxable. Section 245A(a) reverses this treatment for most shareholders that are U.S. corporations (''corporate U.S. shareholders'') by providing, subject to certain conditions and exceptions, a deduction for any dividend received by a corporate U.S. shareholder from a specified 10-percent owned foreign corporation (''SFC'').[3] A 100-percent deduction for dividends essentially means that the dividend income is not taxed in the United States at the corporate level.

Income subject to taxation under the subpart F and global intangible low-taxed income (''GILTI'') regimes generally gives rise to previously taxed earnings and profits (''PTEP''). Distributions of those PTEP are not treated as dividends and thus do not qualify for the section 245A deduction, which only applies to dividends made by SFCs after December 31, 2017, provided certain other requirements are met.

2. Background: Section 965—Transition Tax

Section 965 imposed a new tax (the ''transition tax'') on the post-1986 earnings and profits of certain foreign corporations that had gone untaxed under the pre-Act international tax regime (primarily, the subpart F regime). Earning subject to tax under section 965 gave rise to PTEP, such that future distributions of these earnings are not treated as dividends and thus would not be eligible for a section 245A deduction. By subjecting post-1986 earnings and profits to a transition tax, section 965 generally ensured that post-1986 earnings must be tested under the new international tax regime introduced by the Act in order to qualify for the section 245A deduction (that is, the earnings must not be taxed under subpart F or GILTI). Absent section 965, such untaxed earnings and profits would have been eligible for tax-free distribution under section 245A after December 31, 2017.

The transition tax generally ensures that only post-1986 earnings and profits subject to the new international tax system can qualify for the section 245A deduction.[4] This is clearly the case for calendar year CFCs, because earnings and profits that are earned after December 31, 2017, are subject to the subpart F and GILTI regimes. This is not necessarily the case, however, for fiscal year CFCs (*i.e.,* CFCs with a taxable year that starts after January 1). For these fiscal year CFCs, earnings and profits that are earned between January 1, 2018, and the start of the CFC's first fiscal year beginning on or after January 1, 2018, are not subject to taxation under the GILTI regime. But for these regulations, those earnings could potentially be distributed tax-free at any time after December 31, 2017 under section 245A. Thus, certain earnings may escape U.S. taxation absent these regulations.

3. Background: Section 951A—GILTI Regime

While the Act preserved the existing subpart F regime, legislative history shows congressional concern that the participation exemption system could heighten the incentive to shift profits to low-taxed foreign jurisdictions or tax havens after the Act. *See* Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 365 (the ''Senate Explanation''). For example, Congress expressed concern that a domestic corporation might allocate income susceptible to base erosion to certain foreign affiliates ''where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.'' *See id.* As a result of these concerns, the Act added another, complementary regime to address the additional base erosion incentives resulting from the participation exemption. This regime taxes a U.S. shareholder on its global intangible low-taxed income, or GILTI, with respect to its CFCs at a reduced rate (by reason of a section 250 deduction) under new section 951A.

Section 951A(a) generally subjects a U.S. shareholder to current taxation each year on its GILTI with respect to its CFCs. The GILTI regime applies in the first taxable year of a CFC beginning after December 31, 2017. Thus, in the case of calendar year CFCs, the application of the GILTI regime generally must be taken into account with respect to all new earnings and profits of a CFC earned starting immediately after the final date for measuring earnings and profits subject to section 965. On the other hand, the tested income of a fiscal year CFC is not subject to the GILTI regime until potentially as late as taxable years beginning on December 1, 2018.

As is the case with respect to the subpart F regime, certain CFC income is taxed under the GILTI regime in section 951A regardless of whether the associated earnings and profits are distributed before the end of the CFC's year, thus converting such earnings into PTEP and turning distributions by the CFC into PTEP distributions that do not constitute dividends eligible for the section 245A deduction. *See* Section 959(c), (d).

B. Need for the Final Regulations

Sections 245A, 965, and 951A generally act to tax foreign source income consistently across taxpayers and sources so long as a U.S. shareholder owns the same amount of stock of a calendar year CFC throughout the CFC's entire taxable year. Deviations from that condition, however, potentially allow taxpayers to avoid tax by claiming a section 245A deduction in situations where otherwise identical income would be subject to U.S. tax. For a description of these situations, see Part II of the Summary of Comments and Explanation of Revisions. This circumstance is inconsistent with the purposes of the international tax regime enacted by Congress. These final regulations are needed to limit the section 245A deduction to its intended scope and, thereby, prevent the provision from converting income that should be subject to U.S. tax into non-taxable dividends. In addition, these final regulations respond to comments received in relation to the proposed and temporary regulations.

C. Overview of the Final Regulations

On June 18, 2019, the Treasury Department and the IRS published temporary and proposed regulations that limit the section 245A deduction with respect to a dividend received by a U.S. corporation from certain SFCs so that the deduction is not available for the earnings and profits attributable to base erosion-type income. The temporary and proposed regulations limit the deduction to the portion of the dividend that exceeds the ''ineligible amount'' of the dividend.

Under the regulations, the term ''ineligible amount'' generally means the amount of the dividend that comprises (i) certain earnings and profits of the CFC that were accrued prior to the application of the GILTI regime in section 951A but after December 31, 2017, the last measurement date under section 965 (''extraordinary disposition amounts'' created in ''extraordinary dispositions''), and (ii) current year earnings and profits of the CFC that are attributable to the CFC's subpart F income or tested income under the GILTI regime and that would have given rise to income inclusions under the

[3] A specified 10-percent owned foreign corporation is any foreign corporation, other than a passive foreign investment corporation with respect to a shareholder that is not also a CFC, with at least one corporate U.S. shareholder.

[4] The legislative history of the Act provides that ''[t]he [transition tax applies in] the last taxable year of a deferred foreign income corporation that begins before January 1, 2018, which is that foreign corporation's last taxable year before the transition to the new corporate tax regime elsewhere in the bill goes into effect.'' H. Rep. 115–466 at 613.

subpart F or GILTI regimes, but for a certain change in CFC ownership (''extraordinary reduction amounts'' created in ''extraordinary reductions''). Absent the temporary and proposed regulations, the section 245A deduction could apply with respect to a dividend composed of such earnings, and, as a result, such earnings and profits would inappropriately escape U.S. tax.

A public hearing was held on November 22, 2019. The Treasury Department and the IRS also received written comments with respect to the temporary and proposed regulations. Written and oral comments were carefully considered in developing the final regulations.

In general, the final regulations retain the approach and structure of the temporary and proposed regulations. However, in response to comments, the final regulations make certain revisions to the rules in the temporary and proposed regulations, some of which are explained in part I.D.3 of these Special Analyses below.

D. Economic Analysis of the Final Regulations

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these final regulations.

2. Summary of Economic Effects Relative to No-Action Baseline

To assess the economic effects of these regulations, the Treasury Department and the IRS considered economic effects from limiting the section 245A deduction for (i) extraordinary disposition amounts and (ii) extraordinary reduction amounts.

(i) Because the disallowance of the section 245A deduction for extraordinary disposition amounts generally applies only to earnings and profits accrued prior to the publication of the final regulations, economic activity will generally not be affected by the regulations. Thus, these provisions will largely not give rise to material economic effects. The Treasury Department and the IRS have, however, identified certain circumstances under which the regulations may affect business activity relative to the no-action baseline, which are described below. It is projected that the economic effects of the provisions in these circumstances will be minor.

(ii) Extraordinary reductions stem from certain transfers of ownership of CFC stock.[5] The final regulations may reduce the number of such ownership transfers relative to the no-action baseline. To the extent that these particular extraordinary reductions would have been undertaken under the no-action baseline and will not be undertaken under the final regulations, the regulations may have associated economic effects.

With respect to extraordinary reductions between unrelated parties, there may be economic losses from efficient transactions that no longer take place as a result of the final regulations. However, this effect should be minor because taxpayers can elect to close the taxable year of the corporation being transferred and, as a result, generally suffer no additional tax cost from extraordinary reductions compared to not undertaking the transaction.

The Treasury Department and the IRS project that under the no-action baseline, the majority of extraordinary reductions between related parties would be undertaken for tax avoidance purposes rather than for market-driven reasons. Thus, there would be an economic gain from the reduction in these transfers under the final regulations. The Treasury Department and the IRS project, however, that this gain will be minor because these transfers would be between related parties and should result in only negligible losses in economic performance due to inefficient changes in management, risk-bearing, or other economic activity; thus, there should be little gain from reducing the frequency of such transfers. There may also be an economic loss from these transfers (and thus a source of gain from the final regulations relative to the no-action baseline) due to taxpayer resources expended to carry out such tax planning activities. It is projected that the election to close the taxable year will not meaningfully counter the decrease in these tax avoidance transactions because the election generally prevents tax from being avoided in an extraordinary reduction.

The Treasury Department and the IRS recognize that some related-party extraordinary reductions might take place under the no-action baseline for non-tax-driven reasons, such as for more efficient risk-bearing or other benefits related to managerial control or financing. If these transfers are deterred by the final regulations, this deterrence represents an economic loss from the final regulations. The Treasury Department and the IRS project that the aggregate value of these foregone benefits will be minimal because these transactions could still be undertaken with no additional tax cost relative to not undertaking the transaction if the taxpayer makes an election to close the taxable year of the corporation being transferred. Thus, an overall economic benefit from a reduction in related-party extraordinary reductions under these regulations is projected relative to the no-action baseline.

The final regulations require taxpayers to compute, track, and report information relevant for determination of extraordinary dispositions and extraordinary reductions. The Treasury Department and the IRS project that these additional costs, relative to the no-action baseline, will be modest. In general, with respect to the initial year of an extraordinary disposition or any extraordinary reduction, taxpayers are already required to keep track of the required information for other purposes. For example, to the extent that a U.S. taxpayer sells stock in its CFC, earns income in its CFC, or receives a dividend from a CFC, the taxpayer would otherwise record the information needed to determine eligibility for the section 245A deduction. Additionally, once calculated, the costs to track amounts related to extraordinary dispositions in future years are expected to be minimal (the extraordinary reduction rules only apply on a year-by-year basis and thus generally do not require any additional information to be tracked and reported across multiple years). Thus, the Treasury Department and the IRS expect the compliance burden from these final regulations to be modest relative to the no-action baseline.

[5] Under the Code, and absent these final regulations, a U.S. corporation that transfers stock in its CFC to a different U.S. corporation generally could avoid tax with respect to all of the subpart F and tested income of the CFC for that year (this type of transaction is generally an extraordinary reduction).

The Treasury Department and the IRS have not undertaken a quantitative estimate of the economic effects arising from any reduction in extraordinary reductions. Any such estimates would be highly uncertain because these tax provisions are new and because many of the transfers would be between related parties and possibly of short duration, both of which make estimating the number and economic value of such transfers difficult. The tax planning costs of effecting these transfers are also highly uncertain because these specific tax planning efforts are new. Because it is projected that the economic effects arising from the final regulations will be small, this question is not pursued further.

While it is not currently feasible for the Treasury Department and the IRS to quantify these economic effects, part I.D.3 of these Special Analyses explains the rationale behind certain provisions of these final regulations and provides a qualitative assessment of the alternatives considered.

3. Economic Effects of Specific Provisions

i. Treatment of Extraordinary Disposition Accounts Following Transfers of SFC Stock

a. Background and Alternatives Considered

An extraordinary disposition account is a way to measure the amount of earnings and profits of an SFC that cannot qualify for the section 245A deduction when distributed because they were generated in an extraordinary disposition during the disqualified period. Guidance is needed for the treatment of these accounts when a section 245A shareholder of an SFC holding such an account transfers stock of the SFC to an entity that is not a section 245A shareholder.[6] Such transfers may occur, for example, when the SFC is acquired by a foreign corporation that is not a controlled foreign corporation (a ''CFC'').

Under the temporary and proposed regulations, a transfer of SFC stock to a different section 245A shareholder generally resulted in the transferee assuming the extraordinary disposition account attached to the transferred SFC stock. If there was no successor (*i.e.,* the stock was sold to someone other than a section 245A shareholder), the temporary and proposed regulations contained a rule providing that the account generally was transferred to an upper-tier SFC of the transferred SFC.

The final regulations remove the rule that transfers an extraordinary disposition account to an upper-tier SFC where there is no successor and instead provide that if an SFC is sold and there is no section 245A shareholder of the target SFC after the transaction, the extraordinary disposition account of the target SFC is generally eliminated.

This modified rule recognizes that extraordinary disposition E&P in an extraordinary disposition account remaining at the time the SFC stock is sold to a third party were never used to obtain a tax benefit. If an SFC is sold to a non-section 245A shareholder when it still has an extraordinary disposition account, that means the seller did not need some or all of its extraordinary disposition E&P to support a dividend eligible for a section 245A deduction. Similarly, the acquiror cannot use the extraordinary disposition E&P to claim the section 245A deduction because it is not a section 245A shareholder. In these cases, the Treasury Department and the IRS determined that it would be more appropriate to eliminate the extraordinary disposition account with respect to the SFC, as the section 245A shareholder did not obtain a tax benefit from those earnings and the transferred account would cause tax to be imposed on a distribution of earnings and profits that were not generated in an extraordinary disposition and did not need extraordinary disposition E&P to qualify as tax-free dividends.

The Treasury Department and the IRS considered alternatives that would (i) retain the rule in the temporary and proposed regulations; (ii) expand the rule to transfer the account to any other SFC owned by the section 245A shareholder rather than only a direct upper-tier SFC that owned the SFC whose stock was sold; or (iii) transfer the account to a non-section 245A shareholder that acquires the SFC, who would not be able to make distributions that are denied the section 245A deduction under § 1.245A–5, but would be required to track the account in the event the SFC was ever transferred back to a section 245A shareholder. The first two alternatives were rejected because they were viewed as being punitive to taxpayers who had an extraordinary disposition account but never benefited from extraordinary disposition E&P as they never used those earnings and profits to support a tax-free dividend. The third alternative was rejected due to the difficulty of administration and compliance in cases where an SFC is sold outside the U.S. tax system, as well as the fact that any potential tax avoidance appeared to be sufficiently protected by clarification of the anti-abuse rule in § 1.245A–5(c)(4)(vii).

Although rules governing extraordinary dispositions generally will not have economic effects (because the underlying transactions occurred during the disqualified period), the Treasury Department and the IRS recognize that rules governing extraordinary disposition accounts upon the transfer of SFC stock may affect the decision to sell or transfer the SFC. Such decisions would then potentially have economic effects. The Treasury Department and the IRS do not have readily available data or models to provide further information about the economic consequences of this provision relative to the no-action baseline or regulatory alternatives.

b. Affected Taxpayers

The taxpayers potentially affected by this provision are taxpayers who (i) have extraordinary disposition accounts with respect to an SFC and (ii) transfer stock of that SFC to an entity that is not a 245A shareholder.

Taxpayers who potentially have extraordinary disposition accounts are direct or indirect U.S. shareholders of certain foreign corporations that are eligible for the section 245A deduction with respect to distributions from the foreign corporation, and the foreign corporation uses a fiscal year, as opposed to the calendar year, as its taxable year. The foreign corporation must have engaged in a sale of property to a related party (1) during the period between January 1, 2018, and the end of the foreign corporation's last taxable year beginning before January 1, 2018, (2) outside the ordinary course of the foreign corporation's activities, and (3) generally, while the corporation was a CFC. Additionally, the property sold must be of a type that would give rise to tested income and the value of the property sold must exceed the lesser of $50 million or 5 percent of the total value of all of the property of the foreign corporation.

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. However, the actual number of affected taxpayers is smaller than this because a domestic corporation will not

[6] A section 245A shareholder is any U.S. corporation that owns 10 percent of the stock of an SFC and is thus generally eligible to claim a 245A deduction.

be affected unless its fiscal year CFC engages in a non-routine sale with a related party that is of sufficient magnitude that the final regulations apply. The Treasury Department and the IRS do not have readily available data on the number of taxpayers that transfer SFC stock to persons that are not section 245A shareholders.

ii. Election To Close the CFC's Taxable Year

a. Background and Alternatives Considered

In the absence of further regulations, section 245A could facilitate the avoidance of the subpart F and GILTI regimes through extraordinary reductions by allowing a U.S. shareholder to transfer stock of a CFC to a shareholder who, based on various legal criteria, would not be taxed on the CFC's subpart F income or tested income. In these cases, current year subpart F income and GILTI could escape U.S. taxation altogether. This result would undermine the Act's system for taxing foreign earnings.

In the temporary and proposed regulations, the Treasury Department and the IRS provided taxpayers with an election to close the taxable year of the CFC for all purposes of the Code on the date of an extraordinary reduction. Instead of denying the section 245A deduction, such an election would subject the CFC's earnings and profits for the taxable year up to the date of the extraordinary reduction to taxation under the subpart F or GILTI regimes in the seller's hands, while the remaining earnings and profits of the CFC for the year would be subject to taxation under the subpart F or GILTI regimes in the buyer's hands. The election allows taxpayers to choose the tax treatment that would have been imposed in the absence of the interactions among provisions that otherwise generates inappropriate tax results in the taxable year of an extraordinary reduction. Taxpayers who did not take this election with respect to an extraordinary reduction would be denied a section 245A deduction for certain amounts distributed as part of the extraordinary reduction. The Treasury Department and the IRS have determined that providing this election would result in similar tax treatment of otherwise similar income, a result that generally leads to economically efficient outcomes.

The election in the temporary and proposed regulations was intended to be bilateral, requiring filing of the seller and consent of the buyer of the CFC. Comments expressed confusion about whether the election was unilateral or bilateral, and some of them recommended a unilateral election. The final regulations clarify that the election must reflect a consensus between the buyer and seller of the CFC that was the subject of the extraordinary reduction, since the election has potentially important tax implications for both sides. Since the election to close the taxable year affects the amount of taxable income included by both the buyer and the seller for the year of the extraordinary reduction with respect to the target CFC, it is now clarified that buyers and sellers must mutually agree to make the election.

The Treasury Department and the IRS considered as an alternative adopting certain requests to make the election unilateral, but determined that doing so would inappropriately allow one party to a transaction to affect the tax consequences of the other party without their consent.

b. Affected Taxpayers

The taxpayers potentially affected by this provision are U.S. shareholders that own directly or indirectly stock of a CFC that has a controlling section 245A shareholder that owns more than 50 percent of the stock of the CFC. Additionally, during the taxable year, the controlling section 245A shareholder generally must directly or indirectly sell stock in the CFC that exceeds 10 percent of the controlling section 245A shareholder's interest in the CFC and 5 percent of the total value of the stock of the CFC. Furthermore, in the year of the ownership reduction, the subpart F income and tested income of the CFC must exceed the lesser of $50 million or 5 percent of the CFC's total income for the year.

The Treasury Department and the IRS have not estimated the number of taxpayers that are likely to be affected by these regulations because data on the taxpayers that have engaged or would engage in these particular transactions are not readily available. Based on 2014 Statistics of Income tax data, the Treasury Department and the IRS estimate that there are approximately 15,000 domestic corporations with CFCs. The actual number of affected taxpayers is likely much smaller than this because the regulations affect only those domestic corporations with CFCs for which the controlling section 245A shareholder engages in a sale of the CFC's stock of in a year in which the CFC pays a dividend (or deemed dividend).

iii. Ownership Change Thresholds in the Definition of an Extraordinary Reduction

a. Background and Alternatives Considered

Under the extraordinary reduction rules, the final regulations generally limit the amount of the section 245A deduction when either (i) a controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC or (ii) there is a greater than 10 percent change in the controlling section 245A shareholder's overall ownership of the CFC.

In defining an extraordinary reduction, the Treasury Department and the IRS considered other percentage thresholds for these conditions. The Treasury Department and the IRS expect that the ownership change threshold specified in the final regulations provides a reasonable balance between effective administration of section 245A and similar tax treatment of other similar income. The Treasury Department and the IRS do not have readily available data or models to compute an optimal percentage threshold.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the final regulations are the same as discussed in section D.3.ii.b.

II. Paperwork Reduction Act

The collection of information in the final regulations are in §§ 1.245A–5(e)(3) and 1.6038–2(f)(16).

The collection of information in § 1.245A–5(e)(3) is elective for a domestic corporation that is a controlling section 245A shareholder of a CFC receiving a dividend from the CFC and wants to elect to have none of the dividend considered an extraordinary reduction amount by closing the CFC's tax year. The collection of information is satisfied by timely filing of the ''Elective Section 245A Year-Closing Statement'' with the domestic corporation's original Form 1120, U.S. Corporation Income Tax Return, for the taxable year in which the dividend is received. For purposes of the Paperwork Reduction Act, the reporting burden associated with § 1.245A–5 will be reflected in the Paperwork Reduction Act submission associated with Form 1120 (OMB control no. 1545–0123).

The collection of information in § 1.6038–2(f)(16) is mandatory for every U.S. person that controls a foreign corporation and files Form 5471 for that period (OMB control number 1545–0123

in the case of business taxpayers, formerly, OMB control number 1545–0704) that (1) has paid a dividend for which a deduction under section 245A was limited by an ineligible amount under § 1.245A–5(b) or paid a dividend for which the section 954(c)(6) exception was limited by a tiered extraordinary disposition amount or tiered extraordinary reduction amount under § 1.245A–5(d) and (f), respectively, (2) maintains an extraordinary disposition account with respect to the CFC for which the Form is being filed, or (3) applies the exception to the extraordinary disposition per se rule pursuant to § 1.245A–5(c)(3)(ii)(C)(*2*) during an annual accounting period. The collection of information in § 1.6038–2(f)(16) is satisfied by providing information about the ineligible amount, tiered extraordinary disposition amount, tiered extraordinary reduction amount, balance of the U.S. person's extraordinary disposition account, or reliance on the exception to the extraordinary disposition per se rule for 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)(16) will be reflected in the applicable Paperwork Reduction Act submission, associated with Form 5471. The estimated number of respondents for the reporting burden associated with § 1.6038–2(f)(16) is 12,000–18,000, 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		✓	12,000–18,000

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 temporary regulations is provided in the accompanying table. The reporting burdens associated with the information collections in §§ 1.245A–5(e)(3) and 1.6038–2(f)(16) 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 final 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 final regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the final regulations.

The Treasury Department and the IRS requested comments on all aspects of information collection burdens related to the temporary 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 (if any) to these forms that reflect the information collections contained in the final regulations will be made available for public comment at *https://apps.irs.gov/app/picklist/list/draftTaxForms.html* and will not be finalized until after these forms have been approved by OMB under the PRA.

Information collection	Type of filer	OMB Nos.	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. Additionally, to be subject to the final regulations, the foreign corporation that is owned by the small entity must have engaged in certain related party transactions during its last fiscal taxable year beginning before January 1, 2018, or the U.S. shareholder must have transferred certain stock in the foreign corporation during the taxable year. Based on 2014 Statistics of Income tax data, the Department of the Treasury (''Treasury Department'') and the IRS estimate that there are approximately 15,000 U.S. corporations with controlled foreign corporations (''CFCs''), of which approximately half (6,000–9,000) have less than $25 million in gross receipts. Not all of these corporations will be affected by the final regulations. In particular, only U.S. taxpayers with fiscal year CFCs that transfer assets in related party transactions during the gap period, or

U.S. taxpayers that transfer more than 10 percent of their stock of a CFC in a taxable year or U.S. taxpayers that reduce their ownership of stock of a CFC by more than 10 percent, have the potential to be affected by these regulations. 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 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 these final regulations. To make this determination, the Treasury Department 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 Act and Jobs Act, JCX–67–17, December 18, 2017), resulting in a less than 1% 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. The tax thus amounts to less than 3 to 5 percent of receipts (as defined in 13 CFR 121.104), 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 final regulations because not all the GILTI and subpart F revenue estimated to be attributable to small entities will be captured by the final regulations. Consequently, the Treasury Department and the IRS have determined that § 1.245A–5 will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, the proposed regulations (REG–106282–18) preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses and no comments were received.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The final regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The final regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Drafting Information

The principal authors of the final regulations are Arielle M. Borsos and Logan M. Kincheloe, 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.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

■ **Par. 2.** Reserved §§ 1.245A–1 through 1.245A–4 and § 1.245A–5 are added to read as follows:

§§ 1.245A–1—1.245A–4 [Reserved]

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

(a) *Overview.* This section provides rules that limit a deduction under section 245A(a) to the portion of a dividend that exceeds the ineligible amount of such dividend or the applicability of section 954(c)(6) when a portion of a dividend is paid out of an extraordinary disposition account or when an extraordinary reduction occurs. Paragraph (b) of this section provides rules regarding ineligible amounts. Paragraph (c) of this section provides rules for determining ineligible amounts attributable to an extraordinary disposition. Paragraph (d) of this section provides rules that limit the application of section 954(c)(6) when one or more section 245A shareholders of a lower-tier CFC have an extraordinary disposition account. Paragraph (e) of this section provides rules for determining ineligible amounts attributable to an extraordinary reduction. Paragraph (f) of this section provides rules that limit the application of section 954(c)(6) when a lower-tier CFC has an extraordinary reduction amount. Paragraph (g) of this section provides special rules for purposes of applying this section. Paragraph (h) of this section provides an anti-abuse rule. Paragraph (i) of this section provides definitions. Paragraph (j) of this section provides examples illustrating the application of this section. Paragraph (k) of this section provides the applicability date of this section.

(b) *Limitation of deduction under section 245A*—(1) *In general.* A section 245A shareholder is allowed a section 245A deduction for any dividend received from an SFC (provided all other applicable requirements are satisfied) only to the extent that the dividend exceeds the ineligible amount of the dividend. See paragraphs (j)(2), (4), and (5) of this section for examples illustrating the application of this paragraph (b)(1).

(2) *Definition of ineligible amount.* The term *ineligible amount* means, with respect to a dividend received by a section 245A shareholder from an SFC, an amount equal to the sum of—

(i) 50 percent of the extraordinary disposition amount (as determined under paragraph (c) of this section); and

(ii) The extraordinary reduction amount (as determined under paragraph (e) of this section).

(c) *Rules for determining extraordinary disposition amount*—(1) *Definition of extraordinary disposition amount.* The term *extraordinary disposition amount* means the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder. See paragraph (j)(2) of this section for an example illustrating the application of this paragraph (c).

(2) *Determination of portion of dividend paid out of extraordinary disposition account*—(i) *In general.* For purposes of determining the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder, the following rules apply—

(A) The dividend is first considered paid out of non-extraordinary disposition E&P with respect to the section 245A shareholder; and

(B) The dividend is next considered paid out of the extraordinary disposition account to the extent of the section 245A shareholder's extraordinary disposition account balance.

(ii) *Definition of non-extraordinary disposition E&P.* The term *non-extraordinary disposition E&P* means, with respect to a section 245A shareholder and an SFC, an amount of earnings and profits of the SFC equal to the excess, if any, of—

(A) The product of—

(*1*) The amount of the SFC's earnings and profits described in section 959(c)(3), determined as of the end of the SFC's taxable year (for purposes of paragraph (c)(2)(ii) of this section, without regard to distributions during the taxable year other than as provided in this paragraph (c)(2)(ii)(A)(*1*)), but, if during the taxable year the SFC pays more than one dividend, reduced (but not below zero) by the amounts of any dividends paid by the SFC earlier in the taxable year; and

(*2*) The percentage of the stock (by value) of the SFC that the section 245A shareholder owns directly or indirectly immediately before the distribution; over

(B) The balance of the section 245A shareholder's extraordinary disposition account with respect to the SFC, determined immediately before the distribution.

(3) *Definitions with respect to extraordinary disposition accounts*—(i) *Extraordinary disposition account*—(A) *In general.* The term *extraordinary disposition account* means, with respect to a section 245A shareholder of an SFC, an account, the balance of which is equal to the product of the extraordinary disposition ownership percentage and the extraordinary disposition E&P, reduced (but not below zero) by the prior extraordinary disposition amount, and adjusted under paragraph (c)(4) of this section, as applicable. An extraordinary disposition account is maintained in the same functional currency as the extraordinary disposition E&P.

(B) *Extraordinary disposition ownership percentage.* The term *extraordinary disposition ownership percentage* means the percentage of stock (by value) of an SFC that a section 245A shareholder owns directly or indirectly at the beginning of the disqualified period or, if later, on the first day during the disqualified period on which the SFC is a CFC, regardless of whether the section 245A shareholder owns directly or indirectly such stock of the SFC on the date of an extraordinary disposition giving rise to extraordinary disposition E&P; if not, see paragraph (c)(4) of this section.

(C) *Extraordinary disposition E&P.* The term *extraordinary disposition E&P* means an amount of earnings and profits of an SFC equal to the sum of the net gain recognized by the SFC with respect to specified property in each extraordinary disposition. In the case of an extraordinary disposition with respect to the SFC arising as a result of a disposition of specified property by a specified entity (other than a foreign corporation), an interest of which is owned directly or indirectly (through one or more other specified entities that are not foreign corporations) by the SFC, the net gain taken into account for purposes of the preceding sentence is the SFC's distributive share of the net gain recognized by the specified entity with respect to the specified property.

(D) *Prior extraordinary disposition amount*—(*1*) *General rule.* The term *prior extraordinary disposition amount* means, with respect to an SFC and a section 245A shareholder, the sum of the extraordinary disposition amount of each prior dividend received by the section 245A shareholder from the SFC by reason of paragraph (c)(1) of this section and 200 percent of the sum of the amounts included in the section 245A shareholder's gross income under section 951(a) by reason of paragraph (d) of this section (in the case in which the SFC is, or has been, a lower-tier CFC). A section 245A shareholder's prior extraordinary disposition amount also includes—

(*i*) A prior dividend received by the section 245A shareholder from the SFC to the extent not an extraordinary reduction amount and to the extent the dividend would have been an extraordinary disposition amount but for the failure of the dividend to qualify for the section 245A deduction by reason of one or more of the following: Application of section 245A(e); the recipient domestic corporation does not satisfy the holding period requirement of section 246; or the recipient domestic corporation is not a United States shareholder with respect to the foreign corporation from whose earnings and profits the dividend is sourced;

(*ii*) The portion of a prior dividend (to the extent not a tiered extraordinary disposition amount by reason of paragraph (d) of this section) received by an upper-tier CFC from the SFC that by reason of section 245A(e) or being properly allocable to subpart F income of the SFC for the taxable year of the dividend pursuant to section 954(c)(6)(A) was included in the upper-tier CFC's foreign personal holding company income and was included in gross income by the section 245A shareholder under section 951(a) but would have been a tiered extraordinary disposition amount by reason of paragraph (d) of this section had paragraph (d) applied to the dividend;

(*iii*) If a prior dividend received by an upper-tier CFC from a lower-tier CFC gives rise to a tiered extraordinary disposition amount with respect to the section 245A shareholder by reason of paragraph (d) of this section, the qualified portion; and

(*iv*) 200 percent of an amount included in the gross income of a domestic corporation under section 951(a)(1)(B) with respect to a CFC for the taxable year of the domestic corporation in which or with which the CFC's taxable year ends, to the extent so included by reason of the application of this section to the hypothetical distribution described in § 1.956–1(a)(2), or to the extent the amount would have been so included by reason of the application of this section to the hypothetical distribution but for the application of section 245A(e) or the holding period requirement in section 246 to the hypothetical distribution.

(*2*) *Definition of qualified portion*—(*i*) *In general.* The term *qualified portion* means, with respect to a tiered extraordinary disposition amount of a section 245A shareholder and a lower-tier CFC, 200 percent of the portion of the disqualified amount with respect to

the tiered extraordinary disposition amount equal to the sum of the amounts included in gross income by each U.S. tax resident under section 951(a) in the taxable year in which the tiered extraordinary disposition amount arose with respect to the lower-tier CFC by reason of paragraph (d) of this section. For purposes of the preceding sentence, the reference to a U.S. tax resident does not include any section 245A shareholder with a tiered extraordinary disposition amount with respect to the lower-tier CFC.

(*ii*) *Determining a qualified portion if multiple section 245A shareholders have tiered extraordinary disposition amounts.* For the purposes of applying paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, if more than one section 245A shareholder has a tiered extraordinary disposition amount with respect to a dividend received by an upper-tier CFC from a lower-tier CFC, then the qualified portion with respect to each section 245A shareholder is equal to the amount described in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, without regard to this paragraph (c)(3)(i)(D)(*2*)(*ii*), multiplied by a fraction, the numerator of which is the section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC and the denominator of which is the sum of the tiered extraordinary disposition amounts with respect to each section 245A shareholder and the lower-tier CFC.

(ii) *Extraordinary disposition*—(A) *In general.* Except as provided in paragraph (c)(3)(ii)(E) of this section, the term *extraordinary disposition* means, with respect to an SFC, any disposition of specified property by the SFC on a date on which it was a CFC and during the SFC's disqualified period to a related party if the disposition occurs outside of the ordinary course of the SFC's activities. An extraordinary disposition also includes a disposition during the disqualified period on a date on which the SFC is not a CFC if there is a plan, agreement, or understanding involving a section 245A shareholder to cause the SFC to recognize gain that would give rise to an extraordinary disposition if the SFC were a CFC.

(B) *Facts and circumstances.* A determination as to whether a disposition is undertaken outside of the ordinary course of an SFC's activities is made on the basis of facts and circumstances, taking into account whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency. In addition, a disposition of specified property by an SFC to a related party may be considered outside of the ordinary course of the SFC's activities notwithstanding that the SFC regularly disposes of property of the same type of, or similar to, the specified property to persons that are not related parties.

(C) *Per se rules*—(*1*) *In general.* Even if a disposition would otherwise be considered to be undertaken in the ordinary course of an SFC's activities under the requirements of paragraph (c)(3)(ii)(B) of this section, that disposition is treated as occurring outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or, except as provided in paragraph (c)(3)(ii)(C)(*2*) of this section, if the disposition is of intangible property, as defined in section 367(d)(4).

(*2*) *Exception to the per se rule for certain property*—(*i*) *Exception.* Paragraph (c)(3)(ii)(C)(*1*) of this section does not apply to a disposition of intangible property that is not described in section 367(d)(4)(C) or (F), provided that the property is transferred to a related person during the disqualified period with a reasonable expectation that the related person will resell the property to an unrelated customer within one year. Subject to paragraph (c)(3)(ii)(C)(*2*)(*ii*) of this section, a disposition of intangible property that satisfies the requirements of this paragraph (c)(3)(ii)(C)(*2*)(*i*) is determined to be within or without the ordinary course of an SFC's activities based on the test described in paragraph (c)(3)(ii)(B) of this section.

(*ii*) *Facts and circumstances presumption for property described in section 367(d)(4)(A).* Notwithstanding paragraph (c)(3)(ii)(B) of this section, any disposition described in paragraph (c)(3)(ii)(C)(*2*)(*i*) of this section of a copyright right within the meaning of § 1.861–18 or of intangible property described in section 367(d)(4)(A) is presumed to take place outside of the ordinary course of an SFC's activities for purposes of paragraph (c)(3)(ii)(A) of this section. The presumption in the preceding sentence may be rebutted only if the taxpayer can show that the facts and circumstances clearly establish that the disposition took place in the ordinary course of the SFC's activities.

(D) *Treatment of dispositions by certain specified entities.* For purposes of paragraph (c)(3)(ii)(A) of this section, an extraordinary disposition with respect to an SFC includes a disposition by a specified entity other than a foreign corporation, provided that immediately before or immediately after the disposition the specified entity is a related party with respect to the SFC, the SFC directly or indirectly (through one or more other specified entities other than foreign corporations) owns an interest in the specified entity, and the disposition would have otherwise qualified as an extraordinary disposition had the specified entity been a foreign corporation.

(E) *De minimis exception to extraordinary disposition.* If the sum of the net gain recognized by an SFC with respect to specified property in all dispositions otherwise described in paragraph (c)(3)(ii)(A) of this section does not exceed the lesser of $50 million or 5 percent of the gross value of all of the SFC's property held immediately before the beginning of its disqualified period, then no disposition of specified property by the SFC is an extraordinary disposition.

(iii) *Disqualified period.* The term *disqualified period* means, with respect to an SFC that is a CFC on any day during the taxable year that includes January 1, 2018, 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.

(iv) *Specified property.* The term *specified property* means any property if gain recognized with respect to such property during the disqualified period is not described in section 951A(c)(2)(A)(i)(I) through (V). If only a portion of the gain recognized with respect to property during the disqualified period is gain that is not described in section 951A(c)(2)(A)(i)(I) through (V), then a portion of the property is treated as specified property in an amount that bears the same ratio to the value of the property as the amount of gain not described in section 951A(c)(2)(A)(i)(I) through (V) bears to the total amount of gain recognized with respect to such property during the disqualified period. Specified property is also property with respect to which a loss was recognized during the disqualified period if the loss is properly allocable to income not described in section 951A(c)(2)(A)(i)(I) through (V) under the principles of section 954(b)(5) (specified loss). If only a portion of the loss recognized with respect to property during the disqualified period is specified loss, then a portion of the property is treated as specified property in an amount that bears the same ratio to the value of the property as the amount of specified loss bears to the total amount of loss recognized with respect to such property during the disqualified period.

(4) *Successor rules for extraordinary disposition accounts.* This paragraph (c)(4) applies with respect to an

extraordinary disposition account upon certain direct or indirect transfers of stock of an SFC by a section 245A shareholder.

(i) *Another section 245A shareholder succeeds to all or portion of account.* Except as provided in paragraph (c)(4)(vi) of this section, paragraphs (c)(4)(i)(A) through (D) of this section apply when a section 245A shareholder of an SFC (the *transferor*) transfers directly or indirectly a share of stock (or a portion of a share of stock) of the SFC that it owns directly or indirectly (the share or portion thereof, a *transferred share*).

(A) If immediately after the transfer (taking into account all transactions related to the transfer) another person is a section 245A shareholder of the SFC, then such other person's extraordinary disposition account with respect to the SFC is increased by the person's proportionate share of the amount allocated to the transferred share.

(B) For purposes of paragraph (c)(4)(i)(A) of this section, the amount allocated to a transferred share is equal to the product of—

(*1*) The balance of the transferor's extraordinary disposition account with respect to the SFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(i)(B); and

(*2*) A fraction, the numerator of which is the value of the transferred share and the denominator of which is the value of all of the stock of the SFC that the transferor owns directly or indirectly immediately before the transfer.

(C) For purposes of paragraph (c)(4)(i)(A) of this section, a person's proportionate share of the amount allocated to a transferred share under paragraph (c)(4)(i)(B) of this section is equal to the product of—

(*1*) The amount allocated to the share; and

(*2*) The percentage of the share (by value) that the person owns directly or indirectly immediately after the transfer (taking into account all transactions related to the transfer).

(D) The transferor's extraordinary disposition account with respect to the SFC is decreased by the amount by which another person's extraordinary disposition account with respect to the SFC is increased pursuant to paragraph (c)(4)(i)(A) of this section.

(ii) *Certain section 381 transactions*—(A) *In general.* If assets of an SFC (the *acquired corporation*) are acquired by another SFC (the *acquiring corporation*) pursuant to a transaction described in section 381(a) in which the acquired corporation is the transferor corporation for purposes of section 381, then a section 245A shareholder's extraordinary disposition account with respect to the acquiring corporation is increased by the balance of its extraordinary disposition account with respect to the acquired corporation, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(ii)(A).

(B) *Certain triangular asset reorganizations.* If, in a transaction described in paragraph (c)(4)(ii)(A) of this section, the section 245A shareholder receives stock of a domestic corporation that controls (within the meaning of section 368(c)) the acquiring corporation, the domestic corporation's extraordinary disposition account with respect to the acquiring corporation is increased by the balance of the section 245A shareholder's extraordinary disposition account with respect to the acquired corporation, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(ii)(B).

(iii) *Certain distributions involving section 355 or 356.* In the case of a transaction involving a distribution under section 355 (or so much of section 356 as it relates to section 355) by an SFC (the *distributing corporation*) of stock of another SFC (the *controlled corporation*), a section 245A shareholder's extraordinary disposition account with respect to the distributing corporation is attributed to (and treated as) an extraordinary disposition account with respect to the controlled corporation in a manner similar to how earnings and profits of the distributing corporation and the controlled corporation are adjusted under § 1.312–10. To the extent that a section 245A shareholder's extraordinary disposition account with respect to the distributing CFC is not so attributed to (and treated as) an extraordinary disposition account with respect to the controlled corporation, the extraordinary disposition account remains as an extraordinary disposition account with respect to the distributing corporation.

(iv) *Transfer of all of the stock of the SFC owned by a section 245A shareholder*—(A) *In general.* If, in a transaction described in paragraph (c) of this section, a section 245A shareholder of an SFC transfers directly or indirectly all of the stock of the SFC that it owns directly or indirectly, then, except as provided in paragraph (c)(4)(iv)(B) of this section, any remaining balance of the section 245A shareholder's extraordinary disposition account that is not allocated or attributed under paragraph (c) of this section is eliminated and therefore not taken into account by any person.

(B) *Related party retains the extraordinary distribution account.* If any related party with respect to the section 245A shareholder described in paragraph (c)(4)(iv)(A) of this section is a section 245A shareholder with respect to the SFC immediately after the transfer (taking into account all transactions related to the transfer), then the remaining balance of the section 245A shareholder's extraordinary disposition account with respect to the SFC is added to the related party's extraordinary disposition account. If multiple related parties are section 245A shareholders of the SFC, then the remaining balance of the extraordinary disposition account is allocated between the related parties in proportion to the value of the stock of the SFC that they own directly or indirectly immediately after the transfer (taking into account all transactions related to the transfer).

(v) *Effect of section 338(g) election*—(A) *In general.* Except as provided in paragraph (c)(4)(v)(B) of this section, if an election under section 338(g) is made with respect to a qualified stock purchase (as defined in section 338(d)(3)) of stock of an SFC, then a section 245A shareholder's extraordinary disposition account with respect to the old target (as defined in § 1.338–2(c)(17)) is not treated as (or attributed to) an extraordinary disposition account with respect to the new target (as defined in § 1.338–2(c)(17)). Accordingly, the remaining balance of the old target's extraordinary disposition account is eliminated and is not thereafter taken into account by any person. (B) *Special rules regarding carryover foreign target stock.* If an election under section 338(g) is made with respect to a qualified stock purchase (as described in section 338(d)(3)) of stock of an SFC and there are one or more shares of carryover foreign target stock (''FT stock'') (as described in § 1.338–9(b)(3)(i)), then the following rules apply as to a section 245A shareholder of the new target that after the qualified stock purchase directly or indirectly owns carryover FT stock (such shareholder, the *carryover FT stock shareholder*):

(*1*) In a case in which before the qualified stock purchase the carryover FT stock shareholder directly or indirectly owned carryover FT stock, the carryover FT stock shareholder's extraordinary disposition account with respect to the old target, determined after any reduction pursuant to paragraph (c)(3) of this section by reason

of dividends, is treated as its extraordinary disposition account with respect to the new target.

(*2*) In a case in which before the qualified stock purchase the carryover FT stock shareholder did not directly or indirectly own carryover FT stock, but the stock retains its character as carryover FT stock (taking into account § 1.338–9(b)(3)(vi)), a ratable portion of each section 245A shareholder's extraordinary disposition account with respect to the old target, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends, is treated as the carryover FT stock shareholder's extraordinary disposition account with respect to the new target, based on the value of the carryover FT stock that the carryover FT stock shareholder owns directly or indirectly after the qualified stock purchase relative to the value of all of the stock of the new target.

(vi) *Certain transfers described in § 1.1248–8(a)(1)*—(A) *In general.* If a person transfers stock of an SFC with respect to which a section 245A shareholder has an extraordinary disposition account to a foreign acquiring corporation in a transaction described § 1.1248–8(a)(1) (other than a transfer that is also described in § 1.1248(f)–1(b)(2) or (3)) in which stock of a foreign corporation is received by the transferor, then, except in the case in which the transfer is also described in paragraph (c)(4)(ii) or (iii) of this section, the section 245A shareholder's extraordinary disposition account is not adjusted under this paragraph (c)(4).

(B) *Certain transfers described in § 1.1248(f)–1(b).* In the case of a transfer directly or indirectly of stock of an SFC by a section 245A shareholder described in § 1.1248(f)–1(b)(2) or (3), but which does not result in an income inclusion, in whole or in part, by reason of § 1.1248–2, the section 245A shareholder's extraordinary disposition account with respect to the SFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(vi)(B), is allocated and adjusted in the same manner as under paragraph (c)(4)(i) of this section, except that, for purposes of applying paragraphs (c)(4)(i)(B) and (C) of this section, stock of the SFC that is owned directly or indirectly by persons who are not section 1248 shareholders (as defined in § 1.1248(f)–1(c)(12)) is disregarded.

(vii) *Anti-abuse rule.* Pursuant to paragraph (h) of this section, if a principal purpose of a transaction or series of transactions is to shift to another person, or to avoid, an amount of a section 245A shareholder's extraordinary disposition account with respect to an SFC or otherwise avoid the purposes of this section, then appropriate adjustments are made for purposes of this section, including disregarding the transaction or series of transactions. A principal purpose described in the preceding sentence is deemed to exist if stock of an SFC is directly or indirectly acquired by one of more section 245A shareholders within one year of a transaction or transactions to which paragraph (c)(4)(iv)(A) of this section would otherwise apply.

(d) *Limitation of amount eligible for section 954(c)(6) when there is an extraordinary disposition account with respect to a lower-tier CFC*—(1) *In general.* If an upper-tier CFC receives a dividend from a lower-tier CFC, then the dividend is eligible for the exception to foreign personal holding company income under section 954(c)(6) (provided all other applicable requirements are satisfied) with respect to the portion of the dividend that exceeds the disqualified amount. With respect to the portion of the dividend that does not exceed the disqualified amount, the exception to foreign personal holding company income under section 954(c)(6) is allowed (provided all other applicable requirements are satisfied) only for the amount equal to 50 percent of the portion of the dividend that does not exceed the disqualified amount. The disqualified amount is the quotient of the amounts described in paragraphs (d)(1)(i) and (ii) of this section.

(i) The sum of each section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC.

(ii) The percentage of stock of the upper-tier CFC (by value) owned, in the aggregate, by U.S. tax residents that include in gross income their pro rata share of the upper-tier CFC's subpart F income under section 951(a) on the last day of the upper-tier CFC's taxable year. If a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder of the upper-tier CFC, the amount of stock owned by the U.S. tax resident for purposes of the preceding sentence is determined under the principles of paragraph (g)(3) of this section.

(2) *Definition of tiered extraordinary disposition amount*—(i) *In general.* The term *tiered extraordinary disposition amount* means, with respect to a dividend received by an upper-tier CFC from a lower-tier CFC and a section 245A shareholder, the portion of the dividend that would be an extraordinary disposition amount if the section 245A shareholder received as a dividend its pro rata share of the dividend from the lower-tier CFC. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC from a lower-tier CFC by reason of section 964(e)(4) (in such case, see paragraphs (b)(1) and (g)(2) of this section).

(ii) *Section 245A shareholder's pro rata share of a dividend received by an upper-tier CFC.* For the purposes of paragraph (d)(2)(i) of this section, a section 245A shareholder's pro rata share of the amount of a dividend received by an upper-tier CFC from a lower-tier CFC equals the amount by which the dividend would increase the section 245A shareholder's pro rata share of the upper-tier CFC's subpart F income under section 951(a)(2) and § 1.951–1(b) and (e) if the dividend were included in the upper-tier CFC's foreign personal holding company income under section 951(a)(1), determined without regard to section 952(c) and as if the upper-tier CFC had no deductions properly allocable to the dividend under section 954(b)(5).

(e) *Extraordinary reduction amount*—(1) *In general.* Except as provided in paragraph (e)(3) of this section, the term *extraordinary reduction amount* means, with respect to a dividend received by a controlling section 245A shareholder from a CFC during a taxable year of the CFC ending after December 31, 2017, in which an extraordinary reduction occurs with respect to the controlling section 245A shareholder's ownership of the CFC, the lesser of the amounts described in paragraph (e)(1)(i) or (ii) of this section. *See* paragraphs (j)(4) through (6) of this section for examples illustrating the application of this paragraph (e).

(i) The amount of the dividend.

(ii) The amount equal to the sum of the controlling section 245A shareholder's pre-reduction pro rata share of the CFC's subpart F income (as defined in section 952(a)) and tested income (as defined in section 951A(c)(2)(A)) for the taxable year, reduced, but not below zero, by the prior extraordinary reduction amount.

(2) *Rules regarding extraordinary reduction amounts*—(i) *Extraordinary reduction*—(A) *In general.* Except as provided in paragraph (e)(2)(i)(C) of this section, an *extraordinary reduction* occurs, with respect to a controlling section 245A shareholder's ownership of a CFC during a taxable year of the CFC, if either of the conditions described in paragraph (e)(2)(i)(A)(*1*) or (*2*) of this section is satisfied. See paragraphs (j)(4) and (5) of this section

for examples illustrating an extraordinary reduction.

(*1*) The condition of this paragraph (e)(2)(i)(A)(*1*) requires that during the taxable year, the controlling section 245A shareholder transfers directly or indirectly (other than by reason of a transfer occurring pursuant to an exchange described in section 368(a)(1)(E) or (F)), in the aggregate, more than 10 percent (by value) of the stock of the CFC that the section 245A shareholder owns directly or indirectly as of the beginning of the taxable year of the CFC, provided the stock transferred, in the aggregate, represents at least 5 percent (by value) of the outstanding stock of the CFC as of the beginning of the taxable year of the CFC; or

(*2*) The condition of this paragraph (e)(2)(i)(A)(*2*) requires that, as a result of one or more transactions occurring during the taxable year, the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly as of the close of the last day of the taxable year of the CFC is less than 90 percent of the percentage of stock (by value) that the controlling section 245A shareholder owns directly or indirectly on either of the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section (such percentage, the *initial percentage*), provided the difference between the initial percentage and percentage at the end of the year is at least five percentage points.

(B) *Dates for purposes of the initial percentage.* For purposes of paragraph (e)(2)(i)(A)(*2*) of this section, the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section are—

(*1*) The day of the taxable year on which the controlling section 245A shareholder owns directly or indirectly its highest percentage of stock (by value) of the CFC; and

(*2*) The day immediately before the first day on which stock was transferred directly or indirectly in the preceding taxable year in a transaction (or a series of transactions) occurring pursuant to a plan to reduce the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly.

(C) *Transactions pursuant to which CFC's taxable year ends.* A controlling section 245A shareholder's direct or indirect transfer of stock of a CFC that but for this paragraph (e)(2)(i)(C) would give rise to an extraordinary reduction under paragraph (e)(2)(i)(A) of this section does not give rise to an extraordinary reduction if the taxable year of the CFC ends immediately after the transfer, provided that the controlling section 245A shareholder directly or indirectly owns the stock on the last day of such year. Thus, for example, if a controlling section 245A shareholder exchanges all the stock of a CFC pursuant to a complete liquidation of the CFC, the exchange does not give rise to an extraordinary reduction.

(ii) *Rules for determining pre-reduction pro rata share*—(A) *In general.* Except as provided in paragraph (e)(2)(ii)(B) of this section, the term *pre-reduction pro rata share* means, with respect to a controlling section 245A shareholder and the subpart F income or tested income of a CFC, the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and § 1.951–1(b) and (e) or section 951A(e)(1) and § 1.951A–1(d)(1), respectively, determined based on the controlling section 245A shareholder's direct or indirect ownership of stock of the CFC immediately before the extraordinary reduction (or, if the extraordinary reduction occurs by reason of multiple transactions, immediately before the first transaction) and without regard to section 951(a)(2)(B) and § 1.951–1(b)(1)(ii), but only to the extent that such subpart F income or tested income is not included in the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and § 1.951–1(b) and (e) or section 951A(e)(1) and § 1.951A–1(d)(1), respectively.

(B) *Decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax resident.* A controlling section 245A shareholder's pre-reduction pro rata share of subpart F income or tested income of a CFC for a taxable year is reduced by an amount equal to the sum of the amounts by which each U.S. tax resident's pro rata share of the subpart F income or tested income is increased as a result of a transfer directly or indirectly of stock of the CFC by the controlling section 245A shareholder or an issuance of stock by the CFC (such an amount with respect to a U.S. tax resident, a *specified amount*), in either case, during the taxable year in which the extraordinary reduction occurs. For purposes of this paragraph (e)(2)(ii)(B), if there are extraordinary reductions with respect to more than one controlling section 245A shareholder during the CFC's taxable year, then a U.S. tax resident's specified amount attributable to an acquisition of stock from the CFC is prorated with respect to each controlling section 245A shareholder based on its relative decrease in ownership of the CFC. See paragraph (j)(5) of this section for an example illustrating a decrease in a section 245A shareholder's pre-reduction pro rata share for amounts taken into account by a U.S. tax resident.

(C) *Prior extraordinary reduction amount.* The term *prior extraordinary reduction amount* means, with respect to a CFC and section 245A shareholder and a taxable year of the CFC in which an extraordinary reduction occurs, the sum of the extraordinary reduction amount of each prior dividend received by the section 245A shareholder from the CFC during the taxable year. A section 245A shareholder's prior extraordinary reduction amount also includes—

(*1*) A prior dividend received by the section 245A shareholder from the CFC during the taxable year to the extent the dividend was not eligible for the section 245A deduction by reason of section 245A(e) or the holding period requirement of section 246 not being satisfied but would have been an extraordinary reduction amount had this paragraph (e) applied to the dividend;

(*2*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper tier-CFC, the portion of a prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year of the lower-tier CFC that, by reason of section 245A(e), was included in the upper-tier CFC's foreign personal holding company income and that by reason of section 951(a) was included in income of the section 245A shareholder, and that would have given rise to a tiered extraordinary reduction amount by reason of paragraph (f) of this section had paragraph (f) applied to the dividend of which the section 245A shareholder would have included a pro rata share of the tiered extraordinary reduction amount in income by reason of section 951(a); and

(*3*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper-tier CFC, the sum of the portion of the tiered extraordinary reduction amount of each prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year that is included in income of the section 245A shareholder by reason of section 951(a).

(3) *Exceptions*—(i) *Elective exception to close CFC's taxable year*—(A) *In general.* For a taxable year of a CFC in which an extraordinary reduction occurs with respect to a controlling

section 245A shareholder and for which, absent this paragraph (e)(3)(i), there would be an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero, no amount is considered an extraordinary reduction amount or tiered extraordinary reduction amount with respect to the controlling section 245A shareholder if each controlling section 245A shareholder elects, and each U.S. tax resident described in paragraph (e)(3)(i)(C)(*2*) of this section agrees, pursuant to this paragraph (e)(3)(i), to close the CFC's taxable year for all purposes of the Internal Revenue Code (and, therefore, as to all shareholders of the CFC) as of the end of the date on which the extraordinary reduction occurs, or, if the extraordinary reduction occurs by reason of multiple transactions, as of the end of each date on which a transaction forming a part of the extraordinary reduction occurs. If an election is made pursuant to this paragraph (e)(3)(i), all shareholders of the CFC that are a controlling section 245A shareholder or a U.S. tax resident described in paragraph (e)(3)(i)(C)(*2*) of this section must file their respective U.S. income tax and information returns consistently with the election. If each controlling section 245A shareholder elects to close the CFC's taxable year, that closing will be treated as a change in accounting period for purposes of the notice requirement in § 1.964–1(c)(3)(iii), treating any controlling section 245A shareholders as controlling domestic shareholders for this purpose. However, the notice described in § 1.964–1(c)(3)(iii) does not need to be provided to persons that are U.S. tax residents described in paragraph (e)(3)(i)(C) of this section. For purposes of applying this paragraph (e)(3)(i), a controlling section 245A shareholder that has an extraordinary reduction (or a transaction forming a part thereof) with respect to a CFC is treated as owning the same amount of stock it owned in the CFC immediately before the extraordinary reduction (or a transaction forming a part thereof) on the end of the date on which the extraordinary reduction occurs (or such transaction forming a part thereof occurs). To the extent that shares of a CFC are treated as owned by a controlling section 245A shareholder as of the close of the CFC's taxable year pursuant to the preceding sentence, such shares are treated as not being owned by any other person as of the close of the CFC's taxable year.

(B) *Allocation of foreign taxes.* If an election is made pursuant to this paragraph (e)(3) to close a CFC's taxable year and the CFC's taxable year under foreign law (if any) does not close at the end of the date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to such foreign taxable year are allocated between the period of the foreign taxable year that ends with, and the period of the foreign taxable year that begins after, the date on which the CFC's taxable year closes as a result of the election. If there is more than one date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to the foreign taxable year are allocated to all such periods. The allocation is made based on the respective portions of the taxable income of the CFC (as determined under foreign law) for the foreign taxable year that are attributable under the principles of § 1.1502–76(b) to the periods during the foreign taxable year. Foreign taxes allocated to a period under this paragraph (e)(3)(i)(B) are treated as paid or accrued by the CFC as of the close of that period.

(C) *Time and manner of making election*—(*1*) *Election by controlling section 245A shareholder.* An election pursuant to this paragraph (e)(3) is made and effective if the statement described in paragraph (e)(3)(i)(D) of this section is timely filed (including extensions) by each controlling section 245A shareholder making the election with its original U.S. tax return for the taxable year in which the extraordinary reduction occurs. If a controlling section 245A shareholder is a member of a consolidated group (within the meaning of § 1.1502–1(h)) and participates in the extraordinary reduction, the agent for such group (within the meaning of § 1.1502–77(c)(1)) must file the election described in this paragraph (e)(3) on behalf of such member.

(*2*) *Binding agreement.* Before the filing of the statement described in paragraph (e)(3)(i)(D) of this section, each controlling section 245A shareholder must enter into a written, binding agreement with each U.S. tax resident that on the end of the date on which the extraordinary reduction occurs (or, if the extraordinary reduction occurs by reason of multiple transactions, each U.S. tax resident that on the end of each date on which a transaction forming a part of the extraordinary reduction occurs) owns directly or indirectly, without regard to the final two sentences of paragraph (e)(3)(i)(A) of this section, stock of the CFC and is a United States shareholder with respect to the CFC. In the case of a U.S. tax resident that owns stock of the CFC indirectly through one or more partnerships, the partnership that directly owns the stock of the CFC may enter into the binding agreement on behalf of the U.S. tax resident partner provided that, before the due date of the partner's original Federal income tax return, including extensions, the partner delegated the authority to the partnership to enter into the binding agreement pursuant to a written partnership agreement (within the meaning of § 1.704–1(b)(2)(ii)(*h*)). The written, binding agreement must provide that each controlling section 245A shareholder will elect to close the taxable year of the CFC.

(*3*) *Transition rule.* In the case of an extraordinary reduction occurring before August 27, 2020, the statement described in paragraph (e)(3)(i)(D) of this section is considered timely filed if it is attached by each controlling section 245A shareholder to an original or amended return for the taxable year in which the extraordinary reduction occurs. In the case of an amended return, the statement is considered timely filed only if it is filed with an amended return no later than February 23, 2021.

(D) *Form and content of statement.* The statement required by paragraph (e)(3)(i)(C) of this section is to be titled ''Elective Section 245A Year-Closing Statement.'' The statement must—

(*1*) Identify (by name and tax identification number, if any) each controlling section 245A shareholder, each U.S tax resident described in paragraph (e)(3)(i)(C) of this section, and the CFC;

(*2*) State the date of the extraordinary reduction (or, if the extraordinary reduction includes transactions on more than one date, the dates of all such transactions) to which the election applies;

(*3*) State the filing controlling section 245A shareholder's pro rata share of the subpart F income, tested income, and foreign taxes described in section 960 with respect to the stock of the CFC subject to the extraordinary reduction, and, if applicable, the amount of earnings and profits attributable to such stock within the meaning of section 1248, as of the date of the extraordinary reduction;

(*4*) State that each controlling section 245A shareholder and each U.S tax resident described in paragraph (e)(3)(i)(C) of this section have entered into a written, binding agreement to elect to close the CFC's taxable year in accordance with paragraph (e)(3)(i)(C) of this section; and

(*5*) Be filed in the manner, if any, prescribed by forms, publications, or other guidance published in the Internal Revenue Bulletin.

(E) *Consistency requirements.* If multiple extraordinary reductions occur with respect to one or more controlling section 245A shareholders' ownership in a single CFC during one or more taxable years of the CFC, then to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) section may be made only if it is made for all such extraordinary reductions with respect to the CFC for which there was an extraordinary reduction amount. Furthermore, if an extraordinary reduction occurs with respect to a controlling section 245A shareholders' ownership in one or more CFCs, then, to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) may be made only if it is made for each extraordinary reduction for which there was an extraordinary reduction amount with respect to all of the CFCs that have the same or related (within the meaning of section 267(b) or 707(b)) controlling section 245A shareholders.

(ii) *De minimis subpart F income and tested income.* For a taxable year of a CFC in which an extraordinary reduction occurs, no amount is considered an extraordinary reduction amount (or, with respect to a lower-tier CFC, a tiered extraordinary reduction amount under paragraph (f) of this section) with respect to a controlling section 245A shareholder of the CFC if the sum of the CFC's subpart F income and tested income (as defined in section 951A(c)(2)(A)) for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC's total income for the taxable year.

(f) *Limitation of amount eligible for section 954(c)(6) where extraordinary reduction occurs with respect to lower-tier CFCs*—(1) *In general.* If an extraordinary reduction occurs with respect to a lower-tier CFC and an upper-tier CFC receives a dividend from the lower-tier CFC in the taxable year in which the extraordinary reduction occurs, then the dividend is eligible for the exception to foreign personal holding company income under section 954(c)(6) (provided all other applicable requirements are satisfied) only with respect to the portion of the dividend that exceeds the tiered extraordinary reduction amount. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC by reason of section 964(e)(4) (in this case, see paragraphs (b)(1) and (g)(2) of this section). See paragraph (j)(7) of this section for an example illustrating the application of this paragraph (f)(1).

(2) *Definition of tiered extraordinary reduction amount.* The term *tiered extraordinary reduction amount* means, with respect to the portion of a dividend received by an upper-tier CFC from a lower-tier CFC during a taxable year of the lower-tier CFC, the amount of such dividend equal to the excess, if any, of—

(i) The product of—

(A) The sum of the amount of the subpart F income and tested income of the lower-tier CFC for the taxable year; and

(B) The percentage (by value) of stock of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately before the extraordinary reduction (or the first transaction forming a part thereof); over

(ii) The following amounts—

(A) The sum of each U.S. tax resident's pro rata share of the lower-tier CFC's subpart F income and tested income under section 951(a) or 951A(a), respectively, that is attributable to shares of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately prior to the extraordinary reduction (or the first transaction forming a part thereof), computed without the application of this paragraph (f);

(B) The sum of each prior tiered extraordinary reduction amount and sum of each amount included in an upper-tier CFC's subpart F income by reason of section 245A(e) with respect to prior dividends from the lower-tier CFC during the taxable year;

(C) The sum of each U.S. tax resident's pro rata share of an upper-tier CFC's subpart F income under section 951(a) and § 1.951–1(e) that is attributable to dividends received from the lower-tier CFC in the taxable year of the extraordinary reduction that do not qualify for the exception to foreign personal holding company income under section 954(c)(6) because the dividends, or portions thereof, are properly allocable to subpart F income of the lower-tier CFC for the taxable year of the extraordinary reduction pursuant to section 954(c)(6)(A);

(D) The sum of the prior extraordinary reduction amounts (but, for this purpose, computed without regard to amounts described in paragraphs (e)(2)(ii)(C)(*2*) and (*3*) of this section) of each controlling section 245A shareholder with respect to shares of the lower-tier CFC that were owned by such controlling section 245A shareholder (including indirectly through a specified entity other than a foreign corporation) for a portion of the taxable year but are owned by an upper-tier CFC (including indirectly through a specified entity other than a foreign corporation) at the time of the distribution of the dividend; and

(E) The product of the amount described in paragraph (f)(2)(i)(B) of this section and the sum of the amounts of each U.S. tax resident's pro rata share of subpart F income and tested income for the taxable year under section 951(a) or 951A(a), respectively, attributable to shares of the lower-tier CFC directly or indirectly acquired by the U.S. tax resident from the lower-tier CFC during the taxable year.

(3) *Transition rule for computing tiered extraordinary reduction amount.* Solely for purposes of applying this paragraph (f) in taxable years of a lower-tier CFC beginning on or after January 1, 2018, and ending before June 14, 2019, a tiered extraordinary reduction amount is determined by treating the lower-tier CFC's subpart F income for the taxable year as if it were neither subpart F income nor tested income.

(g) *Special rules.* The rules in this paragraph (g) apply for purposes of this section.

(1) *Source of dividends.* A dividend received by any person is considered received directly by such person from the foreign corporation whose earnings and profits give rise to the dividend. Therefore, for example, if a section 245A shareholder sells or exchanges stock of an upper-tier CFC and the gain recognized on the sale or exchange is included in the gross income of the section 245A shareholder as a dividend under section 1248(a), then, to the extent the dividend is attributable under section 1248(c)(2) to the earnings and profits of a lower-tier CFC owned, within the meaning of section 958(a)(2), by the section 245A shareholder through the upper-tier CFC, the dividend is considered received directly by the section 245A shareholder from the lower-tier CFC.

(2) *Certain section 964(e) inclusions treated as dividends.* An amount included in the gross income of a section 245A shareholder under section 951(a)(1)(A) by reason of section 964(e)(4) is considered a dividend received by the section 245A shareholder directly from the foreign corporation whose earnings and profits give rise to the amount described in section 964(e)(1). Therefore, for example, if an upper-tier CFC sells or exchanges stock of a lower-tier CFC, and, as a result of the sale or exchange, a section 245A shareholder with respect to the upper-tier CFC includes an amount in gross income under section 951(a)(1)(A) by reason of section

964(e)(4), then the inclusion is treated as a dividend received directly by the section 245A shareholder from the lower-tier CFC whose earnings and profits give rise to the dividend, and the section 245A shareholder is not allowed a section 245A deduction for the dividend to the extent of the ineligible amount of such dividend.

(3) *Rules regarding stock ownership and stock transfers*—(i) *Determining indirect ownership of stock of an SFC or a CFC.* For purposes of this section, if a person owns an interest in, or stock of, a specified entity, including through a chain of ownership of one or more other specified entities, then the person is considered to own indirectly a pro rata share of stock of an SFC or a CFC owned by the specified entity. To determine a person's pro rata share of stock owned by a specified entity, the principles of section 958(a) apply without regard to whether the specified entity is foreign or domestic.

(ii) *Determining indirect transfers for stock owned indirectly.* If, under paragraph (g)(3)(i) of this section, a person is considered to own indirectly stock of an SFC or CFC that is owned by a specified entity, then the following rules apply in determining if the person transfers stock of the SFC or CFC—

(A) To the extent the specified entity transfers stock that is considered owned indirectly by the person immediately before the transfer, the person is considered to transfer indirectly such stock;

(B) If the person transfers an interest in, or stock of, the specified entity, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the specified entity that is transferred; and

(C) In the case in which the person owns the specified entity through a chain of ownership of one or more other specified entities, if there is a transfer of an interest in, or stock of, another specified entity in the chain of ownership, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the other specified entity transferred.

(iii) *Definition of specified entity.* The term *specified entity* means any partnership, trust (other than a trust treated as a corporation for U.S. income tax purposes), or estate (in each case, domestic or foreign), or any foreign corporation.

(4) *Coordination rules*—(i) *General rule.* A dividend is first subject to section 245A(e). To the extent the dividend is not a hybrid dividend or tiered hybrid dividend under section 245A(e), the dividend is subject to paragraph (e) or (f) of this section, as applicable, and then, to the extent the dividend is not subject to paragraph (e) or (f) of this section, it is subject to paragraph (c) or (d) of this section, as applicable.

(ii) *Coordination rule for paragraphs (c) and (d) and (e) and (f) of this section, respectively.* If an SFC or CFC pays a dividend (or simultaneous dividends), a portion of which may be subject to paragraph (c) or (e) of this section and a portion of which may be subject to paragraph (d) or (f) of this section, the rules of this section apply by treating the portion of the dividend or dividends that may be subject to paragraph (c) or (e) of this section as if it occurred immediately before the portion of the dividend or dividends that may be subject to paragraph (d) or (f) of this section. For example, if a dividend arising under section 964(e)(4) occurs at the same time as a dividend that would be eligible for the exception to foreign personal holding company income under section 954(c)(6) but for the potential application of paragraph (d) this section, then the tiered extraordinary disposition amount with respect to the other dividend is determined as if the dividend arising under section 964(e)(4) occurs immediately before the other dividend.

(5) *Ordering rule for multiple dividends made by an SFC or a CFC during a taxable year.* If an SFC or a CFC pays dividends on more than one date during its taxable year or at different times on the same date, this section applies based on the order in which the dividends are paid.

(6) *Partner's distributive share of a domestic partnership's pro rata share of subpart F income or tested income.* If a section 245A shareholder or a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder with respect to a CFC and includes in gross income its distributive share of the domestic partnership's inclusion under section 951(a) or 951A(a) with respect to the CFC then, solely for purposes of this section, a reference to the section 245A shareholder's or U.S. tax resident's pro rata share of the CFC's subpart F income or tested income included in gross income under section 951(a) or 951A(a), respectively, includes such person's distributive share of the domestic partnership's pro rata share of the CFC's subpart F income or tested income. A person is an indirect partner with respect to a domestic partnership if the person indirectly owns the domestic partnership through one or more specified entities (other than a foreign corporation).

(7) *Related domestic corporations treated as a single domestic corporation for certain purposes.* For purposes of determining the extent that a dividend is an extraordinary disposition amount or a tiered extraordinary disposition amount, as well as for purposes of determining the extent to which an extraordinary disposition account is reduced by a prior extraordinary disposition amount, domestic corporations that are related parties are treated as a single domestic corporation. Thus, for example, if two domestic corporations are related parties and either or both of them are section 245A shareholders with respect to an SFC, then the extent to which a dividend received by either domestic corporation from the SFC is an extraordinary disposition amount is based on the sum of each domestic corporation's extraordinary disposition account with respect to the SFC. When, by reason of this paragraph (g)(7), the extent to which a dividend is an extraordinary disposition amount or tiered extraordinary disposition amount is determined based on the sum of two or more extraordinary disposition accounts, a pro rata amount in each extraordinary disposition account is considered to give rise to the extraordinary disposition amount or tiered extraordinary disposition amount, if any.

(h) *Anti-abuse rule.* Appropriate adjustments are made pursuant to this section, including adjustments that would disregard a transaction or arrangement in whole or in part, to any amounts determined under (or subject to the application of) this section if a transaction or arrangement is engaged in with a principal purpose of avoiding the purposes of this section. For examples illustrating the application of this paragraph (h), see paragraphs (j)(8) through (10) of this section.

(i) *Definitions.* The following definitions apply for purposes of this section.

(1) *Controlled foreign corporation.* The term *controlled foreign corporation* (or *CFC*) has the meaning provided in section 957.

(2) *Controlling section 245A shareholder.* The term *controlling section 245A shareholder* means, with respect to a CFC, any section 245A shareholder that owns directly or indirectly more than 50 percent (by vote or value) of the stock of the CFC. For purposes of determining whether a section 245A shareholder is a controlling section 245A shareholder with respect to a CFC, all stock of the

CFC owned by a related party with respect to the section 245A shareholder or by other persons acting in concert with the section 245A shareholder to undertake an extraordinary reduction is considered owned by the section 245A shareholder. If section 964(e)(4) applies to a sale or exchange of a lower-tier CFC with respect to a controlling section 245A shareholder, all United States shareholders of the CFC are considered to act in concert with regard to the sale or exchange. In addition, if all persons selling stock in a CFC, held directly, sell such stock to the same buyer or buyers (or a related party with respect to the buyer or buyers) as part of the same plan, all sellers will be considered to act in concert with regard to the sale or exchange.

(3) *Disqualified amount.* The term *disqualified amount* has the meaning set forth in paragraph (d)(1) of this section.

(4) *Disqualified period.* The term *disqualified period* has the meaning set forth in paragraph (c)(3)(iii) of this section.

(5) *Extraordinary disposition.* The term *extraordinary disposition* has the meaning set forth in paragraph (c)(3)(ii) of this section.

(6) *Extraordinary disposition account.* The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i) of this section.

(7) *Extraordinary disposition amount.* The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(1) of this section.

(8) *Extraordinary disposition E&P.* The term *extraordinary E&P* has the meaning set forth in paragraph (c)(3)(i)(C) of this section.

(9) *Extraordinary disposition ownership percentage.* The term extraordinary disposition ownership percentage has the meaning set forth in paragraph (c)(3)(i)(B) of this section.

(10) *Extraordinary reduction.* The term *extraordinary reduction* has the meaning set forth in paragraph (e)(2)(i)(A) of this section.

(11) *Extraordinary reduction amount.* The term *extraordinary reduction amount* has the meaning set forth in paragraph (e)(1) of this section.

(12) *Ineligible amount.* The term *ineligible amount* has the meaning set forth in paragraph (b)(2) of this section.

(13) *Lower-tier CFC.* The term *lower-tier CFC* means a CFC whose stock is owned (within the meaning of section 958(a)(2)), in whole or in part, by another CFC.

(14) *Non-extraordinary disposition E&P.* The term *non-extraordinary disposition E&P* has the meaning set forth in paragraph (c)(2)(ii) of this section.

(15) *Pre-reduction pro rata share.* The term *pre-reduction pro rata share* has the meaning set forth in paragraph (e)(2)(ii) of this section.

(16) *Prior extraordinary disposition amount.* The term *prior extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i)(D) of this section.

(17) *Prior extraordinary reduction amount.* The term *prior extraordinary reduction amount* has the meaning set forth in paragraph (e)(2)(ii)(C) of this section.

(18) *Qualified portion.* The term *qualified portion* has the meaning set forth in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section.

(19) *Related party.* The term *related party* means, with respect to a person, another person bearing a relationship described in section 267(b) or 707(b) to the person, in which case such persons are *related.*

(20) *Section 245A deduction.* The term *section 245A deduction* means, with respect to a dividend received by a section 245A shareholder from an SFC, the amount of the deduction allowed to the section 245A shareholder by reason of the dividend.

(21) *Section 245A shareholder.* The term *section 245A shareholder* means a domestic corporation that is a United States shareholder with respect to an SFC and that owns directly or indirectly stock of the SFC.

(22) *Specified 10-percent owned foreign corporation (SFC).* The term *specified 10-percent owned foreign corporation* (or *SFC*) has the meaning provided in section 245A(b)(1).

(23) *Specified entity.* The term *specified entity* has the meaning set forth in paragraph (g)(3)(iii) of this section.

(24) *Specified property.* The term *specified property* has the meaning set forth in paragraph (c)(3)(iv) of this section.

(25) *Tiered extraordinary disposition amount.* The term *tiered extraordinary disposition amount* has the meaning set forth in paragraph (d)(2)(i) of this section.

(26) *Tiered extraordinary reduction amount.* The term *tiered extraordinary reduction amount* has the meaning set forth in paragraph (f)(2) of this section.

(27) *United States shareholder.* The term *United States shareholder* has the meaning provided in section 951(b).

(28) *Upper-tier CFC.* The term *upper-tier CFC* means a CFC that owns (within the meaning of section 958(a)(2)) stock in another CFC.

(29) *U.S. tax resident.* The term *U.S. tax resident* means a United States person described in section 7701(a)(30)(A) or (C).

(j) *Examples.* The application of this section is illustrated by the examples in this paragraph (j).

(1) *Facts.* Except as otherwise stated, the facts described in this paragraph (j)(1) are assumed for purposes of the examples.

(i) US1 and US2 are domestic corporations, each with a calendar taxable year, and are not related parties with respect to each other.

(ii) CFC1, CFC2, and CFC3 are foreign corporations that are SFCs and CFCs.

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

(iv) Year 2 begins on or after January 1, 2018 and has 365 days.

(v) Absent application of this section, dividends received by US1 and US2 from a CFC meet the requirements to qualify for the section 245A deduction, and dividends received by one CFC from another CFC qualify for the exception to foreign personal holding company income under section 954(c)(6).

(vi) The de minimis rules in paragraphs (c)(3)(ii)(E) and (e)(3)(ii) of this section do not apply.

(vii) Section 1059 is not relevant to the tax results described in the examples in this paragraph (j).

(2) *Example 1. Extraordinary disposition*—(i) *Facts.* US1 and US2 own 60% and 40%, respectively, of the single class of stock of CFC1. CFC1 owns all of the single class of stock of CFC2. CFC1 and CFC2 use the taxable year ending November 30 as their taxable year. On November 1, 2018, CFC1 sells specified property to CFC2 in exchange for $200x of cash (the ''Property Transfer''). The Property Transfer is outside of CFC1's ordinary course of activities. The transferred property has a basis of $100x in the hands of CFC1. CFC1 recognizes $100x of gain as a result of the Property Transfer ($200x − $100x). On December 1, 2018, CFC1 distributes $80x pro rata to US1 ($48x) and US2 ($32x), all of which is a dividend within the meaning of section 316 and treated as a distribution out of earnings described in section 959(c)(3). No other distributions are made by CFC1 to either US1 or US2 in CFC1's taxable year ending November 30, 2019. For its taxable year ending on November 30, 2019, CFC1 has $110x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year.

(ii) *Analysis*—(A) *Identification of extraordinary disposition.* Because CFC1 is a CFC and uses the taxable year ending on November 30, under paragraph (c)(3)(iii) of this section, it has a disqualified period beginning on January 1, 2018, and ending on November 30, 2018. In addition, under paragraph (c)(3)(ii) of this section, the Property Transfer is an extraordinary disposition because it: Is a disposition of specified property by CFC1 on a date on

which it was a CFC and during CFC1's disqualified period; is to CFC2, a related party with respect to CFC1; occurs outside of the ordinary course of CFC1's activities; and, is not subject to the de minimis rule in paragraph (c)(3)(ii)(E) of this section.

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts.* Because CFC1 undertook an extraordinary disposition, under paragraph (c)(3)(i) of this section, a portion of CFC1's earnings and profits are extraordinary disposition E&P and, therefore, give rise to an extraordinary disposition account with respect to each of CFC1's section 245A shareholders. Under paragraph (i)(21) of this section, US1 and US2 are both section 245A shareholders with respect to CFC1. The amount of the extraordinary disposition account with respect to US1 is $60x, which is equal to the product of the extraordinary disposition E&P (the amount of the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and the extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US1 on January 1, 2018 (60%)), reduced by the prior extraordinary disposition amount ($0). *See* paragraph (c)(3)(i) of this section. Similarly, the amount of the extraordinary disposition account with respect to US2 is $40x, which is equal to the product of the extraordinary disposition E&P (the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US2 on January 1, 2018 (40%)), reduced by the prior extraordinary disposition amount ($0).

(C) *Determination of extraordinary disposition amount with respect to US1.* The dividend of $48x paid to US1 on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of the extraordinary disposition account with respect to US1. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US1, to the extent thereof. With respect to US1, $6x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $66x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 60%) over $60x (the balance of US1's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $6x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US1. Under paragraph (c)(2)(i)(B) of this section, the remaining $42x of the dividend is next considered paid out of US1's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $42x of the dividend is considered paid out of the extraordinary disposition account with respect to CFC1 and gives rise to $42x of an extraordinary disposition amount. As a result, US1's prior extraordinary disposition amount is increased by $42x under paragraph (c)(3)(i)(D) of this section, and US1's extraordinary disposition account is reduced to $18x ($60x − $42x) under paragraph (c)(3)(i)(A) of this section.

(D) *Determination of extraordinary disposition amount with respect to US2.* The dividend of $32x paid to US2, on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of extraordinary disposition E&P with respect to US2. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US2, to the extent thereof. With respect to US2, $4x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $44x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 40%) over $40x (the balance of US2's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $4x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US2. Under paragraph (c)(2)(i)(B) of this section, the remaining $28x of the dividend is next considered paid out of US2's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $28x of the dividend is considered paid out of the extraordinary disposition account with respect to US2 and gives rise to $28x of an extraordinary disposition amount. As a result, US2's prior extraordinary disposition amount is increased by $28x under paragraph (c)(3)(i)(D) of this section, and US2's extraordinary disposition account is reduced to $12x ($40x − $28x) under paragraph (c)(3)(i)(A) of this section.

(E) *Determination of ineligible amount with respect to US1 and US2.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $48x, the ineligible amount is $21x, the sum of 50 percent of the extraordinary disposition amount ($42x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US1 of $48x, $27x is eligible for a section 245A deduction. With respect to US2 and the dividend of $32x, the ineligible amount is $14x, the sum of 50% of the extraordinary disposition amount ($28x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US2 of $32x, $18x is eligible for a section 245A deduction.

(3) *Example 2. Application of section 954(c)(6) exception with extraordinary disposition account*—(i) *Facts.* The facts are the same as in paragraph (j)(2)(i) of this section (the facts in *Example 1*) except that the Property Transfer is a sale by CFC2 to CFC1 instead of a sale by CFC1 to CFC2, the $80x distribution is by CFC2 to CFC1 in a separate transaction that is unrelated to the Property Transfer, and the description of the earnings and profits of CFC1 is applied to CFC2. Additionally, absent the application of this section, section 954(c)(6) would apply to the distribution by CFC2 to CFC1. Under section 951(a)(2) and § 1.951–1(b) and (e), US1's pro rata share of any subpart F income of CFC1 is 60% and US2's pro rata share of any subpart F income of CFC2 is 40%.

(ii) *Analysis*—(A) *Identification of extraordinary disposition.* The Property Transfer is an extraordinary disposition under the same analysis as provided in paragraph (j)(2)(ii)(A) of this section (the analysis in *Example 1*).

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts.* Both US1 and US2 are section 245A shareholders with respect to CFC2, US1 has an extraordinary disposition account of $60x with respect to CFC2, and US2 has an extraordinary disposition account of $40x with respect to CFC2 under the same analysis as provided in paragraph (j)(2)(ii)(B) of this section (the analysis in *Example 1*).

(C) *Determination of tiered extraordinary disposition amount*—(*1*) *In general.* US1 and US2 each have a tiered extraordinary disposition amount with respect to the $80x dividend paid by CFC2 to CFC1 to the extent that US1 and US2 would have an extraordinary disposition amount if each had received as a dividend its pro rata share of the dividend from CFC2. *See* paragraph (d)(2)(i) of this section. Under paragraph (d)(2)(ii) of this section, US1's pro rata share of the dividend is $48x (60% × $80x), that is, the increase to US1's pro rata share of the subpart F income if the dividend were included in CFC1's foreign personal holding company income, without regard to section 952(c) and the allocation of expenses. Similarly, US2's pro rata share of the dividend is $32x (40% × $80x).

(*2*) *Determination of tiered extraordinary disposition amount with respect to US1.* The extraordinary disposition amount with respect to US1 is $42x, under the same analysis provided in paragraph (j)(2)(ii)(C) of this section (the analysis in *Example 1*). Accordingly, the tiered extraordinary disposition amount with respect to US1 is $42x.

(*3*) *Determination of extraordinary disposition amount with respect to US2.* The extraordinary disposition amount with respect to US2 is $28x, under the same analysis provided in paragraph (j)(2)(ii)(D) of this section (the analysis in *Example 1*). Accordingly, the tiered extraordinary disposition amount with respect to US2 is $28x.

(D) *Limitation of section 954(c)(6) exception.* The sum of US1 and US2's tiered extraordinary disposition amounts is $70x ($42x + $28x). The portion of the stock of CFC1 (by value) owned (within the meaning of section 958(a)) by U.S. tax residents on the last day of CFC1's taxable year is 100%. Under paragraph (d)(1) of this section, the disqualified amount with respect to the dividend is $70x ($70x/100%). Accordingly, the portion of the $80x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $45x, equal to the sum of $10x (the portion of the $80x dividend that exceeds the $70x disqualified amount) and $35x (50 percent of $70x, the portion of the dividend that does not exceed the disqualified amount). Under section 951(a)(2) and § 1.951–1(b) and (e), US1 includes $21x (60% × $35x) and US2

includes $14x (40% × $35x) in income under section 951(a).

(E) *Changes in extraordinary disposition account of US1.* Under paragraph (c)(3)(i)(D)(*1*) of this section, US1's prior extraordinary disposition amount with respect to CFC2 is increased by $42x, or 200% of $21x, the amount US1 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US1 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US1's extraordinary disposition account is reduced to $18x ($60x − $42x) under paragraph (c)(3)(i)(A) of this section.

(F) *Changes in extraordinary disposition account of US2.* Under paragraph (c)(3)(i)(D)(*1*) of this section, US2's prior extraordinary disposition amount with respect to CFC2 is increased by $28x, or 200% of $14x, the amount US2 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US2 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US2's extraordinary disposition account is reduced to $12x ($40x − $28x) under paragraph (c)(3)(i)(A) of this section.

(4) *Example 3. Extraordinary reduction*—(i) *Facts.* At the beginning of CFC1's taxable year ending on December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. Also as of the beginning of Year 2, CFC1 has no earnings and profits described in section 959(c)(1) or (2), and US1 does not have an extraordinary disposition account with respect to CFC1. As of the end of Year 2, CFC1 has $160x of tested income and no other income. CFC1 has $160x of earnings and profits for Year 2. On October 19, Year 2, US1 sells all of its CFC1 stock to US2 for $100x in a transaction (the ''Stock Sale'') in which US1 recognizes $90x of gain. Under section 1248(a), the entire $90x of gain is included in US1's gross income as a dividend and, pursuant to section 1248(j), the $90x is treated as a dividend for purposes of applying section 245A. At the end of Year 2, under section 951A, US2 takes into account $70x of tested income, calculated as $160x (100% of the $160x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $90x, the amount of dividends received by US1 with respect to the transferred stock, and $128x, the amount of tested income attributable to the transferred stock ($160x) multiplied by 292/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of extraordinary reduction amount.* Under paragraph (e)(1) of this section, the entire $90x dividend to US1 is an extraordinary reduction amount with respect to US1 because the dividend is at least equal to US1's pre-reduction pro rata share of CFC1's Year 2 tested income described in paragraph (e)(2)(ii)(A) of this section ($160x), reduced by the amount of tested income taken into account by US2, a U.S. tax resident, under paragraph (e)(2)(ii)(B) of this section ($70x).

(C) *Determination of ineligible amount.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $90x, the ineligible amount is $90x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($90x). Therefore, with respect to the dividend received of $90x, no portion is eligible for the dividends received deduction allowed under section 245A(a).

(iii) *Alternative facts—election to close CFC's taxable year.* The facts are the same as in paragraph (j)(4)(i) of this section (the facts of this *Example 3*), except that, pursuant to paragraph (e)(3)(i) of this section, US1 elects to close CFC1's Year 2 taxable year for all purposes of the Code as of the end of October 19, Year 2, the date on which the Stock Sale occurs; in addition, US1 and US2 enter into a written, binding agreement that US1 will elect to close CFC1's Year 2 taxable year. Accordingly, under section 951A(a), US1 takes into account 100% of CFC1's tested income for the taxable year beginning January 1, Year 2, and ending October 19, Year 2, and US2 takes into account 100% of CFC1's tested income for the taxable year beginning October 20, Year 2, and ending December 31, Year 2. Under paragraph (e)(3)(i)(A) of this section, no amount is considered an extraordinary reduction amount with respect to US1.

(5) *Example 4. Extraordinary reduction; decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax residents*—(i) *Facts.* At the beginning of CFC1's taxable year ending December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. CFC1 generates $120x of subpart F income during its taxable year ending on December 31, Year 2. On October 1, Year 2, CFC1 distributes a $120x dividend to US1. On October 19, Year 2, US1 sells 100% of its stock of CFC1 to PRS, a domestic partnership, in a transaction in which no gain or loss is realized (the ''Stock Sale''). A, an individual who is a citizen of the United States, and B, a foreign individual who is not a U.S. tax resident, each own 50% of the capital and profits interests of PRS. On December 1, Year 2, US2 and FP, a foreign corporation, contribute property to CFC1; in exchange, each of US2 and FP receives 25% of the stock of CFC1. PRS owns the remaining 50% of the stock of CFC1. US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owns on the first day of Year 2, and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of Year 2 the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the highest percentage of stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of pre-reduction pro rata share.* Before the extraordinary reduction, US1 owned 100% of the stock of CFC1. Thus, under paragraph (e)(2)(ii)(A) of this section, the tentative amount of US1's pre-reduction pro rata share of CFC1's subpart F income is $120x. A and US2 are U.S. tax residents pursuant to paragraph (i)(29) of this section because they are United States persons described in section 7701(a)(30)(A) or (C). Thus, US1's pre-reduction pro rata share amount is subject to the reduction described in paragraph (e)(2)(ii)(B) of this section because U.S. tax residents directly or indirectly acquire stock of CFC1 from US1 or CFC1 during the taxable year in which the extraordinary reduction occurs. With respect to US1's pre-reduction pro rata share of CFC1's subpart F income, the reduction equals the amount of subpart F income of CFC1 taken into account under section 951(a) by these U.S. tax residents.

(C) *Determination of decrease in pre-reduction pro rata share for amounts taken*

into account by U.S. tax resident. On December 31, Year 2, both PRS and US2 will be United States shareholders with respect to CFC1 and will include in gross income their pro rata share of CFC1's subpart F income under section 951(a). With respect to US2, this amount will be $30x, which is equal to 25% of CFC1's subpart F income for the taxable year. With respect to PRS, its pro rata share of $60x under section 951(a)(2)(A) (50% of $120x) will be reduced under section 951(a)(2)(B) by $48x. The section 951(a)(2)(B) reduction is equal to the lesser of the $120x dividend paid with respect to those shares to US1 or $48x (50% × $120x × 292/365, the period during the taxable year that PRS did not own CFC1 stock). Thus, PRS includes $12x in gross income pursuant to section 951(a). Of this amount, $6x is allocated to A (as a 50% partner of PRS) and, therefore, treated as taken into account by A under paragraphs (e)(2)(ii)(B) and (g)(6) of this section. Thus, A and US2 take into account a total of $36x of CFC1's subpart F income under section 951(a). This amount reduces US1's pre-reduction pro rata share of CFC1's subpart F income to $84x ($120x − $36x) under paragraph (e)(2)(ii)(B) of this section. CFC1 did not generate tested income during the taxable year and, therefore, no amount is taken into account under section 951A with respect to CFC1, and US1 has no pre-reduction pro rata share with respect to tested income of CFC1.

(D) *Determination of extraordinary reduction amount.* Under paragraph (e)(1) of this section, the extraordinary reduction amount equals $84x, which is the lesser of the amount of the dividend received by US1 from CFC1 during Year 2 ($120x) and the sum of US1's pre-reduction pro rata share of CFC1's subpart F income ($84x) and tested income ($0).

(E) *Determination of ineligible amount.* Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $120x, the ineligible amount is $84x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($84x). Therefore, with respect to the dividend received by US1 from CFC1, $36x ($120x − $84x) is eligible for a section 245A deduction.

(6) *Example 5. Controlling section 245A shareholder*—(i) *Facts.* US1 and US2 own 30% and 25% of the stock of CFC1, respectively. FP, a foreign corporation that is not a CFC, owns all of the stock of US1 and US2. FP owns the remaining 45% of the stock of CFC1. On September 30, Year 2, US1 sells all of its stock of CFC1 to US3, a domestic corporation that is not a related party with respect to FP, US1, or US2. No person transferred any stock of CFC1 directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1.

(ii) *Analysis.* Under paragraph (i)(21) of this section, US1 is a section 245A shareholder with respect to CFC1, an SFC. Because US1 owns, together with US2 and FP (related persons with respect to US1), more than 50% of the stock of CFC1, US1 is a controlling section 245A shareholder of CFC1. The sale of US1's CFC1 stock results in an extraordinary reduction occurring with respect to US1's ownership of CFC1. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the stock of CFC1 that it owned at the beginning of the year and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2. The extraordinary disposition also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 directly or indirectly owns (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 directly or indirectly owned on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (30%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and end of year percentage (30 percentage points) is at least 5 percentage points.

(7) *Example 6. Limitation of section 954(c)(6) exception with respect to an extraordinary reduction*—(i) *Facts.* At the beginning of CFC1 and CFC2's taxable year ending on December 31, Year 2, US1 and A, an individual who is a citizen of the United States, own 80% and 20% of the single class of stock of CFC1, respectively. CFC1 owns 100% of the stock of CFC2. Both US1 and A are United States shareholders with respect to CFC1 and CFC2, and US1 and A are not related parties with respect to each other. No person transferred CFC2 stock directly or indirectly in Year 2 pursuant to a plan to reduce the percentage of stock (by value) of CFC2 owned by US1, and US1 does not have an extraordinary disposition account with respect to CFC2. At the end of Year 2, and without regard to any distributions during Year 2, CFC2 had $150x of tested income and no other income, and CFC1 had no income or expenses. On June 30, Year 2, CFC2 distributed $150x as a dividend to CFC1, which would qualify for the exception from foreign personal holding company income under section 954(c)(6) but for the application of this section. On August 7, Year 2, CFC1 sells all of its CFC2 stock to US2 for $100x in a transaction (the ''Stock Sale'') in which CFC1 realizes no gain or loss. At the end of Year 2, under section 951A, US2 takes into account $60x of tested income, calculated as $150x (100% of the $150x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $150x, the amount of dividends received by CFC1 during Year 2 with respect to the transferred stock, and $90x, the amount of tested income attributable to the transferred stock ($150x) multiplied by 219/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership.* Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC2, but A is not. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC2. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred indirectly 100% of the CFC2 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC2 at the beginning of Year 2. The extraordinary disposition also occurs because on the last day of the year the percentage of stock (by value) of CFC2 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC2 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC2 stock by value (80%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC2 stock owned by US1, and the difference between the initial percentage and the end of year percentage (80 percentage points) is at least 5 percentage points. Because there is an extraordinary reduction with respect to CFC2 in Year 2 and CFC1 received a dividend from CFC2 in Year 2, under paragraph (f)(1) of this section, it is necessary to determine the limitation on the amount of the dividend eligible for the exception under section 954(c)(6).

(B) *Determination of tiered extraordinary reduction amount.* The limitation on the amount of the dividend eligible for the exception under section 954(c)(6) is based on the tiered extraordinary reduction amount. The sum of the amount of subpart F income and tested income of CFC2 for Year 2 is $150x, and immediately before the extraordinary reduction, CFC1 held 100% of the stock of CFC2. Additionally, US2 is a U.S. tax resident as defined in paragraph (i)(29) of this section because it is a United States person described in section 7701(a)(30)(A) or (C), and US2 has a pro rata share of $60x of tested income under section 951A with respect to CFC2. Accordingly, under paragraph (f)(2) of this section, the tiered extraordinary reduction amount is $90x (($150x × 100%) − $60x).

(C) *Limitation of section 954(c)(6) exception.* Under paragraph (f)(1) of this section, the portion of the $150x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $60x ($150x − $90x). To the extent that the $90x that does not qualify for the exception gives rise to additional subpart F income to CFC1, both US1 and A will take into account their pro rata share of that subpart F income under section 951(a)(2) and § 1.951–1(b) and (e).

(8) *Example 7. Application of anti-abuse rule to a prepayment of a royalty*—(i) *Facts.* US1 owns 100% of the single class of stock of CFC1 and CFC2. CFC1 has a November 30 taxable year, and CFC2 has a calendar year taxable year. There is a license agreement between CFC1 and CFC2 pursuant to which CFC2 is obligated to pay annual royalties to CFC1 for the use of intangible property. As of November 1, 2018, the remaining term of the agreement is 10 years. On November 1, 2018, CFC1 receives from CFC2, and accrues into income, $100x of pre-paid royalties that are for the use of the intangible property for the subsequent 10 years. The form of the

arrangement as a license, including the prepayment of the royalty, is respected for U.S. tax purposes; therefore CFC1's receipt of the $100x royalty prepayment does not constitute a disposition of the intangible property and is excluded from CFC1's subpart F income pursuant to section 954(c)(6). A principal purpose of CFC2 prepaying the royalty is for CFC1 to generate earnings and profits during the disqualified period that would not be subject to current U.S. tax yet may be eligible for the section 245A deduction and could, for example, be used to reduce the amount of gain recognized on a disposition of the stock of CFC1 that would be subject to U.S. tax by increasing the portion of such gain treated as a dividend.

(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.

(9) *Example 8. Application of anti-abuse rule to restructuring transaction*—(i) *Facts.* FP, a foreign corporation with no United States shareholders, owns 100% of the single class of stock of US1. US1 owns 100% of the single class of stock of CFC1 that, in turn, owns 100% of the single class of stock of CFC2. CFC2 has $100x of extraordinary disposition E&P, and US1 has a $100x extraordinary disposition account with respect to CFC2. In Year 1, FP transfers property to CFC1 in exchange for newly issued stock of CFC1. After the transfer, FP and US1 own, respectively, 90% and 10% of the single class of stock of CFC1. In Year 3, CFC2 pays a $100x dividend to CFC1, and the dividend gives rise to a tiered extraordinary disposition amount with respect to US1 of $10x. US1 includes $10x in gross income under section 951(a) with respect to the tiered extraordinary disposition amount. The $10x tiered extraordinary disposition amount reduces US1's extraordinary disposition account from $100x to $90x. In Year 5, CFC1 redeems all of the stock of CFC1 held by US1 in exchange for $100x of cash. Under sections 302(d) and 301(c)(1), the redemption results in a $100x dividend to US1. Under section 959(a), $10x of the $100x dividend is not included in US1's gross income and, but for the application of paragraph (h) of this section, US1 would claim a section 245A deduction of $90x with respect to $90x of the dividend. The transfer of property from FP to CFC1 in exchange for stock of CFC1, the $100x dividend from CFC2 to CFC1, and CFC1's redemption of all of its stock held by US1 (together, the ''Transaction'') were undertaken with the principal purpose of avoiding the application of this section to distributions from CFC2. As a result of the redemption, CFC2 is wholly owned by FP through CFC1, and CFC2's earnings and profits can be distributed without incurring U.S. tax irrespective of the availability of the section 245A deduction or the exception under section 954(c)(6).

(ii) *Analysis.* Because the Transaction 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. Pursuant to paragraph (h) of this section, all $90x of the dividend included in US1's income in Year 5 is treated as an extraordinary disposition amount. Therefore, $45x of the dividend is treated as an ineligible amount for which US1 cannot claim a section 245A deduction pursuant to paragraph (b)(2)(i) of this section (that is, 50% of the extraordinary disposition amount) and, accordingly, US1 is only allowed a section 245A deduction of $45x ($90x dividend received, less the $45x ineligible amount) with respect to the $90x dividend from CFC1 that it included in income. In addition, US1's extraordinary disposition account with respect to CFC2 is reduced from $90x to zero pursuant to paragraph (c)(3)(i)(A) and (D) of this section.

(10) *Example 9. Application of anti-abuse rule to a related-party loan*—(i) *Facts.* US1 owns 100% of the single class of stock of CFC1 and CFC2. US1 does not own stock of any other foreign corporation. US1 intends to repatriate $100x cash from CFC1 at the end of taxable year Y1. At the end of taxable year Y1, CFC1 has $100x of earnings and profits described in section 959(c)(3) (all of which is extraordinary disposition E&P) and $100x of cash, and US1 has an extraordinary disposition account balance with respect to CFC1 equal to $100x. In addition, at the end of taxable year Y1, CFC2 has $100x of earnings and profits described in section 959(c)(3). US1 does not have an extraordinary disposition account with respect to CFC2. Anticipating the application of this section to a distribution from CFC1, US1 instead causes CFC1 to loan $100x of cash to CFC2 during taxable year Y1 in exchange for a $100x note. The form of the transaction is respected as a loan for U.S. tax purposes. At the end of taxable Y1, CFC2 distributes $100x of cash to US1. The loan and distribution are part of a plan a principal purpose of which is to repatriate CFC1's $100x cash without triggering the application of this section.

(ii) *Analysis.* Because the loan from CFC1 to CFC and the subsequent distribution of cash were 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. Pursuant to that rule, the distribution of $100x of cash is treated as a distribution out of US1's extraordinary disposition account with respect to CFC1. Accordingly, the $100x distribution is taxed as a dividend, and only $50x of the dividend received by US1 is eligible for the section 245A deduction pursuant to paragraph (b)(1) of this section. As a result of the distribution, the balance of US1's extraordinary disposition account with respect to CFC1 is reduced by $100x to zero pursuant to paragraph (c)(3)(i)(A) of this section.

(k) *Applicability date*—(1) *In general.* This section applies to taxable periods of a foreign corporation ending on or after June 14, 2019, and to taxable periods of section 245A shareholders in which or with which such taxable periods end. For taxable periods described in the previous sentence, this section (and not § 1.245A–5T) applies regardless of whether, but for this paragraph (k)(1), § 1.245A–5T would apply. See § 1.245A–5T as contained in 26 CFR part 1 edition revised as of April 1, 2020 for distributions occurring after December 31, 2017, as to which this section does not apply.

(2) *Early application of this section.* Notwithstanding paragraph (k)(1) of this section, a taxpayer may choose to apply this section to taxable periods of a foreign corporation ending before June 14, 2019, and to taxable periods of section 245A shareholders in which or with which such taxable periods end, provided that the taxpayer and all persons bearing a relationship to the taxpayer described in section 267(b) or 707(b) apply this section in its entirety for all such taxable periods.

§§ 1.245A–1T through 1.245–4T and 1.245A–5T [Removed]

■ **Par. 3.** Sections 1.245A–1T through 1.245–4T and 1.245A–5T are removed.

■ **Par. 4.** Section 1.245A(e)–1 is amended by, for each paragraph listed in the following table, removing the language in the ''Remove'' column and adding in its place the language in the ''Add'' column.

Paragraph	Remove	Add
(b)(2)	1.245A–5T	1.245A–5
(b)(3) introductory text	1.245A–5T(g)(3)(ii)	1.245A–5(g)(3)(ii)
(c)(3)	1.245A–5T(g)(3)(ii)	1.245A–5(g)(3)(ii)

Paragraph	Remove	Add
(d)(5) introductory text	1.245A–5T(g)(3)(ii)	1.245A–5(g)(3)(ii)
(g)(1)(i)	1.245A–5T	1.245A–5
(g)(1)(iii)	1.245A–5T	1.245A–5
(g)(2)(i)	1.245A–5T	1.245A–5

■ **Par. 5.** Section 1.954(c)(6)–1 is added to read as follows:

§ 1.954(c)(6)–1 Certain cases in which section 954(c)(6) exception not available.

(a) *Cross-references to other rules.* For a non-exclusive list of rules that in certain cases limit the applicability of the exception to foreign personal holding company income under section 954(c)(6), see—

(1) Section 1.245A–5(d) (rules regarding the application of section 954(c)(6) to extraordinary disposition amounts);

(2) Section 1.245A–5(f) (rules regarding the application of section 954(c)(6) to tiered extraordinary reduction amounts);

(3) Section 1.245A(e)–1(c) (rules regarding tiered hybrid dividends);

(4) Section 1.367(b)–4(e)(4) (rules regarding income inclusion and gain recognition in certain exchanges following an inversion transaction);

(5) Section 964(e)(4)(A) (rules regarding certain gain from the sale or exchange of stock that is recharacterized as a dividend); and

(6) Section 1.7701(l)–4(e) (rules regarding recharacterization of certain transactions following an inversion transaction).

(b) *Applicability date.* This section applies as of August 27, 2020.

§ 1.954(c)(6)–1T [Removed]

■ **Par. 6.** Section 1.954(c)(6)–1T is removed.

■ **Par. 7.** Section 1.6038–2 is amended by adding paragraphs (f)(16) and (m)(2) 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) * * *

(16) *Amounts related to extraordinary dispositions and extraordinary reductions.* The corporation must report the information 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 if any of the following conditions are met during the corporation's annual accounting period—

(i) The corporation distributes or receives a dividend that gives rise to an ineligible amount (as defined in § 1.245A–5(i)(12)), a tiered extraordinary disposition amount (as defined in § 1.245A–5(i)(25)), or a tiered extraordinary reduction amount (as defined in § 1.245A–5(i)(26));

(ii) A section 245A shareholder with respect to the corporation has an extraordinary disposition account (as defined in § 1.245A–5(i)(6)); or

(iii) The corporation would have been deemed to have undertaken an extraordinary disposition (as defined in § 1.245A–5(i)(5)) but for the application of § 1.245A–5(c)(3)(ii)(C)(*2*).

* * * * *

(m) * * *

(2) *Special rule for paragraph (f)(16) of this section.* Paragraph (f)(16) of this section applies with respect to information for annual accounting periods to which § 1.245A–5 applies.

* * * * *

§ 1.6038–2T [Removed]

■ **Par. 8.** Section 1.6038–2T is removed.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: August 10, 2020.

David Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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