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Comments on Proposed Regulations under Section 965

Dear Sir or Madam:

I appreciate the opportunity to comment on the proposed regulations entitled "Guidance Regarding the Transition Tax Under Section 965 and Related Provisions" (REG-104226-18) (the "Proposed Regulations"), 83 F.R. 39514 (August 9, 2018).

These comments are provided in my capacity as an individual, and cover 31 areas:

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Introduction

Section 965(a), as enacted by P.L. 115-97 (the law formerly known as the Tax Cuts and Jobs Act of 2017, or the "TCJA"), generally increases the subpart F income of each specified foreign corporation, for its last taxable year beginning before January 1, 2018, by the corporation's accumulated post-1986 deferred foreign income as of November 2, 2017 or December 31, 2017, whichever is greater. Section 965(d)(1) refers to such a specified foreign corporation with positive accumulated post-1986 deferred foreign income as a "deferred foreign income corporation" ("DFIC"). Section 965(d)(2) defines "accumulated post-1986 deferred foreign income" as generally post-1986 earnings and profits ("E&P"), with some exclusions and only taking into account those periods when the corporation was a specified foreign corporation.

A pro rata share of the DFIC's subpart F income is generally included in the gross income ("section 965(a) income") of the DFIC's United States shareholders, which is any U.S. person that owns 10% or more of the DFIC's voting stock.

1. De minimis exceptions for constructive ownership and specified foreign corporation status.

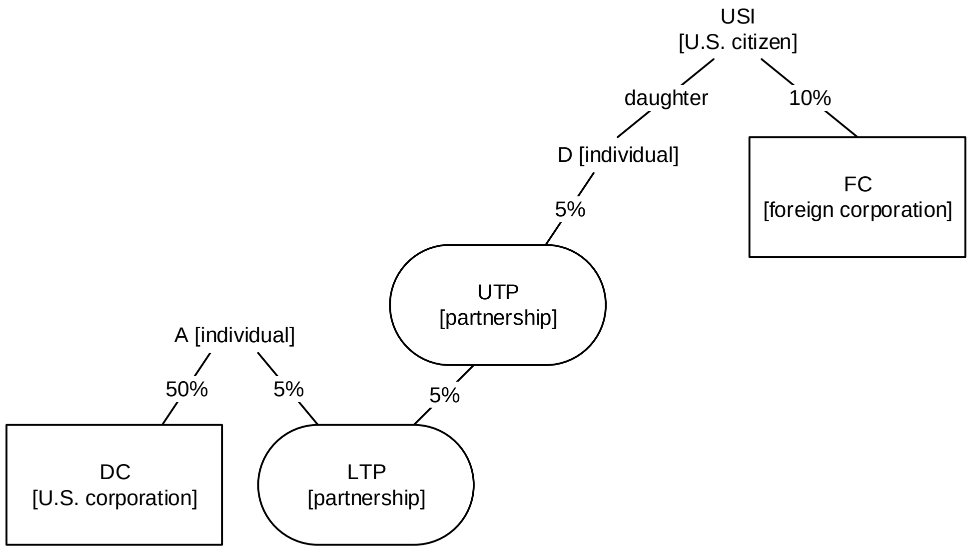
A "specified foreign corporation" is defined in section 965(e)(1) as (A) any controlled foreign corporation (a "CFC," which is a foreign corporation owned more than 50% by vote or value by United States shareholder(s) under section 957(a)) and also (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder. Section 318(a) constructive ownership rules, modified by section 958(b), are taken into account.

Notice 2018-26, 2018-16 I.R.B. 480, § 3.01 and Prop. Treas. Reg. § 1.965-1(f)(45)(ii) provide that, solely for purposes of determining whether a foreign corporation is a non-CFC specified foreign corporation under section 965(e)(1)(B), section 318(a)(3)(A) partner-to-partnership shall not apply if the partner owns (directly or indirectly) less than 5% of the interests in the partnership. Notice 2018-26 explained that "[t]he Treasury Department and the IRS have determined that it would pose compliance difficulties for taxpayers and administrative difficulties for the IRS to require a United States person to determine whether a foreign corporation with respect to which it is a United States shareholder is a specified foreign corporation if such foreign corporation may be a specified foreign corporation solely by reason of downward attribution under section 318(a)(3)(A) of stock from a partner to a partnership when such partner has only a de minimis interest in such partnership."

The same 5% threshold applies to a shareholder of an S corporation, which are treated as partnerships for this purpose under section 318(a)(5)(E) and section 1373(a). The final regulations should provide a similar 5% de minimis exception for beneficiary-to-trust attribution under section 318(a)(3)(B), which currently contains an exception only for *contingent* interests of up to 5%.

For the same compliance and administrative reasons, the final regulations should consider additional de minimis exceptions, which may be based on the fair market value of the attributee entity. For instance, section 318(a)(3) partner-to-partnership downward attribution may have a 25% or higher threshold, in line with section 856(d)(5)(B) in the REIT context, for partnership interests of less than $100,000 in net value, if the partner's ownership is due to constructive ownership, and/or if the attribution is through tiered partnerships.

For example, A, an individual, owns 50% of the stock of a domestic corporation, DC, and 5% of the interests in a partnership, LTP. A United States citizen, USI, owns 10% by vote and value of the stock of a foreign corporation, FC. USI's daughter, D, owns 5% of the interests in a partnership, UTP, which owns 5% of the interests in LTP. The remaining 90% by vote and value of the stock of FC is owned by non-United States persons that are unrelated to A, USI, D, UTP, LTP, and DC.



Under section 318(a)(1) family attribution, D owns the 10% of the stock of FC owned by her father USI. Section 958(b)(1) prevents family attribution of stock owned by a nonresident alien to a U.S. citizen or U.S. resident, but it does not prevent family attribution from a U.S. citizen to any individual.

Under section 318(a)(3)(A) partner-to-partnership attribution, UTP owns the 10% of the stock of FC that is constructively owned by UTP's 5% partner D, LTP owns the 10% of the stock of FC that is constructively owned by LTP's 5% partner UTP, and LTP also owns 50% of the stock of DC that is owned by LTP's 5% partner A.

Under section 318(a)(3)(C) shareholder-to-corporation attribution, DC owns the 10% of the stock of FC that is owned constructively by DC's 50% shareholder LTP. Accordingly, FC is a specified foreign corporation within the meaning of section 965(e)(1)(B), due to 10% constructive ownership by domestic corporation DC. The results would be the same whether A, D, LTP, and UTP are domestic or foreign persons.

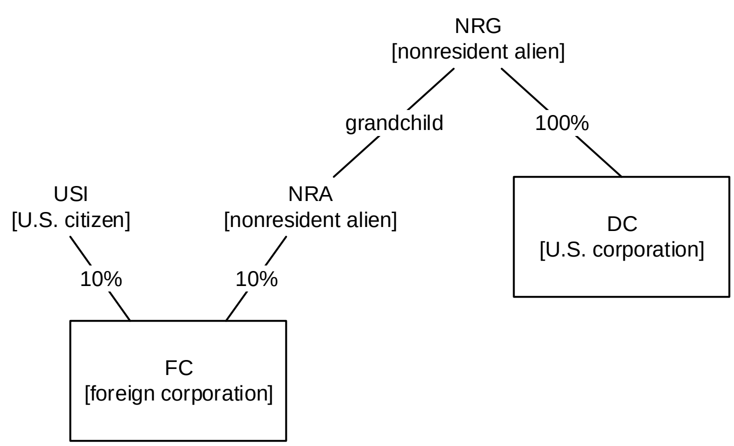
USI accordingly has section 965(a) income with respect to FC, solely because of constructive ownership of the stock of DC through LTP between A and D (USI's daughter and indirect owner of 0.25% of the interests in LTP). Additional thresholds for constructive ownership would help limit A's and D's inquiries into their direct and indirect ownership of domestic corporation stock, which should reduce the number of persons affected by section 965, decrease costs, burden, and administrative complexity, and ensure that the average person spends 5 hours once to comply with section 965.

The final regulations should consider de minimis constructive ownership exceptions in determining specified foreign corporation status under section 965(e)(1)(A), due to the fact that the same compliance difficulties for taxpayers, and administrative difficulties for the IRS, are present when a partner has only a de minimis interest in a partnership in the context of a CFC.

2. Former section 958(b)(4) applies in determining specified foreign corporation status in prior years for computing post-1986 earnings and profits.

The preamble to the Proposed Regulations at 83 F.R. 39537 states that due to the TCJA repeal of former section 958(b)(4), effective beginning in the same taxable year as the section 965(a) income inclusion (the "Inclusion Year"), a foreign corporation may be a specified foreign corporation as a result of foreign-to-domestic downward attribution under section 318(a)(3). The final regulations should clarify that in computing the post-1986 E&P of such a specified foreign corporation under section 965(d)(3), which takes into account only those prior years when the foreign corporation was a specified foreign corporation, former section 958(b)(4) would have applied during those prior years and may potentially not result in specified foreign corporation status during those prior years that increase post-1986 E&P.

For instance, a United States citizen, USI, owns 10% by vote and value of the stock of a foreign corporation, FC. A nonresident alien, NRA, owns 10% by vote and value of the stock of FC. NRA's grandfather, NRG, owns 100% of the stock of a domestic corporation, DC. The remaining 90% by vote and value of the stock of FC is owned by non-United States persons that are unrelated to USI, NRA, NRG, and DC. FC's ownership has been the same in every year after 1986. FC uses the calendar year as its taxable year.



Under section 318(a)(1) family attribution, NRG owns the 10% of the stock of FC owned by his grandchild NRA. Section 958(b)(1) prevents family attribution of stock owned by a nonresident alien to a U.S. citizen or U.S. resident, but it does not prevent family attribution between two nonresident aliens.

Under section 318(a)(3)(C) shareholder-to-corporation attribution, DC owns the 10% of the stock of FC that is owned constructively by DC's 50% shareholder NRG. Accordingly, FC is a specified foreign corporation within the meaning of section 965(e)(1)(B), due to 10% constructive ownership by domestic corporation DC.

However, in computing FC's post-1986 E&P that gives rise to section 965(a) income for its United States shareholder USI, FC's post-1986 E&P should take into account only periods when FC was a specified foreign corporation under the facts and the law applicable at the time. As FC's ownership was the same in the period from 1987 through 2016, FC's post-1986 E&P does not take into account the period from 1987 through 2016, due to former section 958(b)(4) preventing section 318(a)(3)(C) foreign-to-domestic downward attribution from nonresident alien NRG to domestic corporation DC during that period. Accordingly, FC's post-1986 E&P consists only of FC's 2017 earnings, and USI's section 965(a) income consists of a pro rata share of FC's accumulated post-1986 deferred foreign income based on only the 2017 earnings.

3. <u>Accumulated post-1986 deferred foreign income of a non-CFC is reduced by PTI.</u>

Section 965(d)(2)(B) provides that accumulated post-1986 deferred foreign income excludes, in the case of a DFIC that is a CFC, any amount that would be previously taxed income ("<u>PTI</u>") under section 959 if distributed to a United States shareholder. Section 959 is not limited to CFCs, and could apply to a United States shareholder of a non-CFC foreign corporation that was formerly a CFC and had subpart F income. The final regulations should indicate whether a non-CFC specified foreign corporation's accumulated post-1986 deferred foreign income excludes any amount that would be PTI under section 959 if distributed to a United States shareholder (or to a non-United States shareholder if the shareholder were a United States shareholder).

If the answer is in the negative, the final regulations should confirm that the specified foreign corporation's post-1986 E&P, and therefore accumulated post-1986 deferred foreign income, can be reduced by a distribution of PTI in the Inclusion Year, at least before November 2, 2017. Distributions of PTI immediately reduce E&P under section 959(d). Section 965(d)(3)(B) provides that post-1986 E&P is not reduced by reason of dividends distributed during the Inclusion Year, which is an exception that does not apply to PTI distributions given that PTI distributions are not dividends under section 959(d) for purposes of chapter 1 of the Code. Section 245(a)(4) contains a similar definition of post-1986 undistributed earnings, which is computed without "diminution by reason of dividends distributed during such taxable year." H. Conf. Rep. 99-841, at II-629 (1986) noted that section 959(d) was amended to clarify "that any amounts of subpart F income previously taxed that are distributed to U.S. shareholders are to reduce U.S. source earnings and profits and total earnings and profits (as the case may be) in arriving at the proportionate amount of the taxable dividend eligible for the deduction." See also H. Conf. Rep. 115-466, at 599 n. 1490 ("distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits").

4. <u>Specified E&P deficit can be reduced by Inclusion Year distributions of PTI.</u>

Section 965(b) generally provides that a United States shareholder may reduce its section 965(a) income if it owns stock of a specified foreign corporation with a deficit in post-1986 E&P (a "<u>specified E&P deficit</u>") as of November 2, 2017. Section 965(b)(3)(B) refers to such a specified foreign corporation with a specified E&P deficit as an "E&P deficit foreign corporation."

The preamble to the Proposed Regulations at 83 F.R. 39516 states that an E&P deficit foreign corporation's specified E&P deficit under section 965(b)(3)(C) is determined by reference to a deficit in post-1986 E&P, which does not contain any exclusions. Specified E&P deficit therefore does not exclude previously taxed E&P that would be excluded from gross income as a PTI distribution under section 959 if distributed to a United States shareholder.

The final regulations should confirm that post-1986 E&P, and therefore a specified E&P deficit, can be reduced by a PTI distribution in the Inclusion Year, at least before November 2, 2017. As noted above, distributions of PTI immediately reduce E&P under section 959(d), and section 965(d)(3)(B) provides that post-1986 E&P is not reduced by reason of dividends distributed during the Inclusion Year, which does not apply to distributions of PTI given that PTI distributions are not dividends under section 959(d) for purposes of chapter 1 of the Code.

5. <u>Specified E&P deficit is decreased by earnings effectively connected with U.S. trade or business.</u>

Similar to the fact that specified E&P deficit does not exclude previously taxed E&P, the final regulations should confirm that specified E&P deficit is also determined without any exclusion for any earnings or deficits effectively connected with the conduct of a U.S. trade or business. Under section 964(a), E&P is determined according to rules substantially similar to those applicable to domestic corporations, and earnings (or deficits) effectively connected with the conduct of a U.S. trade or business is a form of E&P (or E&P deficit). No express exclusion of earnings and deficits effectively connected with the conduct of a U.S. trade or business is provided in section 965(d)(3) for purposes of determining post-1986 E&P. In contrast, the term accumulated post-1986 deferred foreign income, as defined in section 965(d)(2), explicitly excludes earnings effectively connected with the conduct of a U.S. trade or business and subject to U.S. income tax.

6. <u>Partnership-level specified E&P deficit is allocated to the partners.</u>

The final regulations should clarify that if a domestic partnership (or other domestic pass-through entity) is a United States shareholder of an E&P deficit foreign corporation, the partnership's specified E&P deficit is allocated to the partners. A partner can use the allocated specified E&P deficit to reduce the partner's section 965(a) income from another partnership or a non-partnership investment, with corresponding (elective under Prop. Treas. Reg. § 1.965-2(f)(2)) downward adjustments to the tax basis of the E&P deficit foreign corporation stock and the partner's tax basis in its partnership interest.

The Proposed Regulations appear to allow the above treatment for controlled domestic partnerships as defined under Prop. Treas. Reg. § 1.965-1(e), which treats such controlled domestic partnerships as foreign partnerships for certain section 965 purposes. The same rule should apply to all domestic partnerships, as Congress intended for specified E&P deficits to reduce section 965(a) income, and there is no indication that partnership-level specified E&P deficits should remain trapped at the partnership level and be effectively never unusable by any taxpayer. Such a limitation would penalize taxpayers who operate through domestic partnerships, as no such limitation applies to a foreign partnership that owns stock of an E&P deficit foreign corporation and allocates the specified E&P deficit to its domestic partners under section 958(a). See Notice 2010-41, 2010-22 I.R.B. 715, for a similar subpart F situation in which Treasury treated domestic partnerships as foreign partnerships in order to effectuate Congressional intent. In the GILTI context, with its analogous offsetting of tested income and tested loss, the preamble to the Proposed Treasury Regulations (REG-104390-18) noted that an approach that dramatically alters a U.S. shareholder's income for a taxable year "depending on the legal structure by which the shareholder owns each CFC presents both an inappropriate planning opportunity as well as a trap for the unwary", before arriving at a mostly aggregate approach for partnership-level tested income and tested loss.

A similar issue exists for all S corporations, who should be able to allocate their specified E&P deficit to shareholders. There is no indication that Congress intended to penalize S corporation shareholders compared to their similarly situated counterparts who directly own stock of an E&P deficit foreign corporation.

7. <u>Aggregate foreign cash position determination in prior years.</u>

For a United States shareholder with section 965(a) income, section 965(c) provides a corresponding deduction that generally results in an effective tax rate of 8% or 15.5% if computed according to the section 11 corporate income tax rates applicable for the taxable year of the United States shareholder. The 15.5% rate equivalent percentage applies generally to the extent of the United States shareholder's aggregate foreign cash position.

Section 965(c)(3)(A) (with textual substitutions for clarity) defines a United States shareholder's aggregate foreign cash position as the greater of

(i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder, determined as of the close of such specified foreign corporation's last taxable year of which begins before January 1, 2018, or

(ii) one half of the sum of

  (I) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder, determined as of the close of such specified foreign corporation's last taxable year which ends before November 2, 2017, plus

  (II) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder, determined as of the close of such specified foreign corporation's taxable year which precedes the last taxable year which ends before November 2, 2017.

Prop. Treas. Reg. § 1.965-1(f)(30)(iii) and § 1.965-1(g) Ex. 7 suggest that pro rata share and United States shareholder status are tested separately on each of the three cash measurement dates. The final regulations should confirm that United States shareholder status, the United States shareholder's pro rata share, and specified foreign corporation status are determined based on the facts and applicable law at the time of each cash measurement date.

For example, a foreign corporation was formed on December 1, 2016, and it was owned 15% and 5% by a domestic C corporation on December 31, 2016 and December 31, 2017, respectively. The foreign corporation uses the calendar year as its taxable year. Under section 965(c)(3)(A), the corporate United States shareholder's foreign cash position with respect to the foreign corporation is the greater of

(i) $0, because the domestic corporation was not a United States shareholder of the foreign corporation as of December 31, 2017, or
(ii) one half of the sum of
    (I) the United States shareholder's 15% share of the foreign corporation's cash position as of December 31, 2016, plus
    (II) $0, because the foreign corporation did not exist as of December 31, 2015.

The House bill had specifically provided that in the case of any foreign corporation that did not exist as of either (or both) prior cash measurement dates, the House bill's cash position, normally averaged over the three cash measurement dates, should be computed instead as an average over two dates (or one date). The House bill's provision was deleted in the TCJA, which indicates that the cash position for a non-existent foreign corporation should be $0 instead of being omitted from the averaging formula.

As another example, an individual United States shareholder owns 20% of a foreign corporation's stock. A nonresident alien owns the other 80% of the stock of the foreign corporation and 100% of the stock of a domestic C corporation. The foreign corporation has taxable years ending on November 30. Under section 965(c)(3)(A), the United States shareholder's foreign cash position with respect to the foreign corporation is the greater of

(i) the United States shareholder's 20% share of the specified foreign corporation's cash position as of November 30, 2018, or
(ii) one half of the sum of
    (I) $0, because the foreign corporation was not a specified foreign corporation as of November 30, 2016, plus
    (II) $0, because the foreign corporation was not a specified foreign corporation as of November 30, 2015.

As the foreign corporation was not a specified foreign corporation as of either November 30, 2016 or November 30, 2015, due to former section 958(b)(4) preventing foreign-to-domestic downward attribution, the final regulations should confirm that the United States shareholder's foreign cash position should include only its 20% share of the specified foreign corporation's cash position as of November 30, 2018. Such a result would be consistent with the fact that the shareholder's section 965(a) income does not include any E&P from those prior years.

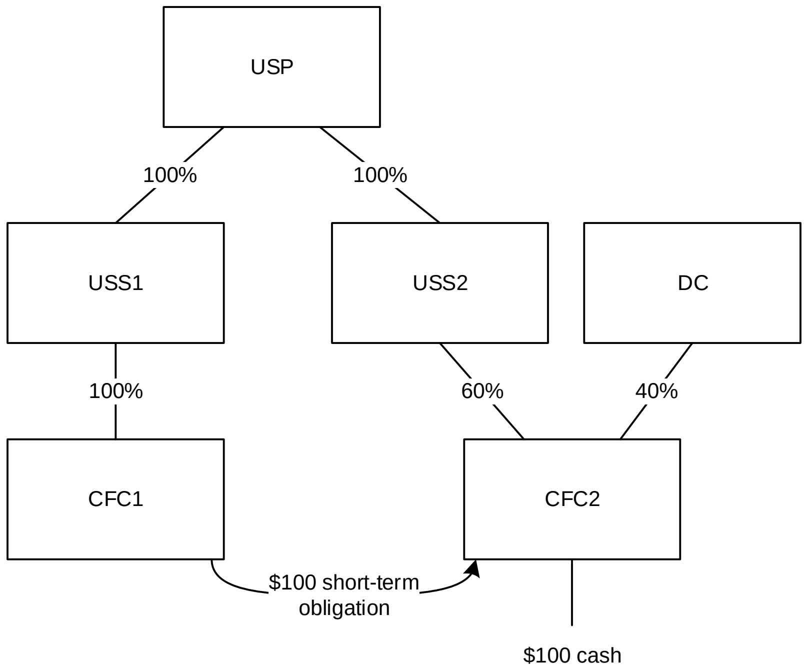
The final regulations should provide rules as to the determination of the United States shareholder's aggregate foreign cash position on cash measurement dates when the specified foreign corporation stock is owned by predecessors or successors, such as in section 381(a) transactions, gifts, partnership mergers, and other nonrecognition transactions. For example, a domestic partnership owns 100% of the stock of a DFIC that uses the calendar year as its taxable year. The domestic partnership undergoes a section 708(b)(1)(B) technical termination on November 15, 2017. The new domestic partnership, in its November 16, 2017 through December 31, 2017 taxable year, should take into account the old domestic partnership's aggregate foreign cash position with respect to the DFIC, as measured on December 31, 2015 and December 31, 2016.

8. <u>Members of a consolidated group should be a single taxpayer in determining cash position.</u>

Prop. Treas. Reg. § 1.965-8(e) treats the members of a consolidated group as a single taxpayer for some section 965 purposes, such as under sections 965(b), (h), (k), and (n), and as separate taxpayers for other purposes, such as in determining each member's section 965(a) income and section 965(c) deduction. Prop. Treas. Reg. § 1.965-8(e)(3) provides a hybrid approach with respect to the aggregate foreign cash position. First, the consolidated group aggregate foreign cash position is determined by adding the aggregate foreign cash position of each member of the group, determined as if each such member were not a member of a consolidated group. Next, the consolidated group aggregate foreign cash position is divided among the consolidated group's members, based on the ratio of their section 965(a) income to the group's total section 965(a) income.

The consolidated group aggregate foreign cash position calculation may lead to double counting when specified foreign corporations are owned by different members of the same consolidated group and have intercompany cash positions. Prop. Treas. Reg. § 1.965-3(b)(1) provides that accounts receivable, accounts payable, short-term obligations, and derivative financial institutions between related (under section 954(d)(3)) specified foreign corporations are disregarded, to the extent of the smallest of the United States shareholder's ownership percentages of the specified foreign corporations on the relevant cash measurement dates. Prop. Treas. Reg. § 1.965-3(b)(2) provides that a United States shareholder's share of a specified foreign corporation's cash position can generally be reduced by net accounts receivable, actively traded property, and short-term obligations that the United States shareholder is taking into account with respect to another specified foreign corporation. Both Prop. Treas. Reg. § 1.965-3(b)(1) and Prop. Treas. Reg. § 1.965-3(b)(2) appear not to apply to the extent that the other specified foreign corporation is owned by a member of the same consolidated group as the United States shareholder.

For example, USP owns all of the stock of USS1 and USS2. Each of USP, USS1, and UUS2 is a domestic corporation and is a member of a consolidated group of which USP is the common parent. USS1 owns 100% of the stock of CFC1. USS2 owns 60% of the stock of CFC2, which is owned 40% by an unrelated United States shareholder DC. CFC1 has made a $100 short-term obligation to CFC2, which has $100 of cash.



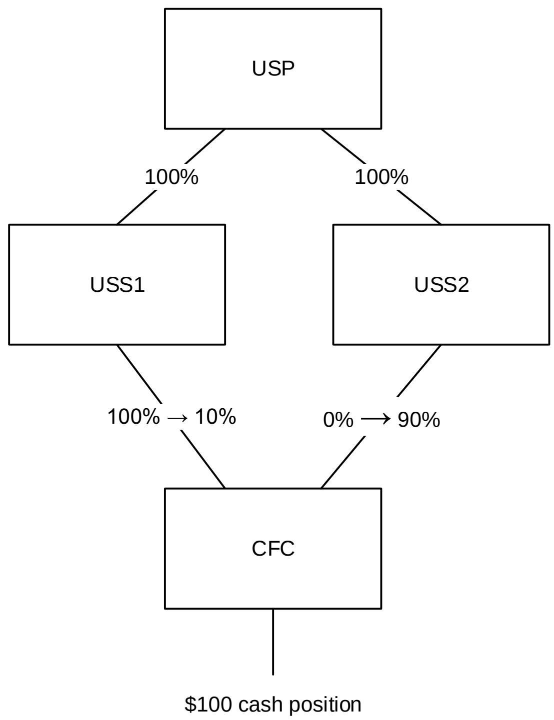
If USP, USS1, and USS2 are treated as separate taxpayers, USS1's cash position is $100, because of CFC2's $100 short-term obligation. USS2's cash position is $60, due to its 60% share of CFC2's $100 cash. The consolidated group aggregate foreign cash position is $160.

In contrast, if USP, USS1, and USS2 are treated as a single taxpayer, the USP consolidated group has a consolidated group aggregate cash position of $100, equal to the group's $60 (60%) share of CFC's $100 cash plus $40 (40%) share of CFC1's $100 short-term obligation (with 60% disregarded under Prop. Treas. Reg. § 1.965-3(b)(1)). The $100 consolidated group aggregate cash position is the more correct result, even if it does not entirely eliminate double counting with United States shareholder DC's $40 share of CFC2's cash.

The consolidated group aggregate foreign cash position calculation may also lead to double counting if the ownership of the specified foreign corporation has shifted among the consolidated group members as of the various cash measurement dates.

For example, USP owns all of the stock of USS1 and USS2. Each of USP, USS1, and USS2 is a domestic corporation and is a member of a consolidated group of which USP is the common parent. USS1 owned 100% of the stock of CFC on December 31, 2015 and December 31, 2016. On December 31, 2017, the stock of CFC is owned 10% by USS1 and 90% by USS2.

CFC has $100 of cash position on each of December 31, 2015, December 31, 2016, and December 31, 2017. Each of USP, USS1, USS2, and CFC has a calendar taxable year.



Under section 965(c)(3)(A), USS1's aggregate foreign cash position is $100, which is the greater of

(iii) USS1's 10% share of CFC's $100 cash position as of December 31, 2017, or
(iv) one half of the sum of
  (III) USS1's 100% share of CFC's $100 cash position as of December 31, 2016, plus
  (IV) USS1's 100% share of CFC's $100 cash position as of December 31, 2015.

Under section 965(c)(3)(A), USS2's aggregate foreign cash position is $90, which is the greater of

(v) USS2's 90% share of CFC's $100 cash position as of December 31, 2017, or
(vi) one half of the sum of
  (V) USS2's 0% share of CFC's $100 cash position as of December 31, 2016, plus
  (VI) USS2's 0% share of CFC's $100 cash position as of December 31, 2015.

The consolidated group aggregate foreign cash position is therefore $190, even though CFC has been 100% owned by the USP consolidated group at all times with only $100 of cash position. The consolidated group aggregate foreign cash position should be only $100.

To prevent double counting, the final regulations should provide that the consolidated group aggregate foreign cash position is determined as if all members of the consolidated group were a single taxpayer as of each of the cash measurement dates. A similar consideration should apply to prevent double counting of foreign cash position among members of an affiliated group, such as if USP and USS did not elect to file a consolidated federal income tax return. Section 965(b) shows an intent for affiliated groups to be treated as a single taxpayer, at least for one purpose, and the same concept can be expanded to include cash positions as being consistent with Congressional intent.

9. Partnership section 965(c) deduction is based on partnership's taxable year and cash position.

Prop. Treas. Reg. § 1.965-1 follows Notice 2018-26 § 3.05(b) in providing that when a domestic partnership (or other domestic pass-through entity) is a United States shareholder of a DFIC and has section 965(a) income, the corresponding section 965(c) deduction is determined at the partnership level under an entity theory of partnerships. See also preamble to the Proposed Regulations at 83 F.R. 39523.

The partnership-level section 965(c) deduction is determined based on the partnership's taxable year and the partnership's aggregate foreign cash position, as confirmed by Prop. Treas. Reg. § 1.965-1(c). To the extent that a partnership's aggregate foreign cash position is reflected in a partnership-level section 965(c) deduction, the final regulations should have double counting rules to ensure that the partnership's cash position is not counted again under section 965(c)(3)(E) in determining a partner's section 965(c) deduction with respect to any other section 965(a) income of the partner.

For example, a domestic partnership owns 100% of the stock of a DFIC. The DFIC uses a fiscal taxable year, and it has $1,000 of section 965(a) income in the 2017-2018 Inclusion Year. The partnership uses a calendar year as its taxable year, and the $1,000 of section 965(a) income is included in the partnership's 2018 taxable year gross income. If the partnership has an aggregate foreign cash position of $1,400, the partnership's section 965(c) deduction is computed entirely based on the 21% federal corporate income tax rate and a 15.5% rate equivalent percentage, which results in a section 965(c) deduction of $262 (= $100 x (21% - 15.5%) / 21%). The partnership allocates its $1,000 of section 965(a) income and $262 of section 965(c) deduction to its partners, who should separately take into account only $400 of the partnership's $1,400 aggregate foreign cash position with respect to the partners' other section 965(a) income.

In addition, the final regulations should confirm that the partner's section 965(a) income allocated from the domestic partnership (or other pass-through entity) can be reduced by the partner's specified E&P deficits from another partnership or a non-partnership investment, with corresponding adjustments to the partner's tax basis in its partnership interest and the partnership's tax basis in its DFIC stock. Congress intended for specified E&P deficits to reduce section 965(a) income, and there is no indication that such offset should be disallowed in the case of section 965(a) income allocated by domestic partnerships.

10. <u>Section 382 and section 1374 treatment of section 965(a) income and section 965(c) deduction.</u>

Section 382(a) generally limits the amount of losses allowed to be used by certain corporations that undergo a 50% ownership change. If the corporation has a net unrealized built-in gain as of the ownership change date, section 382(h)(1)(A) generally increases the section 382 limitation, during the succeeding 5 year recognition period, by the corporation's recognized built-in gains.

Section 382(h)(3)(A) defines "net unrealized built-in gain" as the amount by which the corporation's fair market value of all assets immediately before the ownership change is more than the aggregate adjusted tax basis of such assets at such time.

Section 382(h)(2)(A) defines "recognized built-in gain" as any gain recognized during the recognition period on the disposition of any asset, to the extent of the built-in gain in the asset as of the ownership change date. Section 382(h)(6)(A) further provides that any item of income which is properly take into account during the recognition period, but which is attributable to periods before the ownership change date, shall be treated as recognized built-in gain for the year in which it is properly taken into account, with proper adjustments to net recognized built-in gain under section 382(h)(6)(C). Notice 2003-65, 2003-2 C.B. 747, generally provides that section 382(h)(6)(A) items are limited to items that an accrual method taxpayer would have included the item in income before the change date, and does not include post-ownership-change income from a built-in gain asset such as royalties from a patent.

Similar terms are used in section 1374, for a C corporation that converts to an S corporation, which is generally subject to a corporate-level built-in gains tax for any net recognized built-in gains during a 5 year recognition period after the conversion date, to the extent of the net unrealized built-in gains as of the conversion date. In contrast to section 382, which applies to recognized built-in gains, section 1374 applies only to net recognized built-in gains (recognized built-in gains reduced by recognized built-in losses in the same year). Section 1374(d)(5)(A) provides that any item of income which is properly take into account during the recognition period, but which is attributable to periods before the conversion date's taxable year, shall be treated as recognized built-in gain for the year in which it is properly taken into account, with proper adjustments to net recognized built-in gain under section 1374(d)(5)(C).

The final regulations should clarify the treatment of a corporation's section 965(a) income and section 965(c) deduction for section 382 purposes under Notice 2003-65, 2003-2 C.B. 747, and for section 1374 purposes.

For example, a domestic C corporation undergoes an ownership change on June 30, 2017, at a time when it owns 100% of the stock of a cash-rich DFIC, with stock tax basis of $0 and stock fair market value of $1,000, and some U.S. real property with tax basis of $0 and gross fair market value of $1,000. The shareholder corporation's net unrealized built-in gain is $2,000 (For illustrative purposes, it is assumed that the section 382(h)(3)(B)(i) threshold requirement does not apply). The DFIC uses a calendar year as its taxable year. The DFIC's post-1986 accumulated deferred foreign income was $1,000 on December 31, 2016, $1,500 on June 30, 2017, and $2,000 on December 31, 2017.

The domestic C corporation has $2,000 of section 965(a) income from the DFIC, with a $1,114 (55.7%) section 965(c) deduction, within the 5 year recognition period. The final regulations should clarify whether the shareholder corporation has any recognized built-in gain under section 382.

If section 965(a) income is an item of recognized built-in gain under section 382(h)(6)(A) and section 1374(d)(5)(A), the section 965(c) deduction should be an item of recognized built-in loss that reduces net recognized built-in gain under section 1374. The final regulations should further confirm whether or not the section 1374 built-in gains tax, imposed at the section 11 corporate income tax rate, can be deferred with a section 965(h) election.

11. <u>Stock tax basis adjustments after section 962 election, such as for S corporations.</u>

Prop. Treas. Reg. § 1.965-2(e)(2) reserves on the basis adjustment to DFIC stock for an individual United States shareholder who makes a section 962 election. Section 961(a) provides that for such a shareholder, the stock tax basis increase shall not exceed the amount of tax paid under chapter 1 of the Code on the section 965(a) income (and other subpart F income and GILTI inclusions covered by the section 962 election).

Since section 961(a) refers to the income tax paid, and a deferred tax liability is a tax that has not been paid, an argument could be made that the stock tax basis increase should be made only as of the date of each installment payment of the deferred tax liability, to the extent of such payment. Similarly, the PTI distribution amount under section 962(d) generally cannot exceed the amount of income tax actually paid by the shareholder as of the distribution date. However, such a result would give rise to additional yearly compliance costs, burden, and administrative complexity, and may cause the final regulations' compliance burden for the average domestic pass-through entity and owner to be significantly more than 5 hours once. The result would disfavor those individuals who make a section 962 election, compared to their non-electing counterparts who could defer their income tax liability for 8 years or more and still receive full tax-free PTI distributions.

Whether or not the stock basis increase includes a deferred tax, the final regulations should clarify the stock tax basis adjustments when the owner of a domestic pass-through entity makes a section 962 election with respect to section 965(a) income allocated from the domestic pass-through entity.

For example, an S corporation owns 100% of the stock of a DFIC with $200 of section 965(a) income. The S corporation has two 50% shareholders, A and B, each of whom is indirectly a United States shareholder of the DFIC. The S corporation allocates $100 of section 965(a) income and $77 of section 965(c) deduction to each shareholder in 2017. Shareholder A does not make a section 962 election and pays $39.6 of tax upfront. Shareholder B makes a section 962 election for the $23 of net section 965(a) income, and defers the resulting $8 (21%) of tax indefinitely under a section 965(i) election.

With respect to shareholder A, the S corporation's tax basis in the DFIC stock is increased by $100 under section 961(a), and shareholder A's tax basis in its S corporation stock is also increased by $100 under section 965(f)(2)(A).

Different policy arguments can be made for shareholder B, as to whether the S corporation's tax basis in the DFIC stock should be additionally increased by $0 (B's initial tax paid), $8 (B's deferred tax), or $100 (the section 965(a) income). If the DFIC stock tax basis increase is not $100, the S corporation would have $92 or $100 of gain in the DFIC stock that should theoretically be allocated solely to shareholder B, which would introduce new section 704(c)-like allocation concepts to the S corporation and its two 50%-50% common shareholders.

For a partnership with an individual partner who makes a section 962 election, the final regulations may provide that the inside tax basis increase is $100 while the outside tax basis increase is $0 or $8 (based on the above example). The $92 or $100 difference between inside and outside tax basis would be a negative section 743(b) adjustment between the partnership and the electing partner, allocated to the DFIC stock.

A section 962 election is applicable only for purposes of the chapter 1 income tax, and therefore it has no effect on the section 1411 tax. However, if the taxpayer makes a Treas. Reg. § 1.1411-10(g) election, the final regulations should confirm whether double section 1411 taxation occurs, in the initial year of the section 965(a) income and in the subsequent year when the specified foreign corporation makes a non-PTI distribution under section 962(d). The final regulations should also clarify the effects of double section 1411 taxation on section 1411 tax basis in the DFIC stock.

12. Basis and section 1248 when section 965(a) income is offset by specified E&P deficit.

If a United States shareholder has $100 of section 965(a) income from a wholly owned DFIC that is fully offset by a $100 specified E&P deficit from an E&P deficit foreign corporation, Prop. Treas. Reg. § 1.965-2(f)(1) provide a default rule that the stock tax basis in both the DFIC and the E&P deficit foreign corporation are unchanged. Prop. Treas. Reg. § 1.965-2(f)(2) provides an election, whereby the United States shareholder may increase the DFIC stock basis by $100 and reduce the E&P deficit foreign corporation stock basis by $100.

If no Prop. Treas. Reg. § 1.965-2(f)(2) election is made in the example, the shareholder has $100 of E&P, $100 of section 959 PTI, and a $0 stock tax basis increase in the DFIC. Assume that the shareholder's stock tax basis in the DFIC is $0. The final regulations should confirm the interactions between sections 965, 959, 961, and 1248.

If the shareholder sells all of its DFIC stock for $100, the final regulations should confirm that the $100 of gain is included in the shareholder's gross income as a dividend under section 1248(a), due to the $100 of E&P. Section 1248(d)(1) provides that E&P for section 1248 purposes does not include E&P attributable to any amount previously included in the gross income of the shareholder under section 951 (and not previously distributed under section 959), which does not apply to exclude the $100 of E&P above, because the E&P did not result in $100 of gross income under section 951 for the shareholder. The shareholder had only $0 included in its gross income, due to the $100 specified E&P deficit under section 965(b), which is entitled "[r]eduction in amounts included in gross income of United States shareholders of specified foreign corporations with deficits in earnings and profits." The result is similar to how section 961(a) does not increase the DFIC stock tax basis by the $100 of E&P, because the amount was not included in the gross income of the United States shareholder. The GILTI Proposed Treasury Regulations (REG-104390-18) reaches a similar conclusion under section 951A, where the sale of CFC stock can give rise to a section 1248(a) dividend when the CFC's tested income is offset by another CFC's tested loss.

Similarly, if the DFIC distributes $100 of cash to the shareholder, the $100 of section 301(c)(3) gain is s a $100 dividend under section 1248(a) (last sentence). Section 1248(j) and section 245A may apply to the $100 dividend if the shareholder is a domestic C corporation.

In the case where a Prop. Treas. Reg. § 1.965-2(f)(2) election is made to reduce the tax basis of the stock of the E&P deficit foreign corporation, the final regulations provide for a negative tax basis instead of gain recognition under section 961(b)(2), similar to how Treas. Reg. § 1.1502-19 provides for effectively negative stock tax basis instead of gain recognition under section 301(c)(3) in the consolidated return context. The negative tax basis can be similarly called an "excess loss account" in order to avoid using negative numbers. The purpose of section 965(b) is to provide a United States shareholder with less gross income when it owns an E&P deficit foreign corporation, and such purpose is defeated if there is instead gain under section 961(b)(2).

13. Application of section 965(c)(3)(E) to noncorporate entities.

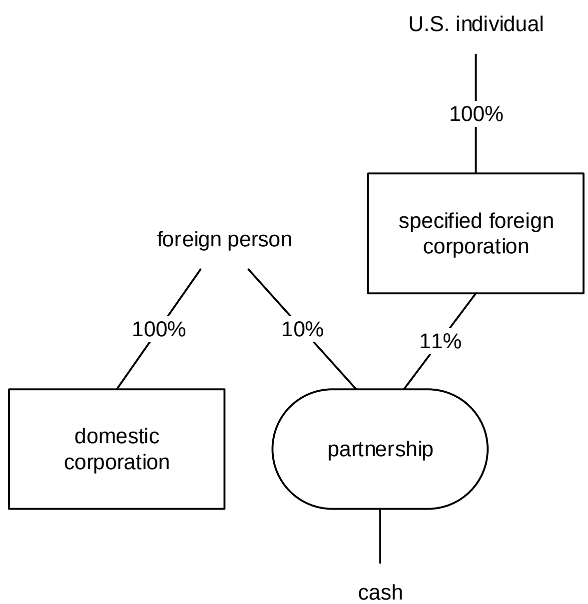
Section 965(c)(3)(E) provides that an entity (other than a corporation) shall be treated as a specified foreign corporation of a United States shareholder for purposes of determining such United States shareholder's aggregate foreign cash position if any interest in such entity is held by a specified foreign corporation of such United States shareholder (determined after application of this subparagraph) and such entity would be a specified foreign corporation of such United States shareholder if such entity were a foreign corporation.

The final regulations should clarify, with a few examples, that the hypothetical specified foreign corporation status may depend on the other owners of the noncorporate entity, after taking into account section 318(a)(3) downward attribution and other constructive ownership rules for interests in the noncorporate entity.

For example, a U.S. person owns 100% of a specified foreign corporation that owns an 11% interest in a general partnership, which may be domestic or foreign. The section 965(c)(3)(E) analysis depends on whether the U.S. person is a C corporation or an individual.

If the U.S. person is a domestic C corporation, who indirectly owns 11% of the partnership, the partnership would be an specified foreign corporation of its indirect corporate United States shareholder under section 965(c)(3)(E) if the partnership were a foreign corporation. The corporation takes into account 11% of the partnership's foreign cash position.

In contrast, if the U.S. person is an individual, who indirectly owns 11% of the partnership, the partnership's hypothetical status as a specified foreign corporation would depend on whether another 10% partner of the partnership is a domestic C corporation or if more than 39% of the partnership is owned by other United States shareholders, after taking into account constructive ownership. If a 10% partner is a foreign person who owns 100% of the stock of a domestic corporation, section 318(a)(3)(A) downward attribution causes that domestic corporation to constructively own 10% of the partnership and cause the partnership to be a hypothetical specified foreign corporation if the partnership were a foreign corporation; the individual takes into account 11% of the partnership's foreign cash position.



Since an indirect partner in a partnership may have some difficulties in gathering information about the other partners and their ownership interests in other partnerships and corporations, the final regulations should consider further de minimis exceptions that limit constructive ownership for purposes of section 965(c)(3)(E). The additional relief would reduce compliance costs, burden, and administrative complexity, because taxpayers generally have no experience with looking into the constructive ownership of their lower-tier noncorporate entity investments and the other partners in those investments.

The final regulations should confirm that the noncorporate entity's section 965(c)(3)(E) hypothetical specified foreign corporation status is determined for a United States shareholder under former section 951(b) according to ownership of 10% or more of the total combined voting power. For example, a U.S. person owns 100% of a specified foreign corporation that is a 90% limited partner in a partnership. The 10% general partner is an unrelated foreign person with no U.S. affiliates. The U.S. person is not a United States shareholder who owns 10% or more of the voting power of the partnership. The partnership is therefore not a specified foreign corporation of the U.S. person if the partnership were a foreign corporation.

14. Section 965(c) deduction reduces adjusted gross income.

Under the text of the Code, an individual's section 965(c) deduction should be a miscellaneous itemized deduction under section 67, as it is not a deduction against adjusted gross income ("AGI") under section 62. A miscellaneous itemized deduction is disallowed for alternative minimum tax ("AMT") purposes in 2017 and for all purposes in 2018. However, Notice 2018-26 § 3.06 and the preamble to the Proposed Regulations at 83 F.R. 39527 state that individual tax rates of 28% in 2017 or 37% in 2018 on section 965(a) income were not intended, and presumably also that Congress did not intend for all individuals to make a section 962 election. Prop. Treas. Reg. § 1.965-3(f)(1) provides that the section 965(c) deduction is not an itemized deduction, but it does not state the nature of the section 965(c) deduction.

Consistent with the requirement in the IRS FAQ Appendix: Q&A2,[1] that an individual taxpayer must report the section 965(a) income and the section 965(c) deduction as a single net amount of Other Income on Form 1040 line 21, the final regulations should confirm that the section 965(c) deduction is an amount that reduces the taxpayer's section 62(a) AGI.

15. Extent of section 965(l) recapture for expatriated entities, including related individuals.

Section 965(l) provides that if a United States shareholder is allowed a section 965(c) deduction, and such shareholder becomes an "expatriated entity" between December 22, 2017 and December 22, 2027 (with respect to a section 7874(a)(2)(B) surrogate foreign corporation that first becomes a surrogate foreign corporation during such 10-year period), then the expatriated entity's U.S. income tax is increased by 35% of the section 965(c) deduction, in the year that the shareholder becomes an "expatriated entity." No FTCs are allowed against the increased U.S. tax.

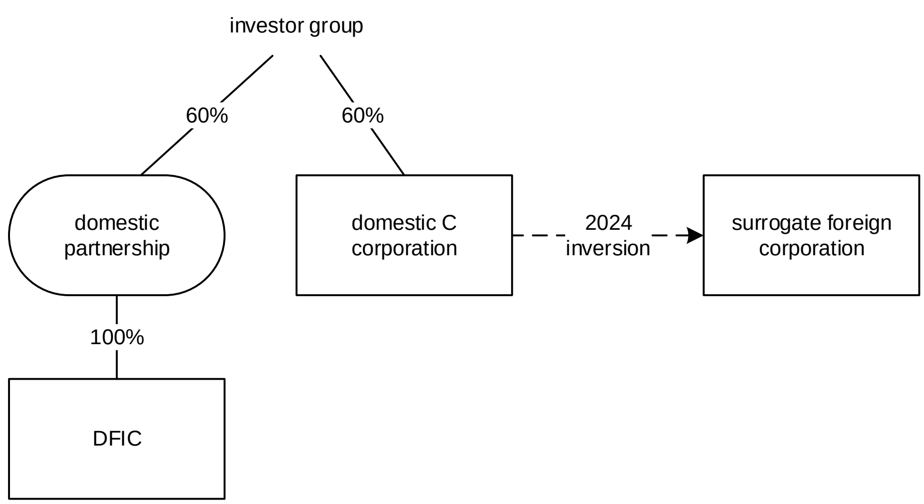
An "expatriated entity," as defined in section 7874(a)(2)(A)(i) and section 965(l)(2), generally includes a domestic corporation or domestic partnership that is acquired by the surrogate foreign corporation in a 60% inversion transaction (i.e., the former owners of the domestic corporation or domestic partnership generally own 60% to 80% of the stock of the surrogate foreign corporation). An "expatriated entity" also includes under section 7874(a)(2)(A)(ii) any United States person who is related, under section 267(b) or section 707(b)(1), to a domestic corporation or domestic partnership that is an expatriated entity. In the context of section 7874, such a "related" expatriated entity, which could be a U.S. individual,

[1] Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns, available at https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns

generally recognizes inversion gain from any transfer of stock or other property that is part of the 60% inversion transaction.

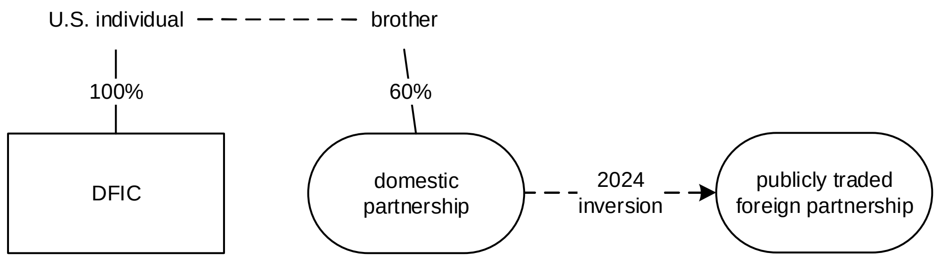
The final regulations should clarify, and consider limiting, the circumstances where a section 7874(a)(2)(A)(ii) expatriated entity should have U.S. income tax under section 965(l), particularly if the inversion transaction is unconnected with the DFIC.

For example, a group of investors own 60% of the interests in a domestic partnership and 60% of the stock of a domestic C corporation. The other 40% of the partnership and the corporation are owned by unrelated persons. The partnership owns 100% of the stock of a DFIC, and the partnership has $1,000 of section 965(a) income and $619 of section 965(c) deduction in 2018. In 2024, all of the stock of the domestic corporation is acquired by a surrogate foreign corporation in a 60% inversion transaction. The domestic corporation is an expatriated entity under section 7874(a)(2)(A)(i). The domestic partnership is related to the domestic C corporation under section 267(b)(10) and is therefore an expatriated entity under section 7874(a)(2)(A)(ii). The final regulations should confirm whether or not the domestic partnership has, or the partners of the domestic partnership collectively have, U.S. income tax of $217 ($619 section 965(c) deduction multiplied by 35% tax rate) in 2024. The additional U.S. tax may be limited to only domestic taxable persons in the investor group, not foreign persons or tax-exempt organizations.



Section 965(l)(2) provides that an “expatriated entity” does not include an entity with respect to a surrogate foreign corporation subject to section 7874(b) in an 80% inversion transaction. The reference to “entity” in section 965(l)(2), as well as the use of the 35% U.S. tax rate in section 965(l)(1), suggests that section 965(l) was intended to apply only to a domestic corporation in section 7874(a)(2)(A)(i) that underwent a 60% inversion transaction. The final regulations should clarify the extent that section 965(l) can apply to a related U.S. individual, who is usually not subject to a 35% U.S. tax rate (cf. section 7874(e)(2)(C)).

For example, a U.S. individual owns 100% of the stock of a DFIC, and she has $1,000 of section 965(a) income and $619 of section 965(c) deduction in 2018. In 2024, the U.S. individual's brother transfers his 60% interest in a domestic partnership (along with the other partners in the partnership) to a publicly traded foreign partnership (treated as a surrogate foreign corporation under Treas. Reg. § 1.7874-2(g)) in a 60% inversion transaction. The domestic partnership is an expatriated entity under section 7874(a)(2)(A)(i).



The U.S. individual is related to the domestic C corporation under section 707(b)(1)(A) and is therefore an expatriated entity under section 7874(a)(2)(A)(ii). The U.S. individual apparently has U.S. income tax of $217 ($619 section 965(c) deduction multiplied by 35% tax rate) in 2024, due to her brother's partnership interests.

If section 965(l) applies to U.S. individuals, the final regulations should clarify whether section 965(l)(2) applies only to an "entity," or whether it can exclude a U.S. individual who is a section 7874(a)(2)(A)(ii) expatriated entity with respect to an 80% inversion transaction.

16. <u>Section 965(g) applicable percentage for section 965(b) previously taxed E&P.</u>

Section 965(g) provides that no deduction or foreign tax credit ("<u>FTC</u>") is allowed for the applicable percentage, between 55.7% and 77.1%, of any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a section 965(c) deduction is allowed. The applicable percentage depends on whether the section 965(c) deduction results in an 8% rate equivalent percentage or a 15.5% rate equivalent percentage. Foreign taxes treated as paid or accrued includes indirect FTCs arising under section 960(a) from foreign taxes paid by the specified foreign corporation, which are subject to section 965(g).

Prop. Treas. Reg. § 1.965-5(b) provides that no deduction or FTC is allowed for the section 965(g) applicable percentage of any foreign withholding taxes imposed on a PTI distribution with respect to section 965(a) previously taxed E&P or section 965(b) previously taxed E&P (e.g., accumulated post-1986 deferred foreign income that was offset by a specified E&P deficit).

The final regulations should clarify what is the section 965(g) applicable percentage for a distribution of section 965(b) previously taxed E&P. The 8% or 15.5% rate equivalent dividend percentage creates a section 965(c) deduction only for section 965(a) income. In contrast, section 965(b) previously taxed E&P was offset by a specified E&P deficit, so it did not give rise to any section 965(a) income or section 965(c) deduction.

For example, a corporate United States shareholder has $1,000 of accumulated post-1986 deferred foreign income from DFIC A in 2017, $1,000 of specified E&P deficit from an E&P deficit foreign corporation in 2017, and $1,000 of accumulated post-1986 deferred foreign income from (fiscal year) DFIC B in 2018. Each of DFIC A, the E&P deficit foreign corporation, and DFIC B has a foreign cash position of $300 with respect to the United States shareholder, which has an aggregate foreign cash position of $1,200.

The United States shareholder has $0 of section 965(a) income in 2017 and $1,000 of section 965(a) income in 2018. Due to its $1,200 aggregate foreign cash position, the United States shareholder has a $262 section 965(c) deduction in 2018, to arrive at a 15.5% rate equivalent dividend percentage in 2018.

The section 965(g) applicable percentage for a $1,000 PTI distribution from DFIC B is clearly 55.7%, given that all of DFIC B's $1,000 of section 965(a) income was subject to the 15.5% rate equivalent dividend percentage. The section 965(g) applicable percentage for a $1,000 PTI distribution from DFIC A is unclear, when the shareholder did not have any section 965(a) income in 2017.

Even if the shareholder's DFIC B section 965(a) income were included in 2017 instead of 2018, it does not seem reasonable to apply the same 55.7% applicable percentage in 2017 to the $1,000 PTI distribution from DFIC B. At least $1,000 of the aggregate foreign cash position was already counted in reducing the section 965(g) applicable percentage for the $1,000 of section 965(a) previously taxed E&P with respect to DFIC B, and the same foreign cash position should not be counted again in reducing the section 965(g) applicable percentage for the $1,000 of section 965(b) previously taxed E&P with respect to DFIC A.

17. Section 965(g) applicable percentage for FTC from gain on the sale of DFIC stock.

Section 961(a) and Prop. Treas. Reg. § 1.965-2(f)(2) increase the U.S. tax basis of DFIC stock, to the extent of section 965(a) previously taxed E&P and section 965(b) previously taxed E&P, respectively. The final regulations should indicate whether section 965(g) applies to the applicable percentage of any foreign income taxes imposed on the shareholder's foreign tax gain from the sale of specified foreign corporation stock, to the extent of the tax basis increase under section 961(a) or Prop. Treas. Reg. § 1.965-2(f)(2) for U.S. income tax purposes.

18. Section 965(g) applicable percentage for foreign income taxes that are not net basis taxes.

Prop. Treas. Reg. § 1.965-5(b) provides that no deduction or FTC is allowed for the applicable percentage of "net basis taxes" imposed on a U.S. citizen by the citizen's jurisdiction of residence upon a receipt of a PTI distribution with respect to section 965(a) income (or section 965(a) income offset by specified E&P deficit). The final regulations should define what are "net basis taxes" for this purpose. For example, the French contribution sociale généralisée and the contribution pour le remboursement de la dette sociale are imposed on most types of investment income and capital gains, with few allowed deductions. To the extent that such taxes can give rise to FTCs under Eshel v. Comm'r, 831 F.3d 512 (D.C. Cir. 2016) and subsequent case law, as well as similar taxes in other countries that do not have totalization agreements with the United States, the final regulations should confirm that they are gross basis taxes not subject to the section 965(g) applicable percentage.

19. Relevant section 904 regulations can more clearly address foreign withholding taxes.

The preamble to the Proposed Regulations at 83 F.R. 39532 states that the application of section 904 is clear with respect to section 965(a) income, indirect FTCs, and direct FTCs, and that "[f]or example, withholding tax imposed on a distribution of section 965(a) previously taxed earnings and profits and section 965(b) previously taxed earnings and profits will be related to the separate category of income to which the original section 965(a) inclusion was assigned. See §1.904-6(b)(2) and (c), Example 7."

While the cited provisions of Treas. Reg. § 1.904-6 do discuss the application of section 904 to subpart F income and indirect FTCs, the provisions could be clearer about direct FTCs.

Treas. Reg. § 1.904-6(b)(2) provides that the principles similar to that of Treas. Reg. § 1.904-6(b)(1) shall apply to PTI distributions. Treas. Reg. § 1.904-6(b)(1) provides rules for subpart F income and the indirect FTCs under sections 902 and 960. The same rules for income and indirect FTCs apply to PTI distributions. The effect of the rules is to ensure that indirect FTCs are properly adjusted in the event of PTI distributions, as illustrated by Treas. Reg. § 1.904-6(c) Ex. 7.

It is less clear that any of the provisions refers to direct FTCs. Treas. Reg. § 1.904-6(c) Ex. 7 has no reference to direct FTCs, other than: "Assume that no withholding tax is imposed with respect to the distribution from T to S." There is no mention of direct FTCs and foreign withholding taxes in Treas. Reg. § 1.904-6(b), which is consistent with its heading that refers to only sections 902 and 960.

The final regulations should update the Treas. Reg. § 1.904-6(b) or similar guidance to address foreign withholding taxes on distributions of PTI, whether from subpart F income (including section 965(a) income) or GILTI inclusions.

20. Acceleration event for section 965(h) election, and triggering event for section 965(i) election.

After a taxpayer makes a section 965(h) election, section 965(h)(3) provides that the deferred tax payment is accelerated if there is a liquidation or sale of substantially all the assets of the taxpayer, or certain other acceleration events. However, the sale of substantially all of the assets of a taxpayer to a buyer is not an acceleration event if such buyer enters into a transfer agreement to be liable for the deferred tax, in the same manner as if such buyer were the taxpayer. Prop. Treas. Reg. § 1.965-7(b)(3)(ii)(B) provides that an acceleration event includes a liquidation, sale, exchange, or other disposition of substantially all of the assets of the taxpayer, including by reason of death in the case of an individual. In the case of death, the transferee cannot enter into a transfer agreement under Prop. Treas. Reg. § 1.965-7(b)(3)(iii)(A)(i).

After an S corporation shareholder makes a section 965(i) election, section 965(i)(2) provides that the indefinite tax deferral ends if there is a liquidation or sale of substantially all the assets of the S corporation, a transfer of any share of the S corporation’s stock by the taxpayer (including by reason of death or otherwise), or certain other triggering events. However, a transfer of stock is not a triggering event if the transferee enters into a transfer agreement under section 965(i)(3) to be liability for the deferred tax, in the same manner as if such transferee were the taxpayer. Prop. Treas. Reg. § 1.965-7(c)(3)(ii) provides that a section 965(i)(2) triggering event includes death in the case of an individual S corporation shareholder, and the transferee can enter into a transfer agreement to continue deferring the tax. The S corporation shareholder can also make a section 965(h) election under Prop. Treas. Reg. § 1.965-7(c)(3)(v) at the time of the triggering event.

The final regulations should not treat death as an acceleration event, since section 965 treats death only as a triggering event in section 965(i)(2) but not explicitly as an acceleration event in section 965(h)(3). It should be noted that the November 2, 2017 House bill that introduced section 965 also contained new section 2210 to entirely eliminate the estate tax, which showed a Congressional intent to generally not treat death as a taxing event.

If the final regulations treat death as an acceleration event, the transferee should be able to enter into a transfer agreement to continue the section 965(h) election. Prop. Treas. Reg. § 1.965-7(c)(3)(v) allows a new section 965(h) election to be made after death as a triggering event, and there is no clear reason why the procedures for death are different when it is an acceleration event.

Prop. Treas. Reg. § 1.965-7(b)(3)(iii)(B) and § 1.965-7(c)(3)(iv)(B) provide that that transfer agreement may be made only by a single U.S. person that is not a domestic pass-through entity. In the case of a sale, exchange, or bequest to multiple transferees, it is unclear whether a transfer agreement can be entered into by the largest transferee, the largest transferee who also acquires substantially all of the assets, or no transferee. The final regulations should allow multiple transferees, who collectively acquire substantially all of the assets, to enter into a transfer agreement with joint and several liability. While section 965(h)(3) and section 965(i)(2) refer to “a buyer” and “the transferee,” 1 U.S.C. § 1 provides that in determining the meaning of any Act of Congress, words importing the singular include and apply to several persons, parties, or things, unless context dictates otherwise. See Guardian Industries Corp. v. Comm’r, 143 T.C. 1 (2014). Congress was concerned about its ability to collect the deferred tax when a taxpayer has disposed of all of its assets, and such concern is addressed if multiple transferees collectively enter into a transfer agreement to be liable for the tax.

If the buyer or transferee is a domestic pass-through entity, the domestic pass-through entity and/or its owners should be able to enter into a transfer agreement. For example, if an S corporation sells all of its assets to another S corporation, the transferee S corporation should be able to continue the section 965(i) election. Alternatively, the transferee S corporation's shareholders can enter into the transfer agreement, as if the transferee S corporation had originally recognized the section 965(a) income.

Prop. Treas. Reg. § 1.965-7(b)(3)(ii)(F) provides that an acceleration event includes a consolidated group ceasing to exist or otherwise discontinuing in the filing of a consolidated return, and a transfer agreement is permitted only if the consolidated group is joining a different consolidated group. The final regulations should allow a nonconsolidated successor to the consolidated group to enter into a transfer agreement, such as if a consolidated group parent liquidated all of its subsidiaries and/or makes a REIT election, given that the nonconsolidated successor has all of the assets of the consolidated group.

The final regulations should clarify the meaning of "substantially all," which can vary from 70% in Treas. Reg. § 301.6111-3(b)(3)(i)(D) and Rev. Proc. 77-37, 1977-2 C.B. 568, to 85% in Treas. Reg. § 1.1394-1(l) and Treas. Reg. § 1.45D-1(c)(5).

21. <u>REIT section 965(m) election should not affect PTI and tax basis in DFIC stock.</u>

Section 965(m) provides that if a REIT is a United States shareholder of a DFIC, the REIT can elect for its section 965(a) income (and the section 965(c) deduction) to be taken into account in gross income (for purposes of computing section 857(b) REIT taxable income) over an 8 year period, which is analogous to the 8-year tax deferral of the section 965(h) election.

Section 959 generally allows the DFIC to make tax-free PTI distributions for amounts that are, or have been, included in gross income of its United States shareholder under section 951(a). Similarly, section 961 generally provides that a United States shareholder increases the tax basis in its DFIC stock by the amount required to be included in gross income under section 951(a) with respect to the DFIC stock, but only to the extent that such amount was included in the gross income of the United States shareholder.

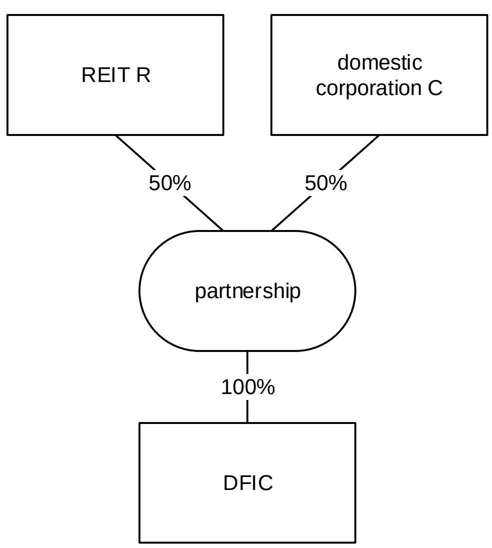
The preamble to the Proposed Regulations at 83 F.R. 39535 treats the section 965(m) election's deferral of gross income, for purposes of computing section 857(b) REIT taxable income, as a deferral of gross income for purposes of section 959 and section 961. The final regulations should reconsider this result, as it treats REITs that make the section 965(m) election worse than their non-REIT counterparts who make the section 965(h) election.

For example, a REIT owns 100% of a DFIC. The DFIC has $1,000 of section 965(a) income in 2017, which after a $771 section 965(c) deduction results in $229 of net REIT taxable income in 2017. The REIT has $0 other net income. The REIT makes a section 965(m) election, so that it has only $18 (8%) of REIT taxable income in 2017. The $18 of REIT taxable income consists of $80 of section 965(a) income and $62 of section 965(c) deduction in 2017.

The REIT's section 959 PTI and section 961 tax basis increase for 2017 in the DFIC is limited to only the $80 of undeferred section 965(a) income in 2017. A non-REIT taxpayer .who makes the section 965(h) election to defer tax, includes the full amount of section 965(a) income in gross income, with resulting full increase of PTI and stock tax basis.

H. Conf. Rep. 115-466, at 616, noted that the section 965(m) election was added by the Senate bill in order "to alleviate burden of compliance with this section [965] by REITs," with emphasis on the fact that a REIT generally distributes 90% or more of its taxable income as dividends-paid deductions that reduce the REIT's net tax liability to close to zero. An 8-year deferral of tax would not have much benefit for a REIT and its typically minimal tax liability, which prompted the section 965(m) election to defer REIT taxable income instead. Congress's attempt to level the playing field for REITs was likely not intended to leave an uneven corner where a non-REITs can receive full PTI distributions from the DFIC while a REIT cannot.

When a REIT's section 959 PTI and section 961 tax basis increase are both limited to only the undeferred section 965(a) income, a partnership with section 965(a) income and a REIT partner may have to make special adjustments to take into account the REIT's section 965(m) election. For example, a partnership has two equal partners, a REIT R and a domestic C corporation C. The partnership owns 100% of the stock of a DFIC and has $2,000 of section 965(a) income in 2017, which is allocated $1,000 to R and $1,000 to C. R makes a section 965(m) election to have $80 of section 965(a) income and $62 of section 965(c) deduction in 2017. C has $1,000 of section 965(a) income and $771 of section 965(c) deduction in 2017, which gives rise to $80 of corporate tax that is deferred over 8 years with a section 965(h) election (and $6.4 of tax in 2017). The partnership may have $1,000 of PTI and tax basis increase in the DFIC with respect to partner C, and only $80 of PTI and tax basis increase in the DFIC with respect to partner R, which would require section 704(c) principles to apply to the DFIC. The REIT and the partnership have additional costs, burden, and administrative complexity as they track the incremental increase in PTI and tax basis for eight years.



22. REIT E&P should be determined with section 965(c) and section 965(m).

The final regulations should clarify the effect of the section 965(m) election on a REIT's E&P, and consider regulatory relief for differences between E&P and REIT taxable income as a result of the section 965(c) deduction and the section 965(m) election. The differences may result in REIT shareholder dividend income being more than five times REIT taxable income.

For example, a REIT owns 100% of the stock of a DFIC. The DFIC has $1,000 of section 965(a) income in 2017, which after a $771 section 965(c) deduction results in $229 of net REIT taxable income in 2017. The REIT has $0 other net income. The REIT makes a section 965(m) election, so that it has only $18 (8%) of REIT taxable income in 2017 that it must distribute in 2017.

The final regulations should provide that the REIT's E&P is also deferred for 8 years under the section 965(m) election. Such a rule ensures that a REIT will have sufficient E&P in each year to reduce the REIT taxable income to zero with a dividends-paid deduction, and avoid any timing differences and double counting in computing REIT shareholder dividend income. The final regulations should further provide that the REIT's E&P is reduced by the section 965(c) deduction, such as the $771 in the above example. With such regulatory relief, the REIT can distribute $18 as a taxable dividend in 2017, and any further 2017 distributions would be a return of capital under section 301(c)(2) or (3). Similarly, $18 of the REIT's 2018 distribution is a taxable dividend to the shareholders.

Without such regulatory relief, if the REIT pays $1,000 to its shareholders in 2017, the shareholders have $1,000 of REIT dividend income due to the REIT's $1,000 of E&P in 2017, thereby eliminating the entire advantage of the section 965(c) deduction and the section 965(m) election. In 2018, the REIT has another $18 of taxable income, which requires the REIT to distribute another $18 dividend to its shareholders in order to reduce REIT taxable income to zero. Ultimately, the REIT that has $229 of REIT taxable income in one year can give rise to up to $1,211 of shareholder dividend income over eight years, which is contrary to the Congressional intent to provide the section 965(c) deduction and the section 965(m) election as a benefit for REITs.

A similar issue arises for a parent REIT with one or more subsidiary REITs. If the subsidiary REIT has section 965(a) income with a section 965(c) deduction, its distributions to the parent REIT that is treated as a REIT dividend should be limited to the non-deferred net amount. Otherwise, a REIT that operates through parent and subsidiary REITs, for various non-tax business reasons, is substantially penalized by effectively losing both the section 965(c) deduction and the section 965(m) election at the parent REIT level.

For example, a parent REIT owns 100% of the common stock of subsidiary REIT, which owns 100% of the stock of a DFIC. The parent REIT has a $1,000 tax basis in its subsidiary REIT stock. The DFIC has $1,000 of section 965(a) income, which after a $771 section 965(c) deduction results in $229 of net taxable income to the subsidiary REIT. The subsidiary REIT makes a section 965(m) election, in order to have $18 (8%) of taxable income in the first year. The subsidiary REIT has $0 other net income.

If the subsidiary REIT distributes $1,000 to the parent REIT, only $18 of that distribution should be REIT dividend income for the parent REIT. The remaining $982 distribution is a return of capital under section 301(c)(2). The parent REIT should have only $18 of qualifying REIT income under section 856(c)(2)(A) and section 856(c)(3)(D), for purposes of the section 856(c)(2) and (c)(3) REIT gross income tests, respectively.

23. <u>RIC E&P should be determined in accordance with section 965(c).</u>

The final regulations should consider similar regulatory relief for purposes of computing the E&P of a regulated investment company ("<u>RIC</u>") with section 965(a) income, which should be reduced by the section 965(c) deduction.

A close analogue to the section 965(c) deduction is the section 243 dividends-received deduction, as a non-cash tax deduction intended to result in a lower effective federal income tax rate for dividends paid by a domestic C corporation to another domestic C corporation. The section 243 deduction similarly changed based on the actual federal income tax rate. For a domestic C corporation subject to a 35% corporate income tax rate in 2017 or earlier, a 70% section 243 deduction resulted in an effective tax rate of 10.5%. For a domestic C corporation subject to a 21% corporate income tax rate in 2018 or earlier, the TCJA reduced the section 243 deduction to 50% in order to remain at the same effective tax rate of 10.5%.

A RIC that earns dividend income from a domestic C corporation may effectively pass through the dividend income under section 854 to its corporate shareholders, who can be entitled to the section 243 dividends-received deduction at the shareholder level. The shareholder corporation is generally taxed at the same 10.5% rate for dividends received directly from another domestic corporation and for dividends received through a RIC. In contrast, such equality of treatment is lacking for RIC section 965(a) income.

For example, a RIC has $1,000 of dividend income from a domestic C corporation and $1,000 of section 965(a) income from a cash-rich DFIC in 2017. The DFIC distributes $1,000 to the RIC in order for the section 965(a) to be qualifying income for the section 851(b) gross income test. The RIC has $2,000 of total cash, which it distributes to a domestic C corporation shareholder.

For the $1,000 RIC distribution attributable to the RIC's domestic dividend, the domestic C corporation shareholder has $1,000 dividend income, $700 section 243 dividends-received deduction, and therefore $300 of net income. The shareholder pays $105 (35%) of tax on the $1,000 cash received.

For the $1,000 RIC distribution attributable to the RIC's section 965(a) income, it appears that the RIC's E&P and therefore the shareholder's dividend income is the entire $1,000, notwithstanding the RIC's $557 section 965(c) deduction at the RIC level. There is no further section 965(c) deduction at the shareholder level. As a result, the shareholder pays $350 (35%) of tax on the $1,000 cash received, rather than the intended 15.5%.

The final regulations should provide that the section 965(c) deduction reduces RIC E&P, so that only $443 of the $1,000 RIC distribution is a dividend to the shareholder. The shareholder pays $155 (35%) of tax on $443 of dividend income, which equates to an effective 15.5% tax rate on the $1,000 distribution.

24. <u>Interaction of section 965(m) election with section 965(n) election should be clarified.</u>

Section 965(n)(1) allows an election for a United States shareholder of a DFIC to disregard its section 965(a) income (and section 965(c) deduction and related section 78 gross-up) for purposes of computing (A) the shareholder's section 172 net operating loss ("<u>NOL</u>") deduction and (B) the shareholder's taxable income that may be reduced by NOL carryovers or carrybacks under section 172. Prop. Treas. Reg. § 1.965-7(e)(1)(i) provides that the taxpayer may apply the section 965(n) election to disregard the section 965 amounts in generating an NOL for the taxable year.

For a REIT that makes a section 965(m) election, the final regulations should indicate whether the REIT can make a section 965(n) election for each year in the 8-year section 965(m) deferral period. If the REIT can only make the section 965(n) election for the first year but not for years 2 through 8, the REIT effectively can only preserve its NOLs in the first year, to the extent of 8% of the section 965 amounts. The preserved NOLs would be used against the 92% of the section 965 amounts in years 2 through 8. In contrast, a non-REIT taxpayer that makes a section 965(h) election effectively preserves its NOLs through the entire 8 year period, at least with respect to the section 965(a) income and its U.S. tax.

Section 965(n) contains an ambiguity in the terms of the relevant taxable year of the NOL. Section 965(n)(1) refers to the taxable year described in section 965(a), which is the DFIC's last taxable year beginning before January 1, 2018. The United States shareholder's taxable year does not necessarily coincide with that DFIC taxable year, such as if the DFIC is on a fiscal taxable year while the shareholder is on a calendar taxable year. However, section 965(n) nevertheless treats the DFIC's section 965(a) taxable year as the relevant taxable year in determining the amount of the shareholder's NOL for such taxable year, the amount of shareholder taxable income for such taxable year that may be reduced by NOL carryovers or carrybacks to such taxable year, and the due date of the return for making the election. Based on the statutory ambiguity and Congressional intent, the final regulations should allow the section 965(n) election to be made for any taxable year of a United States shareholder that has section 965(a) income during such year.

25. <u>DFIC dividends can increase the net tax liability under section 965.</u>

Section 965(h) allows an 8-year deferral of a United States shareholder's net tax liability under section 965, which is defined in section 965(h)(6)(A) as (i) the taxpayer's net income tax over (ii) the taxpayer's hypothetical net income tax determined (I) without regard to section 965 and (II) without regard to any income or deduction properly attributable to a dividend received by the United States shareholder from any DFIC.

The final regulations should clarify the scope of the section 965(h)(6)(A)(ii)(II) DFIC dividend exception, as to whether it includes any dividends (or deemed dividends) received by the United States shareholder from the DFIC before the DFIC's Inclusion Year.

For example, a corporate United States shareholder owns 100% of the stock of DFIC A and 100% of the stock of DFIC B. The shareholder and DFIC A both use the calendar year as the taxable year. DFIC B uses a fiscal year ending November 30 as its taxable year.

DFIC A has $437 of accumulated post-1986 deferred foreign income as of both November 2, 2017 and December 31, 2017. Neither DFIC has any aggregate foreign cash position. Accordingly, the United States shareholder has $437 of section 965(a) income in 2017 from DFIC A, with a $337 (77.1%) section 965(c) deduction.

DFIC B started with $110 of post-1986 earnings and profits in 2017, but DFIC B distributed $100 to the United States shareholder on October 15, 2017. DFIC B therefore has $10 of accumulated post-1986 deferred foreign income for its December 1, 2017 to November 30, 2018 taxable year, and that $10 of section 965(a) income is included in the United States shareholder's 2018 taxable year gross income. For 2017, the United States shareholder has $100 of dividend income from DFIC B.

Assuming that the United States shareholder has zero other net taxable income, it has $200 of taxable income in 2017, consisting of $437 of section 965(a) income, $337 of section 965(c) deduction, and $100 of dividend income from DFIC B. The $200 of taxable income results in $70 (35%) of U.S. income tax in 2017. The section 965(h)(6)(A)(i) minuend is therefore $70 of U.S. tax.

The section 965(h)(6)(A)(ii) subtrahend is determined without regard to the $437 section 965(a) income from DFIC A, the $337 section 965(c) deduction, and the $100 dividend from DFIC B. The section 965(h)(6)(A)(i) subtrahend is therefore the U.S. income tax on $0 of income, or $0. The section 965(h)(6)(A) net tax liability under section 965 is $70, which can be deferred with a section 965(h) election.

26. <u>The $1 million exception to an acceleration event should be in the final regulations.</u>

IRS FAQ Q16 provides that if an individual's net tax liability under section 965 in the 2017 taxable year is less than $1 million, the individual's failure to make the full first installment will not result in an addition to tax, and therefore will not result in a section 965(h)(3) acceleration event, as long as the individual pays the full first and second installments by the second installment due date. The preamble to the Proposed Regulations at 83 F.R. 39537 indirectly refers to the existence of the $1 million exception.

The $1 million exception should be incorporated in the final regulations, in order to facilitate taxpayer reliance. See Nina Olson, <u>IRS Frequently Asked Questions Can be a Trap for</u>

the Unwary, available at https://taxpayeradvocate.irs.gov/news/irs-frequently-asked-questions-can-be-a-trap-for-the-unwary ("the IRS may change the answer to an FAQ (or unexpectedly reinterpret an FAQ) to the detriment of taxpayers who rely on them.")

The final regulations should clarify the scope of the $1 million exception, such as:

1. Whether the exception is available for trusts and estates, domestic or foreign,
2. Whether a married couple filing jointly has a $1 million exception or a $2 million exception, and
3. Whether the exception is available if the taxpayer originally calculated a net tax liability under section 965 of under $1 million, but the IRS later assesses a deficiency that increases the amount to above $1 million.

27. Overpayment of tax in connection with section 965(h) or 965(i) election.

IRS FAQ Q14 provides that if a taxpayer makes the section 965(h) election to defer its tax liability over the 8 year period, the taxpayer is not entitled to a refund of any 2017 overpayments until the entire deferred 2017 income tax liability is paid off. See also IRS Internal Legal Memorandum PMTA 2018-016 (August 2, 2018).

The final regulations should clarify whether the same Treasury position on tax refunds applies to an S corporation shareholder who makes a section 965(i) election, and who might never be entitled to any tax refund from the IRS until the indefinitely deferred section 965 net tax liability is paid in full. Cf. Treas. Reg. § 15A.453-1(c)(2) (an installment obligation can have a stated maximum principal amount and an undeterminable payment period).

In either the section 965(h) election case or the section 965(i) election case, the lack of tax refunds penalizes those taxpayers who happen to be otherwise entitled to tax refunds for reasons unrelated to section 965, compared to their counterparts who monitor their estimated tax payments and withholding tax payments more carefully. The extra attention required to not overpay one's income taxes during the 8-year deferral period (or indefinitely during the section 965(i) deferral period) can result in additional costs, burden, and administrative complexity, which may increase a taxpayer's section 965 annual compliance burdens to beyond 5 hours once.

28. Section 965(n) NOL election applies for purposes of the AMT and the section 1411 tax.

The final regulations should clarify whether the section 965(n) election for current year losses (and any prior NOL carryovers) can also be made for purposes of the taxpayer's section 56(a)(4) AMT NOL deduction, in the absence of a regular tax NOL. For example, a U.S. individual has $100 of regular taxable income and negative $50 of AMT taxable income in 2017 in the absence of section 965, plus $80 of net section 965(a) income and section 965(c) deduction for both regular tax and AMT purposes. A section 965(n) election in 2017 would have no effect for regular tax purposes given the lack of a regular tax NOL, but would allow a $50

AMT NOL carryover from 2017 to 2018; the taxpayer would have $180 of regular taxable income and $80 of AMT taxable income in 2017.

For section 1411 tax purposes, Treas. Reg. § 1.1411-4(h) allows an NOL that is based on the regular tax NOL. The final regulations should indicate whether or not the section 965(n) election applies for purposes of the Treas. Reg. § 1.1411-4(h) NOL under the section 1411 tax, which should take into account the timing of the actual distributions subject to the section 1411 tax and any Treas. Reg. § 1.1411-10(g) election. For example, a taxpayer with section 965(a) income from a DFIC in 2017 might not have net investment income subject to the section 1411 tax until the DFIC makes a distribution in 2019, in which year the taxpayer may have some NOLs for purposes of the section 1411 tax. A section 965(n) election could be allowed in 2019 for purposes of the section 1411 tax, in order to preserve those section 1411 NOLs and match the regular tax NOLs that were preserved by a section 965(n) election made in 2017.

29. Section 965(a) income and section 965(c) deduction under the 59A minimum tax.

The final regulations should address how section 965 interacts with the new section 59A base erosion and anti-tax abuse tax.

For 2018, section 59A(b)(1) provides that the base erosion minimum tax amount is equal to 5% (or 6% for banks and securities dealers) of the taxpayer's modified taxable income, minus the taxpayer's section 26(b) regular tax liability without regard to certain credits, such as FTCs. The section 26(b) regular tax liability is determined without regard to any section 965(h) election to defer some of that regular tax liability.

Section 59A(e)(1)(B) provides that the section 59A tax generally applies only to domestic C corporations with average annual gross receipts of at least $500 million for the prior three-year period. All persons treated as a single employer under section 52(a) are treated as one person in determining gross receipts under section 59A(e)(3), e.g., a controlled group of corporations with more than 50% common ownership under section 1563, but without the section 1563(b)(2)(C) exception for foreign corporations. For a foreign corporation, its gross receipts generally includes only amounts effectively connected with the conduct of a U.S. trade or business under section 59A(e)(2)(A).

If a domestic C corporation owns more than 50% of the stock of a specified foreign corporation, so that the two corporations are treated as one person for section 59A(e)(3) gross receipts purposes, any section 965(a) income from the specified foreign corporation to the domestic C corporation should be disregarded as effectively a payment between branches of a single person. The final regulations should confirm that section 965(a) income between controlled group members is excluded. Instead, the domestic C corporation's gross receipts includes the specified foreign corporation's income effectively connected with the conduct of a U.S. trade or business.

For a domestic C corporation and a specified foreign corporation that are not in the same controlled group of corporations, the final regulations should confirm whether the domestic C corporation's gross receipts is increased by the section 965(a) income, and reduced by the section 965(c) deduction, from the specified foreign corporation.

Section 59A(e)(1)(C) provides that the section 59A tax applies only if the taxpayer's base erosion percentage is 3% (or 2% for banks and securities dealers) or higher, as determined under section 59(c)(4) as generally the taxpayer's base erosion tax benefits divided by the taxpayer's aggregate allowable deductions. Section 59A(c)(4)(B)(i) provides that the deductions in the denominator do not include any deduction allowed under sections 172, 245A, or 250.

All persons treated as a single employer under section 52(a) are treated as one person for determining base erosion percentage under section 59A(e)(3), e.g., a controlled group of corporations with more than 50% common ownership under section 1563, but without the section 1563(b)(2)(C) exception for foreign corporations. When base erosion payments are made to foreign entities within the controlled group, such base erosion payments appear to be disregarded in both the numerator and the denominator of the base erosion percentage calculation. Similarly, deductions for non-base-erosion payments made within the controlled group appear to be disregarded in the denominator. The final regulations should indicate whether a domestic C corporations' section 965(c) deduction, with respect to a specified foreign corporation that is part of the same controlled group of corporations, should be disregarded from the denominator in determining the base erosion percentage.

For a domestic C corporation and a specified foreign corporation that are not in the same controlled group of corporations, the final regulations should confirm that the domestic C corporation's section 965(c) deduction from the specified foreign corporation is an allowable deduction that increases the denominator of the base erosion percentage.

30. <u>The 1.4% section 4368 tax is determined under section 4940 principles.</u>

The Proposed Regulations describe the treatment of section 965(a) income for purposes of the 1% or 2% section 4940 tax on the net investment income of private foundations, such as Prop. Treas. Reg. § 1.965-3(f)(4) providing that the section 965(c) deduction is not allowed for purposes of computing net investment income. In addition, the preamble to the Proposed Regulations at 83 F.R. 39534 notes that the section 4940 tax is not permitted the 8-year section 965(h) deferral election.

The final regulations should clarify that the same section 4940 principles apply to the 1.4% section 4968 tax, as enacted by the TCJA to apply to the net investment income of applicable educational institutions. Section 4968(c) provides that net investment income under the section 4968 tax shall be determined under rules similar to the rules of section 4940(c), which defines net investment income under the section 4940 tax.

The section 4968 tax is effective for taxable years of applicable educational institutions beginning after December 31, 2017. An applicable educational institution may have section 965(a) income subject to the section 4968 tax, such as if the applicable educational institution uses a calendar taxable year and owns stock of a DFIC that is on a 2017-2018 fiscal taxable year, in which case the DFIC's section 965(a) income and other subpart F income are included in the educational institution's 2018 taxable year under section 951(a)(1). An applicable educational institution may also have section 965(a) income subject to the section 4968 tax if it owns an interest in a domestic partnership that has a 2017-2018 fiscal taxable year and owns DFIC stock.

Notice 2018-55, 2018-26 IRB 773, provides that an applicable educational institution effectively has a basis step-up to the fair market value of its assets as of December 31, 2017, for purposes of determining subsequent capital gain or loss subject to the section 4968 tax. The final regulations should confirm whether the applicable educational institution's tax basis in a fiscal taxable year DFIC's stock, equal to the DFIC stock's fair market value as of December 31, 2017, should be further adjusted upward (or downward) under section 961 by the DFIC's 2017-2018 section 965(a) income as of November 2, 2017 or December 31, 2017 (or specified E&P deficit as of November 2, 2017).

For example, an applicable educational institution owns 100% of the stock of a DFIC, which has $1,000 of accumulated post-1986 deferred foreign income on both November 2, 2017 and December 31, 2017. The DFIC uses a taxable year ending November 30, while the applicable educational institution has a calendar taxable year. The fair market value of 100% of the DFIC stock is $2,000 on December 31, 2017. Under Notice 2018-55, the applicable educational institution has a tax basis of $2,000 in its DFIC stock as of December 31, 2017 for purposes of the section 4968 tax. The applicable educational institution has $1,000 of section 965(a) income under section 951(a)(1) in 2018, which may increase its tax basis in the DFIC stock by a further $1,000 under section 961, to a tax basis of $3,000.

31. <u>Section 965(a) income under the unrelated business income tax.</u>

Section 511(a)(1) imposes the section 11 corporate income tax on the unrelated business taxable income ("<u>UBTI</u>") of certain tax-exempt organizations. For certain charitable trusts and other tax-exempt trusts under section 511(b)(2), section 511(b)(1) imposes tax on UBTI at the section 1(e) tax rates generally applicable to non-grantor trusts. Section 515 allows the UBTI tax to be reduced by section 901 FTCs, which includes taxes deemed paid under section 960 in the case of a (tax-exempt) corporation.

UBTI is generally defined in section 512(a)(1) as the tax-exempt organization's income from any unrelated trade or business. Section 512(b)(1) provides that UBTI excludes all dividends. Treas. Reg. § 1.512(b)-1(a)(1) provides that UBTI excludes dividends and other substantially similar income from ordinary and routine investments to the extent determined by the IRS Commissioner.

The final regulations should confirm that section 965(a) income (and other subpart F income) is covered by the section 512(a)(1) UBTI exclusion, consistent with Notice 2018-67

§ 10, some PLRs,[2] and the legislative history of section 512(b)(17) in H. Rep. 104-586, at 136 (1996) and H. Conf. Rep. 104-737, at 294 (1996).

Section 512(b)(17) is a look-through rule providing that, notwithstanding the UBTI dividend exclusion in section 512(b)(1), a tax-exempt organization's subpart F income shall be UBTI to the extent attributable to insurance income as defined under section 953, if the income would be gross income from a unrelated trade or business if derived directly by the tax-exempt organization. An exception is allowed under section 512(b)(17)(B) for insurance with respect to the tax-exempt organization itself or affiliated parties.

A DFIC's section 953 insurance income from 1987 through 2017 might not have given rise to subpart F income during those prior years under various exceptions, such as due to the <5% de minimis rule of section 954(b)(3), the section 954(b)(4) high-tax exception, or if the corporation is a non-CFC specified foreign corporation. The insurance income increases the DFIC's accumulated post-1986 deferred foreign income and is part of the section 965(a) income of any tax-exempt organization that is a United States shareholder of the DFIC. It is unclear whether the section 512(b)(17) inclusion of section 953 insurance income is made before or after taking into account some or all of the exceptions.

For example, a section 511(b)(2) tax-exempt trust owns 100% of the stock of a DFIC. Both the trust and the DFIC use the calendar year as the taxable year. In 2016, the DFIC earned $1,000 of section 953 insurance income that was subject to an effective foreign income tax rate of 32%, which results in $680 of after-tax earnings. The tax-exempt trust elects to use the section 954(b)(4) high-tax exception and has no subpart F income in 2016. Section 512(b)(17) therefore does not apply to the tax-exempt trust in 2016. The $680 of after-tax earnings is part of the DFIC's accumulated post-1986 deferred foreign income and gives rise to $680 of section 965(a) income for the tax-exempt trust in 2017.

The final regulations should clarify whether, and to what extent, the section 512(b)(17) look-through rule applies to a tax-exempt organization's section 965(a) income. If the tax-exempt trust has $680 of UBTI in 2017 under section 512(b)(17), the tax-exempt trust is subject to $269 of federal income tax at the highest marginal tax rate of 39.6%, with no benefit from the $320 of indirect FTCs.

The final regulations should confirm whether a section 962 election is allowed for a tax-exempt trust's section 511 tax on subpart F income that is UBTI. The section 962 election is allowed generally for trusts under Treas. Reg. § 1.962-2(a). With the election, the tax-exempt trust has $680 of UBTI (subpart F income) and $320 of section 78 gross-up taxed as a dividend, along with $320 of indirect FTCs under section 960.

The final regulations should further confirm that the section 78 gross-up related to the section 512(b)(17) subpart F UBTI is not subpart F income that could be UBTI under section

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[2] PLR 201430017, 201043041, 199952086, 9507007, 9027051, 9024086, 9024026, 8922047, 8836037, 8819034. But see PLR 9043039, which looked through the controlled foreign corporation to treat the subpart F income as earned directly by a tax-exempt organization shareholder, for purposes of computing the shareholder's UBTI.

512(b)(17). Section 512(b)(17) applies only to amounts included in gross income under section 951(a)(1)(A), which does not include the gross-up amounts under section 78. The section 78 gross-up is a dividend covered by the section 512(b)(1) exclusion. For comparison, other statutory provisions treat the section 78 gross-up as subpart F income for specific purposes, such as section 904(d)(3)(G) and section 965(n)(2). See also section 250(a)(1)(B).

I would be pleased to discuss these comments if you believe it would be helpful. Please feel free to contact me at (212) 903-8713 or lzhang@rhtax.com.

Respectfully submitted,

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Comments on Proposed Regulations under Section 965

Dear Sir or Madam:

I appreciate the opportunity to comment on the proposed regulations entitled "Guidance Regarding the Transition Tax Under Section 965 and Related Provisions" (REG-104226-18) (the "Proposed Regulations"), 83 F.R. 39514 (August 9, 2018).

This letter is a supplement to my earlier comments submitted on September 18, 2018, available at https://www.regulations.gov/document?D=IRS-2018-0019-0050

For convenience, I have continued the numbering system from my prior comments.

32. Double inclusion of section 965(a) income and other subpart F income with section 962 election.

Section 965(a) income is based on the specified foreign corporation's accumulated post-1986 deferred foreign income, which is defined in section 965(d)(2) as the corporation's post-1986 E&P, except for (A) earnings attributable to income effectively connected with a U.S. trade or business and subject to U.S. income tax, and (B) in the case of a CFC, earnings that would be excluded from a shareholder's gross income under section 959 if distributed.

The final regulations should clarify the determination of accumulated post-1986 deferred foreign income for an individual United States shareholder who had subpart F income in a prior year and made a section 962 election for that prior year. Section 962(d) causes some of such subpart F income to not be eligible for the section 959 gross income exclusion, and therefore such subpart F income may be taxed again as section 965(a) income in the Inclusion Year.

For example, an individual United States shareholder owns 100% of the stock of a CFC, which had $100 of subpart F income in 2016. The CFC uses the calendar year as its taxable year. The individual United States shareholder made a 2016 section 962 election, had $100 of subpart F income subject to the 35% corporate income tax rate, and paid $35 of corporate income tax in 2016. Under section 962(d), the CFC may distribute $35 to the shareholder as a PTI distribution excluded from gross income under section 959, but the shareholder has gross income if the CFC distributes its $65 of remaining earnings.

Even if the CFC has no additional income in 2017, its post-1986 accumulated deferred foreign income as of November 2, 2017 or December 31, 2017 appears to be $65, equal to its $100 post-1986 E&P minus the $35 amount that would be excluded from the shareholder's gross income under section 959 if distributed. Section 962(d) provides that the remaining $65 of earnings is not excluded from the shareholder's gross income under section 959 if distributed, and therefore the $65 is not excluded from the CFC's post-1986 accumulated deferred foreign income.

Accordingly, the individual United States shareholder has $65 of section 965 subpart F income in 2017, which is duplicative of $65 of its $100 of subpart F income in 2016. Regulatory relief should be provided to ameliorate the double taxation.

If the final regulations nevertheless indicate that the CFC's accumulated post-1986 deferred foreign income includes the $65 of earnings described above, the final regulations should provide that the indirect FTCs attributable to the $65 of earnings are available to the individual shareholder who makes a section 962 election in 2017, even though such indirect FTCs may have been previously used in 2016. While FTCs are generally not permitted to be used twice, an exception should be made when the related income is subject to U.S. tax twice. The final regulations should also clarify the effects of the double taxation on PTI and stock tax basis.

The same result may occur when the CFC has non-section-965 subpart F income in the Inclusion Year. For example, an individual United States shareholder owns 100% of the stock of a CFC, which has $100 of non-section-965 subpart F income in 2017. The CFC uses the calendar year as its taxable year. If the individual makes a section 962 election for 2017, it is possible that the individual has $100 of non-section-965 subpart F income in 2017 as well as $65 of section 965(a) income in 2017. The 2017 non-section-965 subpart F income of $65 is not excluded from gross income under section 962(d) due to the section 962 election, and therefore is part of the CFC's accumulated post-1986 deferred foreign income. Such double inclusion would significantly discourage individuals from making the section 962 election when the DFIC has non-section-965 subpart F income in the Inclusion Year, which conflicts with Congressional intent in drafting the section 965(c)(2) rate equivalent percentages based on the corporate income tax rate in order to generally encourage individuals to make the section 962 election. See H. Conf. Rep. 115-466, at 620 n. 1513 (2017).

33. Tax basis increase after section 965(m) election in connection with stock sale.

Section 965(m) provides that if a REIT is a United States shareholder of a DFIC, the REIT can elect for its section 965(a) income (and the section 965(c) deduction) to be taken into account in gross income (for purposes of computing section 857(b) REIT taxable income) over an 8 year period, which is analogous to the 8-year tax deferral of the section 965(h) election. The preamble to the Proposed Regulations at 83 F.R. 39535 treats the section 965(m) election as also deferring gross income for purposes of 961, and therefore the increase in DFIC stock basis is made annually over the 8 year period. A prior comment (#21) requested a reconsideration of this result, for various policy and administrative reasons.

If the final regulations nevertheless provides that the REIT increases its DFIC stock basis, E&P, and PTI over the 8 year period, the regulations should clarify the results when the REIT sells some or all of the DFIC stock during the 8 year period.

For example, a REIT owns 100% of a DFIC. The REIT has a tax basis of $0 in the DFIC stock. The DFIC has $1,000 of section 965(a) income in 2017, which after a $771 section 965(c) deduction results in $229 of net REIT taxable income in 2017. The REIT has $0 other net income. The REIT makes a section 965(m) election, so that it has only $18 (8%) of REIT taxable income in 2017. The $18 of REIT taxable income consists of $80 of section 965(a) income and $62 of section 965(c) deduction in 2017.

The REIT's section 961 tax basis increase for 2017 in the DFIC is limited to only the $80 of undeferred section 965(a) income in 2017. The tax basis increase in 2018 is another $80, in 2019 is another $80, and so on until the entire $1,000 basis increase is applied through 2024.

In early 2018, the REIT sells all of its DFIC stock for $1,000. The REIT does not sell substantially all of its assets or engage in any other transaction that triggers acceleration of the deferred income under section 965(m)(2)(B)(ii).

Since the REIT's stock tax basis in the DFIC stock is $80 in early 2018, the REIT may recognize $920 of capital gain from the sale in 2018. The stock tax basis increase in later years cannot be applied to any remaining DFIC stock, with unclear results. It is possible that the REIT has a $80 capital loss in 2018, an $80 capital loss in 2019, and so on until it has a total of $920 of capital losses through 2024. The REIT may find it difficult to use the capital losses, with their limited carryover periods under sections 1212(a)(1) and 1212(a)(4). The final regulations should provide that the DFIC stock tax basis is increased to $1,000 upon sale. Similar rules should apply to E&P and PTI, and with pro ration rules for a disposition of some but not all of the DFIC stock.

34. Tax basis increase after section 962 election in connection with stock sale.

A similar issue as comment #33 above occurs in connection with an individual United States shareholder who makes a section 962 election for section 965(a) income from a DFIC and makes a section 965(h) election to defer the regular tax liability on the section 965(a) income over 8 years. Section 962(d) provides that PTI with respect to the DFIC is increased by the tax paid, which may require the individual's PTI to be increased with each tax installment paid over the 8 years. Prop. Treas. Reg. § 1.965-2(e)(2) reserves on the basis adjustment to the DFIC stock, which may similarly be increased over the 8 years.

If the final regulations provide that the individual increases its DFIC stock basis, E&P, and PTI over the 8 year period, the regulations should clarify the results when the individual sells some or all of the DFIC stock during the 8 year period.

For example, an individual owns 100% of a DFIC. The individual has a tax basis of $0 in the DFIC stock. The DFIC has $1,000 of section 965(a) income in 2017, which after a $771 section 965(c) deduction results in $229 of net income in 2017. The individual makes a section 962 election to pay the 35% corporate tax rate on the $229 of income, or $80 of tax. The individual also makes a section 965(h) election to defer the $80 of tax, with $16 of tax due for 2017, $16 of tax due for 2018, and so on.

The individual's PTI and stock tax basis increase for 2017 in the DFIC may be limited to only the $16 of tax paid for 2017. The tax basis increase in 2018 is another $16, in 2019 is another $16, and so on until the entire $80 basis increase is applied through 2024.

In early 2018, the individual sells all of her DFIC stock for $1,000. The individual does not sell substantially all of her assets or engage in any other transaction that triggers acceleration of the deferred tax under section 965(h)(3).

Since the individual's stock tax basis in the DFIC stock is $16 in early 2018, the individual may recognize $984 of capital gain from the sale in 2018. The stock tax basis increase in later years cannot be applied to any remaining DFIC stock, with unclear results. The individual may have a $16 capital loss in 2018, a $16 capital loss in 2019, and so on until a total of $64 of capital losses through 2024. Alternatively, the individual may have to increase the stock basis of a related corporation by $16 in 2018, $16 in 2019, and so on. Neither result is administratively simple or theoretically ideal, and the final regulations should instead provide that the DFIC PTI and stock tax basis are increased to $80 at the time of sale, and with pro ration rules for a disposition of some but not all of the DFIC stock.

35. Section 965(i) election by domestic pass-through owner.

Prop. Treas. Reg. § 1.965-1(e)(19) and §1.965-1(e)(28) define a "domestic pass-through entity" as any U.S. person to the extent that the income or deductions of the person are included in the income of one or more direct or indirect owners or beneficiaries of the person. For example, if a domestic trust is subject to federal income tax on a portion of its section 965(a) income, and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion.

Prop. Treas. Reg. § 1.965-7(b)(1) provides that any person, including a domestic pass-through owner with respect to a domestic pass-through entity that is a United States shareholder of a DFIC, but not a domestic pass-through entity itself, may make a section 965(h) election. Prop. Treas. Reg. § 1.965-7(c)(1) provides that each shareholder, other than a domestic pass-through entity, of an S corporation that is a United States shareholder of a DFIC may make a section 965(i) election.

The wording difference between Prop. Treas. Reg. § 1.965-7(b)(1) and Prop. Treas. Reg. § 1.965-7(c)(1) suggests that a domestic pass-through owner can make a section 965(h) election but cannot make a section 965(i) election. The final regulations should clarify the circumstances in which an S corporation is owned by a domestic pass-through entity, and add that in those cases the domestic pass-through owner(s) can make a section 965(i) election. There does not appear to be any policy rationale for allowing domestic pass-through owners to make the section 965(h) election but not the section 965(i) election.

The final regulations should clarify whether grantor trusts are domestic pass-through entities. Cf. T.D. 9829 (Dec. 29, 2017); Textron Inc. v. Comm'r, 117 T.C. 67 (2001); Rothstein v. Comm'r, 735 F.2d 704 (2nd Cir. 1984). Either way, the grantor should be permitted to make the section 965(i) election. For a section 1361(c)(2)(A)(iv) qualified voting trust, the final regulations should similarly clarify that the beneficiaries should be permitted to make the elections, due to the grantor trust rules applying under Treas. Reg. § 1.1361-1(h)(3)(i)(E).

In contrast, for a testamentary trust under section 1361(c)(2)(A)(ii) or section 1361(c)(2)(A)(iii), the final regulations should confirm that the trust makes the section 965(h) and section 965(i) elections. Section 1361(c)(2)(B) treats the estate of the grantor or the estate of the testator as the S corporation shareholder, but only for purposes of the section 1361(b)(1) S corporation eligibility requirements. Treas. Reg. § 1.1361-1(h)(3)(ii) treats the testamentary trust as the S corporation shareholder for taxable income purposes under sections 1366, 1367, and 1368.

36. Section 965 treatment of electing small business trust and qualified subchapter S trust.

An electing small business trust ("ESBT") can be an S corporation shareholder under section 1361(c)(2)(A)(v). Section 641(c)(1)(A) provides that, for purposes of chapter 1 of the Code, "the portion of any electing small business trust which consists of stock in 1 or more S corporations shall be treated as a separate trust." However, the ESBT is treated as a single trust for administrative purposes, such as having one taxpayer identification number and filing one tax return, under Treas. Reg. § 1.641(c)-1(a).

The final regulations should clarify whether an ESBT is treated as two separate taxpayers for purposes of section 965. One trust portion may own the stock of 1 or more S corporations with section 965(a) income, while the other trust portion may own directly or indirectly stock of a DFIC with section 965(a) income. Separate tax treatment may mean that each trust portion must separately make a section 965(h) election, and the S portion may make a section 965(i) election. A section 965(h)(3) acceleration event for one trust portion may not affect the section 965(h) election for the other trust portion. Similarly, each trust portion could separately make a section 965(n) election or a section 962 election.

For a section 1361(d) qualified subchapter S trust ("QSST"), the income beneficiary is taxed under Treas. Reg. § 1.1361-1(j)(8) on the S corporation's income under the grantor trust rules. The QSST's other assets are taxed under general trust rules, which may be a non-grantor trust. The final regulations should clarify whether a QSST is separated between the S portion and the non-S portion for purposes of section 965, and whether the income beneficiary should make the section 965(h) and section 965(i) elections for the S portion.

A testamentary trust can become an ESBT or QSST. An ESBT can convert into a qualified subchapter S trust under Treas. Reg. § 1.1361-1(m)(7), or vice versa under Treas. Reg. § 1.1361-1(j)(12). The final regulations should clarify whether such changes in trust status are acceleration events, triggering events, or both.

If the ESBT disposes of all of its S corporation stock, the trust generally ceases to be an ESBT under Treas. Reg. § 1.1361-1(m)(5)(ii). If a QSST disposes of its S corporation stock, the QSST election (and grantor trust status) terminates as to the stock sold. The final regulations should clarify whether such terminations of ESBT or QSST status are acceleration events with respect to the S portion of the trust, when the trust itself has not disposed of substantially all of its total assets.

37. Tax-exempt organizations as S corporation shareholders.

Section 1361(c)(6) provides that a shareholder of an S corporation may include a section 401(a) or section 501(c)(3) organization that is exempt from taxation under section 501(a). A similar grandfathering rule exists in section 1361(c)(2)(A)(vi) for certain IRAs and Roth IRAs that own stock of an S corporation that is a bank or depository institution holding company as of October 22, 2004. In both cases, the income allocated from the S corporation is treated as UBTI of the tax-exempt organization (or IRA) under section 512(e), except generally in the case of employer securities held by an employee stock ownership plan.

Section 515 allows the UBTI tax to be reduced by section 901 FTCs, which includes taxes deemed paid under section 960 in the case of a (tax-exempt) corporation.

The TCJA enacted section 512(a)(6) to generally provide that a tax-exempt organization separately computes its UBTI from each separate trade or business, so that losses from one trade or business cannot offset income from another trade or business, effective for taxable years beginning in 2018 and later. Notice 2018-67 allows a tax-exempt organization to aggregate certain investment activities for section 512(a)(6) purposes, with more limited aggregation for certain partnerships' investment activities.

The final regulations should clarify the extent that section 512(a)(6) applies to section 512(e) S corporation income, particularly the S corporation's section 965(a) income. For example, it is unclear whether the 2018 section 965(a) income from the S corporation's DFIC stock should be aggregated with the S corporation's other 2018 investment income and losses. Notice 2018-67 does not specify whether its partnership aggregation rules apply to S corporations. It is unclear whether the tax-exempt organization's 2018 specified E&P deficit from one S corporation may offset 2018 section 965(a) income from another S corporation, or even from a DFIC owned by the same S corporation.

38. <u>Section 965(k) 6-year statute of limitations</u>.

Section 6501 generally provides a 3 year statute of limitations, or 6 years for a substantial omission of gross income, after an income tax return is filed. Notwithstanding section 6501, section 965(k) provides that the statute of limitations for the net tax liability under section 965, as defined in section 965(h)(6), is 6 years from the filing date of the tax return with the section 965(a) income. Section 965(h)(6) defines the net tax liability under section 965 with respect to a United States shareholder as generally the excess, if any, of (i) the taxpayer's net income tax over (ii) the taxpayer's hypothetical net income tax determined (I) without regard to section 965 and (II) without regard to any income or deduction properly attributable to a dividend received by the United States shareholder from any DFIC.

The final regulations should clarify whether the 6 year statute of limitations applies only to United States shareholders, who are by definition the only persons with a net tax liability under section 965, or to all U.S. persons with section 965(a) income, such as a partner in a domestic pass-through entity that owns DFIC stock and the partner is not a United States shareholder of the DFIC. The fact that the Proposed Regulations allow the section 965(h) election and the section 965(i) election for such domestic pass-through owners should not have any bearing on whether the section 965(k) 6 year statute of limitations applies to such owners, given that section 965(k) does not require that the United States shareholder makes a section 965(h) or section 965(i) election.

The final regulations should clarify the effect, if any, of section 965(k) on partnerships that are subject to the partnership audit rules as enacted by the Bipartisan Budget Act of 2015 (P.L. 114-74), which are effective in 2018 (or earlier if elected by the partnership). Section 6235 provides a 3 year statute of limitations (or 6 years if the partnership has a substantial omission of gross income) for the partnership, which appear to operate independently of section 6501 and are thus not modified by section 965(k). It is not apparent that the "net tax liability under this section [965]" that is subject to section 965(k) is a partnership-related item under section 6241(a)(2)(B), which is determined at the partnership level under section 6221(a). If the partnership makes a section 6226(a) "push-out" election for the reviewed-year partners to take the partnership's section 965(a) income and other partnership adjustments into account, the final regulations should clarify some of the consequences, such as whether the section 965(c) deduction is recomputed based on the corporate income tax rates that apply in the partnership's reviewed year.

As net tax liability under section 965 refers only to the regular income tax, the final regulations should confirm that section 965(k) does not affect the statute of limitations for the AMT, the section 1411 tax, the section 4368 tax (see comment #30), and the section 4940 tax.

For a shareholder of an S corporation, section 965(i)(6) provides that the statute of limitations for collecting the tax liability deferred under section 965(i) shall not be treated as beginning before the date of the triggering event with respect to the liability. The final regulations should confirm that there is no interaction between section 965(k) and section 965(i)(6), so that the statute of limitations ends 3 years after the triggering event.

I would be pleased to discuss these comments if you believe it would be helpful. Please feel free to contact me at (212) 903-8713 orlzhang@rhtax.com.

Respectfully submitted,

Libin Zhang