June 20, 2019

Hon. Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Comments on Proposed Regulations Addressing Section 250

Dear Commissioner Rettig:

Enclosed please find comments on the Proposed Regulations under and related to Section 250 of the Internal Revenue Code (“Comments”). These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Eric Solomon  
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury  
Lafayette “Chip” G. Harter III, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury  
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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Proposed Regulations Addressing Section 250

These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Ari Berk, Joseph Calianno, Michael Carew, Alan T. Cathcart, Clayton Collins, Donald Graham, Morgan Hann, Miles Johnson, Robert Kantowitz, Seevun Kozar, Christine Lehman, Kimberly Tan Majure, Barbara Rasch, Teisha Ruggiero, Magda Szabo, and Marina Vishnepolskaya. They were reviewed by Edward Tanenbaum of the Committee on Government Submissions and Eric B. Sloan, Vice Chair of Government Relations for the Tax Section.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting, review, or approval of these Comments.

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Date:       June 20, 2019
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I. EXECUTIVE SUMMARY

Public Law 115-97 (the “Act”), enacted on December 22, 2017, modified the way in which the United States taxes multinational companies. As part of this modification, the Act added section 250 to the Code, which allows a domestic corporation a deduction equal to 37.5% of its “foreign-derived intangible income” (“FDII”) (i.e., certain income above a specified threshold that is attributable to foreign operations or foreign activities) as well as a deduction equal to 50% of its “global intangible low-taxed income” within the meaning of section 951A (“GILTI”). The FDII deduction is intended to achieve parity with the lower effective tax rate applicable to GILTI and therefore to neutralize the role of tax considerations for a domestic corporation deciding whether to earn income attributable to foreign operations directly or through foreign subsidiaries treated as “controlled foreign corporations” under section 957.

On March 6, 2019, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) published proposed regulations under section 250 as part of an ongoing effort to issue implementing guidance for the provisions of the Act (the “Proposed Regulations”). We commend Treasury and the Service for issuing the Proposed Regulations, which provide much needed guidance with respect to the FDII deduction. We respectfully recommend, however, that certain portions of the Proposed Regulations be reconsidered and clarified further.

Our recommendations are summarized below and discussed in more detail in Part III of this letter.

A. Foreign Use for General Property

1. Modify the requirement of Proposed Regulation section 1.250(b)-4(d) to clarify that the relevant testing period is limited to the three years following the date of delivery of the general property.

2. Clarify the Proposed Regulations to provide that, with respect to a sale of a partnership interest that does not constitute an interest in a widely held or publicly traded partnership (and thus qualifies as general property), the determination of foreign use is made at the partnership level.

B. Exclusion for Financial Services Income

Clarify the Proposed Regulations to provide specific rules for the characterization and sourcing of income from derivatives and other financial instruments that are not
treated as “financial services income,” such as pairing the treatment of such income with income from related sales and services transactions.

C. Scope of Foreign Branch Income

Clarify the treatment with respect to the disposition of a partnership interest or disregarded entity for purposes of the expanded definition of “foreign branch income” under Proposed Regulation section 1.250(b)-1(c)(11) and provide examples of transactions that the expanded definition is intended to capture.

D. Disregarded Transfers between Domestic Corporation and Foreign Branch

Modify the definition of foreign branch income for FDII purposes to provide that no adjustments are required under Proposed Regulation section 1.904-4(f)(2)(vi)(D) where such adjustments would have the effect of increasing the gross income attributable to the foreign branch resulting from a transfer of intangible property from the foreign branch to the foreign branch owner.

E. Application of Section 250 to Partnerships and their Partners

1. Provide relief from the requirement for a partnership to report certain FDII items to its partners on their Schedules K-1 pursuant to Proposed Regulation section 1.250(b)-1(e)(2) if the partnership has performed reasonable due diligence as to the identity of its (direct and indirect) partners and reasonably relied upon information received from its partners about their non-U.S. and/or non-corporate status.

2. Provide that a domestic corporate partner’s section 250 deduction is disregarded for purposes of calculating the partnership’s “adjusted taxable income” under section 163(j)(4)(A).

F. General Services Provided to Business Recipients

1. Modify the definition of “benefit” in Proposed Regulation section 1.250(b)-5(c)(1) so that it references Regulation section 1.482-9(l)(3)(i), with a rebuttable presumption of a “benefit” in the case of unrelated party transactions.

2. Clarify in Proposed Regulation section 1.250(b)-5(e)(2)(ii) that where a recipient of a service, such as a foreign partnership, does not have an office or other “fixed place of business,” that such recipient is presumed to have operations in the location where it is formed or incorporated.

3. Modify Proposed Regulation section 1.250(b)-5(e)(2)(i)(A) so that service renderers need to obtain documentation only to the effect that benefits are accruing to service recipients in non-U.S. locations generally (rather than documentation that identifies the specific non-U.S. locations of such benefits), to increase consistency in taxpayer compliance and administrability of the rules.
4. Modify Proposed Regulation section 1.250(b)-5(e)(3) to (i) provide that service renderers may use any reasonable documentation to identify the location of benefits accruing to service recipients and (ii) increase the threshold for “small businesses” and “small transactions.”

II. BACKGROUND

A. Overview

The Act modifies the way in which the United States taxes multinational companies. Prior to the Act, the United States generally taxed the income of U.S. persons at the same rate of tax, without regard to whether the income was U.S.-source or foreign-source. Under that regime, U.S. tax on foreign-source income earned through a foreign corporation generally could be deferred until the foreign corporation distributed its earnings (i.e., via a dividend), subject to certain anti-deferral rules. When the corporation was located in a foreign jurisdiction with a relatively low (or zero) tax rate, U.S. taxpayers could be incentivized to retain their foreign earnings outside of the United States and defer U.S. tax indefinitely.

Concerned that the worldwide taxation system discouraged reinvestment in the United States of earnings located in foreign jurisdictions, in particular for domestic corporations doing business internationally, Congress sought to change the Code to facilitate repatriation of foreign earnings and move closer to a territorial system of taxation. Some of the mechanisms that the Act employs to effect this change include reducing the U.S. corporate tax rate to 21%, providing a limited participation exemption of 100%, introducing mandatory repatriation (at reduced rates for domestic corporations), and allowing a deduction for a portion of a domestic corporation’s FDII.

Section 250 generally allows domestic corporations a deduction equal to 37.5% of their FDII and 50% of their GILTI, subject to limitations based on the corporation’s taxable income. FDII is the product of a corporation’s deemed intangible income (“DII”) and the ratio of its foreign-derived deduction eligible income (“FDDEI”) to its total deduction eligible income (“DEI”). A corporation’s DII is the excess, if any, of its

5 U.S. shareholders of “controlled foreign corporations” within the meaning of section 957 (“CFCs”) were (and remain) subject to an anti-deferral regime contained in subpart F of the Code, which taxes the U.S. shareholder based on certain types of foreign income (e.g., mobile and passive income) earned by the CFC whether or not the related earnings are distributed to U.S. shareholders. See I.R.C. §§ 951-964. Subpart F survived in the Act and was enhanced by the GILTI rules. I.R.C. § 951A.
6 The Act does not represent a full transition to a territorial system, however, as many of the new provisions apply only to U.S. corporations (and not all U.S. persons) and, as noted above, U.S. shareholders of a CFC are subject to current tax under the new GILTI rules in section 951A as well as the existing rules in subpart F.
7 I.R.C. § 11.
8 I.R.C. § 245A.
9 I.R.C. § 965.
10 I.R.C. §§ 250(a)(1)(A) and (a)(2). The FDII deduction is available for taxable years beginning after December 31, 2017, with the deduction reducing to 21.875% of FDII for taxable years beginning after December 31, 2025. I.R.C. § 250(a)(3). Section 250(a)(2) limits the deduction for FDII and GILTI to a corporation’s taxable income.
11 I.R.C. § 250(b)(1).
DEI over a 10% rate of return on the corporation’s qualified business asset investment (“QBAI”).12 QBAI is computed by averaging, on a quarterly basis, the corporation’s adjusted bases in tangible property used in its trade or business for the production of DEI, and for which a deduction under section 167 is permitted.13 DEI is the excess, if any, of a corporation’s gross income with certain modifications (“gross DEI”),14 over the deductions (including taxes) properly allocable to such income.15 Finally, FDDEI is the portion of a corporation’s DEI that is derived in connection with (1) property that is sold by the corporation to a non-U.S. person for foreign use or (2) services that the corporation provides to a person, or with respect to property, not located within the United States.16

Section 250 also provides special rules regarding the treatment of property and services that a corporation provides to domestic intermediaries and related parties.17 With respect to sales of property to an unrelated person, to the extent the property is sold for further manufacture or other modification in the United States, the property is not treated as sold for foreign use, even if the unrelated person ultimately uses the property for a foreign use.18 Similarly, if a corporation provides services to an unrelated person located in the United States, any income from those services is not FDDEI irrespective of the use to which the unrelated person applies the services.19 The taxpayer has the burden of establishing, to the satisfaction of the Secretary, that the sale of property is for a foreign use, or that services are provided to a person, or with respect to property, not located in the United States.

For transactions with related parties,20 if a corporation sells property to a related foreign party, the sale does not satisfy the foreign use requirement for FDDEI unless (1) the property is ultimately sold by a related foreign party to an unrelated foreign person, or used by a related foreign party in connection with property that is sold or services that are

12 I.R.C. § 250(b)(2).
13 I.R.C. § 951A(d). Section 250(b)(2)(B) defines QBAI for FDII purposes by reference to the corresponding definition of QBAI for GILTI purposes, substituting DEI for “tested income” and disregarding whether or not the corporation is a CFC.
14 Sections 250(b)(3)(A)(i)(I)-(VI) provide that gross DEI does not include a corporation’s (1) income inclusions under section 951(a)(1), (2) GILTI inclusions, (3) financial services income (defined in section 904(d)(2)(D)), (4) dividends received from a CFC, (5) domestic oil and gas extraction income (defined in section 907(c)(1)), and (6) foreign branch income (defined in section 904(d)(2)(J)).
15 I.R.C. § 250(b)(4). In determining FDDEI, “foreign use” means any use, consumption, or disposition not within the United States. I.R.C. § 250(b)(4)(A). Further, for purposes of FDII, the terms sold, sells, and sale include any lease, license, exchange, or other disposition. I.R.C. § 250(b)(4)(E).
16 I.R.C. §§ 250(b)(5)(B) and (C).
17 I.R.C. §§ 250(b)(5)(A) and (C).
20 For the purposes of determining foreign use, a related party is any member of an affiliated group, as defined in section 1504(a) except that the requisite ownership is “more than 50%” and insurance companies subject to tax under section 801 and foreign corporations (sections 1504(b)(2) and (3), respectively) are included in the affiliated group. I.R.C. § 250(b)(5)(D). Further, a person (that is not a corporation) is treated as a member of the affiliated group if the person is controlled by members of the group (including any members treated as such by reason of this rule) or controls any member, with control as defined in section 954(d)(3). I.R.C. § 250(b)(5)(D).
provided to an unrelated foreign person; and (2) the property is for foreign use.\footnote{1} Income from a service that a corporation provides to a related party that is not located in the United States is not FDDEI, unless the service provided is not substantially similar to services provided by the related foreign party to persons located within the United States.\footnote{2}

**B. Proposed Regulations**

In addition to general rules for determining the amount of the FDII and GILTI deductions available to domestic corporations under section 250, including reporting requirements, ordering rules, and rules for applying the taxable income limitation, the Proposed Regulations provide guidance with respect to (1) the calculation of the FDII deduction, and the treatment of consolidated groups, partnership income, and unrelated business taxable income of tax-exempt corporations; (2) the QBAI calculation for FDII, including rules for dual-use property, short taxable years, and calculating a corporate partner’s share of a partnership’s QBAI; (3) the determination of gross FDDEI, along with a special rule for foreign military sales; (4) the determination of when sales of property produce FDDEI, including loss transactions; (5) the determination of when the provision of services produces FDDEI, distinguishing between “proximate services,” “property services,” “transportation services,” and all other types of services (“general services”); and (6) related party sales and services.\footnote{3} We discuss the Proposed Regulations in detail below, in Part III., as relevant to our Comments.

**III. DETAILED DISCUSSION**

**A. Foreign Use for Sales of General Property**

1. **Three-Year Requirement**

Proposed Regulation section 1.250(b)-4 provides rules for determining whether a sale of property is treated as for a foreign use. For these purposes, Proposed Regulation section 1.250(b)-4(d) and (e) contain separate requirements applicable to sales of "general property" and sales of “intangible property,” respectively.

As a general matter, Proposed Regulation section 1.250(b)-4(d) treats the sale of general property (\textit{i.e.}, property that does not fall within the scope of “intangible property”) as having a foreign use if the seller meets the documentation requirements related to foreign use of the property. More specifically, Proposed Regulation section 1.250(b)-4(d)(2) defines foreign use by reference to two conditions, either one of which must be established to support a determination that foreign use exists. As relevant here, the first condition is articulated in Proposed Regulation section 1.250(b)-4(d)(2)(i), which provides that the property cannot be subject to a domestic use “within three years of” the

\footnote{1}{I.R.C. § 250(b)(5)(C)(i).}\footnote{2}{I.R.C. § 250(b)(5)(C)(ii).}\footnote{3}{\textit{Id.}}
date of delivery (the “three-year requirement”).\textsuperscript{24} According to Proposed Regulation section 1.250(b)-4(d)(2)(ii), domestic use occurs if the general property is subject to any use, consumption, or disposition within the United States, or the property is subject to manufacture, assembly, or other processing within the United States. Proposed Regulation section 1.250(b)-4(d)(2)(iii) provides a series of tests for determining whether property is subject to manufacture, assembly, or other processing.

We believe that certain aspects of these proposed requirements are unintentionally broad and may lead to confusion. In particular, the three-year requirement establishes a testing period “within” three years of the date of delivery, which could reasonably be interpreted to include the three-year period preceding, as well as following, delivery. Applied in conjunction with the domestic use rule, the requirement would appear to exclude cases in which taxpayers manufactured goods in the United States and exported the goods within the following three years; this seems to be an unintentional result. To avoid such an interpretation, we respectfully recommend that the requirement be modified, so that property cannot be subject to a domestic use “within three years following” the date of delivery.

2. **Determination of Foreign Use for Sales of Partnership Interests That Are Not “Securities”**

Under Proposed Regulation section 1.250(b)-4, a sale of general property to a foreign person for a foreign use qualifies as an FDDEI sale. The definition of general property under Proposed Regulation section 1.250(b)-3(b)(3) excludes, among other items, any “security,” as such term is defined in section 475(c)(2).\textsuperscript{25} Section 475(c)(2) defines “security” to include any “partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust.”\textsuperscript{26} Accordingly, a sale by a domestic corporation of an interest in a widely held or publicly traded partnership cannot qualify as an FDDEI sale. The preamble to the Proposed Regulations states that this result is appropriate because these types of “financial instruments are not subject to ‘any use, consumption, or disposition’ outside the United States within the meaning of section 250(b)(5)(A)” (i.e., this type of property cannot be subject to a foreign use).\textsuperscript{27} Nonetheless, a partnership interest that is not an interest in a widely held or publicly traded partnership (a “Qualifying Partnership Interest”) is not excluded from the definition of general property.\textsuperscript{28} Thus, a sale of such Qualifying Partnership Interest by a domestic corporation presumably qualifies as an FDDEI sale, assuming the other requirements of Proposed Regulation section 1.250(b)-4 are satisfied.\textsuperscript{29} However, the Proposed Regulations do not address the conditions under

\textsuperscript{24} Alternatively, a seller may establish the second condition, contained in Prop. Reg. § 1.250(b)-4(d)(2)(ii), if the property is subject to manufacture, assembly, or other processing outside the United States before the property is subject to a domestic use.

\textsuperscript{25} Prop. Reg. § 1.250(b)-3(b)(3)(ii).

\textsuperscript{26} I.R.C. §§ 475(c)(2)(A) and (B) (emphasis added).

\textsuperscript{27} Prop. Reg. § 1.250(b)-1, 84 Fed. Reg. at 8194.

\textsuperscript{28} The term “general property,” as defined by Prop. Reg. § 1.250(b)-3(b)(3), would include any property other than intangible property, securities or commodities.

\textsuperscript{29} Compare the rules under section 199A, which contain a clear reference to both partnership interests that qualify as “securities” under section 475(c)(2) as well as other types of partnership interests—a specified
which a sale of a Qualifying Partnership Interest will satisfy the foreign use requirement of Proposed Regulation section 1.250(b)-4(d) nor do they address the approach with respect to the partnership that a partner should use in making such determination.

Accordingly, we respectfully recommend that the final regulations provide that, with respect to a sale of a Qualifying Partnership Interest by a domestic corporation, the determination of foreign use is made by looking through to the underlying assets of the partnership (the “Look-Through Approach”). This approach would look to whether the partnership’s use of its relevant property would satisfy the foreign use requirement, taking into account the assets, activities, and characteristics of the partnership. An alternative approach would preclude taxpayers from looking through to the partnership’s underlying assets (the “Pure Entity Approach”) and, instead, would require an evaluation of whether the foreign purchaser of the partnership interest acquired the partnership interest itself for a foreign use. On balance, we believe the Look-Through Approach is more appropriate—the Proposed Regulations plainly permit a Qualifying Partnership Interest to qualify as general property, yet it is unclear whether (and to what extent) a foreign person’s acquisition of a Qualifying Partnership Interest could ever be subject to a foreign use without a look-through rule. For example, the preamble to the Proposed Regulations suggests that a sale of a “security” (as defined in section 475(c)) could never be for a foreign use.

A look-through approach would also be consistent with other rules contained in the Proposed Regulations. For example, Proposed Regulation sections 1.250(b)-4(e) and 1.250(b)-1(e)(1) generally allow a domestic corporate partner to claim the applicable FDI deduction with respect to its share of the FDDEI transactions of a partnership. In addition, the Proposed Regulations generally treat the sale of a partnership interest as giving rise to foreign branch income to the extent the income or gain arises from the indirect sale of foreign branch assets. The Look-Through Approach would also be consistent with the approach Congress ultimately adopted in section 864(c)(8) with respect to a foreign partner’s sale of an interest in a partnership that is engaged in a U.S. trade or business.

For example, assume that a domestic corporation (“DC”) owns a Qualifying Partnership Interest in a partnership (“PRS”) whose sole asset is intangible property (as defined in Proposed Regulation section 1.250(b)-3(b)(4)) that is not used in a foreign branch. Assume further that DC sells its Qualifying Partnership Interest to a foreign person (within the meaning of Proposed Regulation section 1.250(b)-3(b)(2)) (“Foreign Buyer”). Consistent with the Look-Through Approach described above, we believe that, as long as PRS (1) uses the intangible property outside of the United States in a manner that satisfies the foreign use requirement under Proposed Regulation section 1.250(b)-
4(e) and (2) satisfies all applicable documentation requirements as if it had sold its intangible property to Foreign Buyer directly, the sale of an interest in PRS by DC should be treated as an FDDEI sale. Without a clarification that allows the sale to qualify as an FDDEI sale, there could be different results for a domestic corporate partner as between the direct sale of the intangible property by the underlying partnership and the indirect sale of the same intangible property via the domestic corporation’s sale of its partnership interest. Additionally, adopting the Pure Entity Approach would likely have the effect of over- or under-stating gross FDDEI by treating the entire amount of the gain (or loss) on the sale of a Qualifying Partnership Interest by a domestic corporation as either income from an FDDEI sale or not, without taking into account the property’s use at the partnership level. Accordingly, we believe that this approach presents unnecessary distortions as well as noneconomic incentives for a taxpayer to structure a disposition in a particular manner to ensure the availability of the FDII deduction. Additionally, we see no tax policy rationale for applying the Pure Entity Approach in this context.

For these reasons, we respectfully recommend that Treasury and the Service modify the Proposed Regulations to provide that, with respect to a sale of a Qualifying Partnership Interest by a domestic corporation, the determination of foreign use is made at the partnership level, using the Look-Through Approach described above and taking into account that some property of the partnership may be subject to foreign use and other property of the partnership may not be subject to foreign use.

B. Exclusion for Financial Services Income

Section 250(b)(3)(A)(i)(III) excludes from DEI “any financial services income (as defined in section 904(d)(2)(D)) of such corporation.” The Proposed Regulations expand this cross-reference to include a reference to Proposed Regulation section 1.904-4(e)(1)(i). Under these cross-references, “financial services income” means certain income derived by a person that is actively engaged in the conduct of banking, insurance, or a similar business (the “active financing business requirement”).

33 Requiring PRS to satisfy the applicable documentation requirements as if it had sold the relevant assets to Foreign Buyer would be consistent with the determination of foreign use at the partnership level and would protect government interests by ensuring that foreign use is documented appropriately even in the case of a sale of a Qualifying Partnership Interest (rather than a direct sale of assets).
34 If PRS owned property other than the intangible property, the Look-Through Approach would generally consider whether each separate property was subject to a foreign use (making such determination at the partnership level, based on the assets and operations of the partnership). If any property was not subject to a foreign use under such approach, then a portion of the gain or the loss on the sale of the Qualifying Partnership Interest would not be treated as arising from an FDDEI sale.
35 A partner that sells an interest in a partnership subject to section 751(a) is required to attach a statement setting forth such selling partner’s share of the gain or loss attributable to the section 751 property of the partnership. See Reg. § 1.751-1(a)(3) and Form 8308 (Report of a Sale or Exchange of Certain Partnership Interests). Moreover, analysis of the particular attributes of the property of a partnership is generally required for purposes of section 864(c)(8) when a foreign partner disposes of an interest in a partnership that has ECI property. A property-by-property approach for purposes of determining the foreign use of partnership property under the Look-Through Approach could be applied in a manner similar to sections 751(a) or 864(c)(8) when a domestic corporation sells an interest in the partnership to a foreign person.
Consequently, income earned in the context of an active financial services business (“active financial services income”) is excluded from DEI but the same income earned outside of an active financial services business (“non-active financial services income”) is included in DEI. The Proposed Regulations provide scant guidance on the treatment of non-active “financial services income” generally, and no guidance on how such income is sourced or otherwise treated for FDII purposes.38

The provisions of sections 250(b)(3) and (b)(4), as well as Proposed Regulation sections 1.250(b)-1(c)(14) and (15), call for specific allocation of both income and associated expenses, and the Proposed Regulations refer to Regulation sections 1.861-8 through 1.861-14T and 1.861-17 for purposes of allocating expenses to gross FDDEI and gross non-FDDEI.39 However, there is no specific language providing characterization rules for non-excluded income, loss or associated expenses from financial instruments.

In our experience, the use of derivatives and other instruments generating income that would generally qualify as “financial services income” (but for the active financing business requirement) is especially common for multinational businesses that have a strong need to, for example, reduce or manage risk against factors such as currency fluctuation in the context of nonfinancial business operations. Income from instruments such as hedges, payments on notional principal contracts, and other derivatives are therefore both necessary and common for many taxpayers in normal operating businesses that would not satisfy the active financing business requirement. In those cases, the Proposed Regulations would treat income from such instruments as DEI (i.e., it would not be excluded under Proposed Regulation section 1.250(b)-1(c)(14)), which would be a favorable result for taxpayers hoping to benefit from FDII. Without specific rules for allocating income, loss, and expenses from non-active derivatives between FDDEI and non-FDDEI, taxpayers could take inconsistent positions regarding the characterization of these items and characterization of items from the underlying transactions. This could occur, for example, if the taxpayer engages in an underlying transaction with a U.S. person but engages in a related hedging transaction with a foreign person, or vice-versa.

There are two general approaches that the Proposed Regulations could take. The first would be to associate the income, loss, and expenses of the derivatives with that of the underlying transaction, so that the characterization of the underlying transaction (i.e., as FDDEI or non-FDDEI) would determine the characterization of the derivatives. The alternative approach would be to treat the derivative transaction as a separate transaction, and test it for FDDEI under the rules regarding sales of intangible property.40 We have considered these two approaches and respectfully recommends that final regulations require the treatment of items from the hedging transaction to follow the treatment of

38 Notably, the overall statutory exclusion for active financial services income for such entities is incongruous with the treatment under GILTI in general, including eligibility for the 50% deduction under section 250(a)(1)(B). Financial services income earned by a CFC is included under the GILTI rules as foreign sourced income and hence is eligible for the 50% GILTI deduction. However, relative to FDII, only financial services income generated by an active business is specifically excluded from gross DEI.

39 Prop. Reg. § 1.250(b)-1(d).

40 Intangible property is defined by reference to section 367(d)(4), which includes contracts and other items, “the value or potential value of which is not attributable to tangible property. . .” Prop. Reg. § 1.250(b)-3(b)(4).
items from the underlying transaction. This approach avoids potential distortions between identified and unidentified hedges and is consistent, e.g., with the “business needs” exception from foreign personal holding company income, for foreign currency gains directly attributable to the business needs of a controlled foreign corporation.41

C. Scope of Foreign Branch Income Definition

As discussed above, the Act added a new definition of foreign branch income, which is relevant for foreign tax credit purposes as a separate limitation under section 904(d) and for FDII purposes as an exclusion from DEI under section 250(b)(3)(A)(i)(VI).42

Under section 904(d)(2)(J)(i), the foreign branch income of a U.S. person is generally defined as “the business profits of such United States person which are attributable to one or more qualified business units (as defined in section 989(a)) in one or more foreign countries.”43 In a separate notice of proposed rulemaking, Treasury and the Service proposed an extensive set of rules under which a U.S. corporation would determine its foreign branch income for foreign tax credit purposes.44 Proposed Regulation section 1.904-4(f)(2)(i) defines foreign branch income generally to be the gross income attributable to a foreign branch to the extent the gross income (adjusted to conform to U.S. federal income tax principles) is reflected on the separate set of books and records of the foreign branch.45 Additionally, disregarded payments between a foreign branch and its owner that are reflected on a branch’s books and records and that are allocable to non-passive category income of the foreign branch are regarded for the limited purpose of adjusting the amount of the U.S. person’s gross foreign branch income and gross general category income.46

For FDII purposes, the Proposed Regulations define foreign branch income by reference to the proposed definition of foreign branch income for foreign tax credit purposes, with certain adjustments. Specifically, the Proposed Regulations would modify the definition of foreign branch income for FDII purposes by including any income or gain that would not be treated as gross income attributable to a foreign branch under Regulation section 1.904-4(f) but that arises from the direct or indirect sale (as defined in Proposed Regulation section 1.250(b)-3(b)(7)) of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or interest in a partnership.47

Importantly, for foreign tax credit purposes, foreign branch income generally does not include gain from the non-ordinary course disposition of an interest in a partnership

41 I.R.C. § 954(c)(1)(D).
43 Under section 904(d)(2)(J)(ii), passive category income is not included in foreign branch income.
44 See Prop. Reg. § 1.904-4(f).
45 Generally, income attributable to U.S. activities and income arising from stock (except for certain dealer property as defined in Reg. § 1.954-2(a)(4)(v) if the branch were a CFC) are not included in foreign branch income. See Prop. Reg. §§ 1.904-4(f)(2)(i) and (ii).
47 See Prop. Reg. § 1.250(b)-1(c)(11).
or other passthrough entity or interest in a disregarded entity.\textsuperscript{48} As noted above, for FDII purposes, foreign branch income \textit{does include} “any income or gain that would not be treated as gross income attributable to a foreign branch under Regulation section 1.904-4(f) but that arises from the direct or indirect sale (as defined in Proposed Regulation section 1.250(b)-3(b)(7)) of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or interest in a partnership.”\textsuperscript{49} We read the expanded definition of foreign branch income for FDII purposes to include income from the sale of an interest in a partnership or other passthrough entity or interest in a disregarded entity. Further, we do not read this language to require that a U.S. person further adjust its gross general category income as a result of the disposition of an asset that was transferred to a branch in a disregarded transaction.

We respectfully request that Treasury and the Service provide for this differing treatment of income from the disposition of a partnership interest or disregarded entity for FDII purposes and foreign tax credit purposes, as well as examples of other types of transactions that the expanded definition of foreign branch income is intended to capture.

\textbf{D. Disregarded Transfers Between Domestic Corporation and Foreign Branch}

In discussing the interaction of sections 250 and 904(a), including treating disregarded transactions as regarded for purposes of determining whether the gross income of a U.S. person is attributable to the foreign branch basket, Treasury and the Service state the following in the notice of proposed rulemaking regarding the Proposed Regulations under section 904:

Finally, in order to accurately reflect the gross income attributable to a foreign branch, a determination that affects not only the application of section 904(a) but also the determination of deduction eligible income under section 250(b)(3)(A), the proposed regulations provide that gross income attributable to a foreign branch that is not passive category income must be adjusted to reflect certain transactions that are disregarded for Federal income tax purposes….

\ldots

The proposed regulations provide an exception from the special rules regarding disregarded transactions that applies to contributions, remittances, and payments of interest (including certain interest equivalents). Proposed §1.904-4(f)(2)(vi)(C). Generally, contributions, remittances, and interest payments to or from a foreign branch reflect a shift of, or return on, capital rather than a payment for goods and services. However, the different treatment of contributions and remittances, on the one hand, and other disregarded transactions, on the other, could allow for non-economic reallocations of the amount of gross income attributable to the foreign branch category. \textit{To prevent this in connection with certain transactions, the proposed regulations require the amount of gross income attributable to a foreign branch (and the amount attributable to the foreign branch owner) to be adjusted to account for consideration that would be


\textsuperscript{49} Prop. Reg. § 1.250(b)-1(c)(11).
due in any disregarded transactions in which property described in section 367(d)(4) is transferred to or from a foreign branch if the transactions were regarded, whether or not a disregarded payment is made in connection with the transfer. Proposed §1.904-4(f)(2)(vi)(D). The proposed regulations further require that the amount of any adjustment under the disregarded payment provisions must be determined under the arm’s length principle of section 482 and the regulations under that section. Proposed §1.904-4(f)(2)(vi)(E) (emphasis added).50

Consistent with the language in the preamble, Proposed Regulation section 1.904-4(f)(2)(vi)(D) states: “[T]he amount of gross income attributable to a foreign branch (and the amount of gross income attributable to its foreign branch owner) that is not passive category income must be adjusted … to reflect all transactions that are disregarded for Federal income tax purposes in which property described in section 367(d)(4) is transferred to or from a foreign branch, whether or not a disregarded payment is made in connection with the transfer. In determining the amount of gross income that is attributable to a foreign branch that must be adjusted by reason of this paragraph …, the principles of sections 367(d) and 482 apply” (emphasis added).51

The Proposed Regulations under section 250 cross-reference Proposed Regulation section 1.904-4(f)(2) in defining foreign branch income. Specifically, Proposed Regulation section 1.250(b)-1(c)(11) provides: “The term foreign branch income means gross income attributable to a foreign branch of a domestic corporation or a partnership under §1.904-4(f)(2), except that the term also includes any income or gain that would not be treated as gross income attributable to a foreign branch under §1.904-4(f) but that arises from the direct or indirect sale (as defined in §1.250 (b)-3(b)(7)) of any asset (other than stock) that produces gross income attributable to a foreign branch, including by reason of the sale of a disregarded entity or interest in a partnership. See also §1.904-4 (f)(2)(v) (providing that if a principal purpose of recording or failing to record an item of gross income on the books and records of a foreign branch is the avoidance of the purposes of section 250 (in connection with section 250(b)(3)(A)(i)(VI)), the item must be attributed to one or more foreign branches of the foreign branch owner in a manner that reflects the substance of the transaction).”

Historically, Congress has expressed concerns with outbound transfers of intangible property from the United States, as such transfers potentially would allow U.S. taxpayers to move intangible property into foreign jurisdictions and thereby avoid U.S. tax on the appreciation or future income with respect to such property. As a result, Congress has enacted a number of provisions designed to address these concerns. For instance, sections 367(d) and (e)(2)52 address the transfer of intangible property from a U.S. person to a foreign person in certain nonrecognition transactions, generally requiring the U.S. transferor to recognize gain (subject to U.S. tax) as a result of such transfer. Section 482 also has been applied in conjunction with these provisions to address outbound transfers of intangible property from the United States, including in taxable

50 Prop. Reg. § 1.904-4
52 See also I.R.C. § 721(c) (addressing certain transfers of property to partnerships), and Temp. Reg. § 1.721(c)-1T-7T.
transactions. Therefore, to the extent that Treasury and the Service have determined that disregarded transactions should be regarded for purposes of determining whether income should be included in (or excluded from) the foreign branch basket for foreign tax credit purposes, it is understandable that, in connection with a transfer of intangible property described in section 367(d)(4) from the foreign branch owner to the foreign branch, Treasury and the Service would seek to apply the principles of sections 367(d) and 482 to determine the extent to which income should be treated as foreign branch income for purposes of the FDII deduction. However, transfers of intangible property described in section 367(d)(4) from the foreign branch to the foreign branch owner (i.e., transfers into the United States) do not present the same concerns articulated above.

Additionally, from a policy perspective, it can be argued that not requiring an adjustment under Proposed Regulation section 1.904-4(f)(2)(vi)(D) when a foreign branch transfers intangible property to the foreign branch owner is consistent with Congressional intent in enacting section 250. One of the goals of Congress in enacting section 250 was to reduce the incentive of a domestic corporation to move intangible property offshore. However, the enactment of section 250 also could be viewed as encouraging U.S. corporations to locate intangible property in the United States. Arguably, the enactment of section 250 reflects an intent on the part of Congress to have domestic corporations locate intangible property in the United States and take advantage of the FDII deduction. A Senate proposal that would have facilitated the distributions of intangible property from a controlled foreign corporation to a domestic corporation in a tax efficient manner appears to support this policy goal. Even though this Senate proposal was not included as part of the Act, it does reflect a general intent by Congress to have intangible property located in the United States.

53 Reg. § 1.482-4.
54 By applying these rules to disregarded transfers to a foreign branch, it generally would provide parity with outbound transfers to foreign corporations or partnerships.
55 See Sec. 14203 of the Senate amendment of the Act entitled “Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders.” The Conference Report to accompany the Act provided the following with respect to such provision:

For certain distributions of intangible property held by a CFC on the date of enactment of this provision, the fair market value of the property on the date of the distribution is treated as not exceeding the adjusted basis of the property immediately before the distribution. If the distribution is not a dividend, a U.S. shareholder’s adjusted basis in the stock of the CFC with respect to which the distribution is made is increased by the amount (if any) of the distribution that would, but for this provision, be includible in gross income. The adjusted basis of the property in the hands of the U.S. shareholder immediately after the distribution is the adjusted basis immediately before the distribution, reduced by the amount of the increase (if any) described previously.

For purposes of the provision, intangible property means intangible property as described in section 936(h)(3)(B) and computer software as described in section 197(e)(3)(B).

The provision applies to distributions that are (1) received by a domestic corporation from a CFC with respect to which it is a U.S. shareholder and (2) made by the CFC before the last day of the third taxable year of the CFC beginning after December 31, 2017.

This provision was not included in the Act.
Nevertheless, Proposed Regulation section 1.904-4(f)(2)(vi)(D) requires adjustments to the gross income attributable to a foreign branch under the “principles of sections 367(d) and 482” where intangible property is transferred from a foreign branch. Assume that a foreign branch distributes to its U.S. corporate owner intangible property and the U.S. corporate owner generates income from the use of that intangible property that would qualify for the FDII deduction. Based on the language included Proposed Regulation § 1.904-4(f)(2)(vi)(D), it appears that the amount of income that would be eligible for the FDII deduction could be reduced as a result of the application of the Proposed Regulation. This result could be viewed as being inconsistent with the Congressional intent in enacting section 250, as discussed above.

Accordingly, we recommend that Treasury and the Service modify the definition of foreign branch income for FDII purposes such that it would not include any adjustments otherwise required under Proposed Regulation section 1.904-4(f)(2)(vi)(D) if such adjustments would increase the gross income attributable to the foreign branch as a result of the transfer of intangible property from the foreign branch to the foreign branch owner.

E. Application of Section 250 to Partnerships and their Partners

1. Partnership Reporting Requirements

If a partnership is required to file a return under section 6031 and the partnership has one or more direct or indirect partners that are domestic corporations, the Proposed Regulations would require the partnership to provide certain information to those domestic corporate partners. Specifically, Proposed Regulation section 1.250(b)-1(e)(2) would require the partnership to furnish, on or with the partner’s Schedule K-1, “the partner’s share of the partnership’s gross DEI, gross FDDEI, deductions that are definitely related to the partnership’s gross DEI and gross FDDEI, and partnership QBAI” (collectively, “Partnership FDII Items”). The Proposed Regulations would impose this reporting obligation “for each taxable year in which the partnership has gross DEI, gross FDDEI, deductions that are definitely related to the partnership’s gross DEI or gross FDDEI, or partnership specified tangible property.”

Generally, a partnership that files a return under section 6031 will know and report on Schedule K-1, Part II, the entity classification of each of its direct partners. However, the partnership may not know whether a domestic corporation owns an indirect interest in the partnership through one or more tiers of other partnerships. There could also be instances in which a direct or indirect partner engages in a transaction (such as contributing an interest in the partnership to a corporation) or makes an entity classification election to change its classification to a corporation and does not inform the partnership of the transaction or the election.

56 Generally, a partnership is required to file a return unless the partnership is a foreign partnership that, for its taxable year, has no gross income from sources within the U.S. and no ECI. See Reg. § 1.6031(a)-1.
57 Prop. Reg. § 1.250(b)-1(e)(2).
58 Id.
We agree with Treasury and the Service that it is appropriate to require a partnership to report Partnership FDII Items to domestic corporate partners if the partnership knows or has reason to know it has domestic corporate partners or upon the request of a domestic corporate partner. However, a partnership that does not report Partnership FDII Items because, despite exercising reasonable diligence, it is not aware of the domestic corporate status of a single partner, could unintentionally fail to satisfy this reporting requirement as currently drafted. A partnership that reasonably believes it has no direct or indirect domestic corporate partners would nevertheless be required to compute the partnership’s gross DEI, gross FDDEI, deductions related thereto, and partnership QBAI under Proposed Regulation section 1.250(b)-1(e)(2). This reporting requirement could therefore impose an unnecessary administrative burden on a partnership whose partners would have no reason to know their share of the Partnership FDII Items. Given that the use of Partnership FDII items by a partner can only reduce that partner’s tax liability, we do not expect a more limited reporting requirement to injure the government’s interests. Accordingly, we request that Treasury and the Service consider providing some form of relief from a broad obligation to report Partnership FDII Items.

We also recommend that penalties for a partnership’s failure to report Partnership FDII Items should be subject to a reasonable cause exception—in particular, penalty relief for reasonable reliance on information obtained in the partnership’s due diligence. This would be consistent, for example, with similar relief provided with respect to certain failures to report information in connection with IRS Form 8865 (Return of U.S. Persons with Respect to Certain Foreign Partnerships).59

2. Interaction of Section 250 Deduction with Section 163(j)(4)(A)

The Proposed Regulations provide certain mechanical rules for computing the section 250 deduction and the section 163(j) limitation for taxpayers that have FDII and business interest expense subject to section 163(j). The Proposed Regulations do not propose any modifications to the provisions of Proposed Regulation section 1.163(j)-6, which is the portion of the regulations under section 163(j)(4) that applies to partnerships.60 In the preamble to the Proposed Regulations, however, Treasury and the Service request comments on “how the section 250 deduction should be accounted for in determining a partnership’s adjusted taxable income (‘ATI’) under section 163(j)(4)(A).”61

Proposed Regulation section 1.250(a)-1(c)(4) and Proposed Regulation section 1.163(j)-1(b)(37)(ii) provide rules coordinating the computation of the section 250 deduction and the section 163(j) interest deduction limitation. In general, for purposes of computing a taxpayer’s section 163(j) limitation, a tentative section 250 deduction is taken into account in determining the taxpayer’s adjusted taxable income.62 Importantly, however, section 163(j)(4)(A) applies section 163(j) at the partnership level and the

59 See, e.g., Reg. § 1.6038-1(j)(4).
61 Prop. Reg. § 1.250(b)-1.
section 250 deduction is not allowed to a partnership, but rather to the domestic corporation that is a partner in the partnership.\textsuperscript{63}

The section 250 deduction is available for two types of foreign income earned by a domestic corporation: GILTI and FDII. With regard to GILTI, Proposed Regulation section 1.163(j)-7(d)(1) generally would subtract the net amount of a taxpayer’s GILTI and the tentative section 250 deduction with respect to that GILTI from the taxpayer’s ATI.\textsuperscript{64} Thus, the Proposed Regulations under section 163(j) would provide that GILTI, and the corresponding section 250 deduction, would not be included in the ATI of a partnership or any of its partners.\textsuperscript{65} Because a partnership or its partners’ GILTI inclusion resulting in a section 250 deduction generally will not be included in a partnership’s ATI, we recommend that final regulations clarify that the section 250 deduction with regard to the GILTI of any domestic corporate partner of a partnership also is not taken into account for purposes of determining the partnership’s ATI under section 163(j)(4)(A).

Unlike GILTI, the components that make up a corporate partner’s FDII generally would be included in a partnership’s ATI, because DEI, FDDEI, and related deductions are generally included in taxable income. Nevertheless, we recommend that a domestic corporate partner’s section 250 deduction with respect to FDII should not be taken into account for purposes of determining a partnership’s ATI because such an approach is consistent with the entity approach of section 163(j) and other policy decisions Treasury and the Service have made regarding section 163(j), as outlined below.

In addition to clarifying that a partnership is not allowed a section 250 deduction, the Proposed Regulations specifically adopt “an aggregate approach to partnerships for determining a domestic corporate partner’s FDII.”\textsuperscript{66} Thus, the section 250 deduction is a partner-level deduction because it is not allowed to a partnership and is allowed only to a domestic corporate partner. The Proposed Regulations under section 163(j) would provide rules addressing other partner-level adjustments related to the computation of a partnership’s ATI.\textsuperscript{67} In the preamble to the Proposed Regulations under section 163(j), Treasury and the Service indicated that several approaches were considered to address the impact of section 743(b) basis adjustments, section 704(c)(1)(C) built-in loss amounts, and section 704(c) remedial allocations (collectively, the “Partner-Level Adjustments”)

\textsuperscript{63} I.R.C. § 250(a)(1); Prop. Reg. § 1.250(b)-1.
\textsuperscript{64} Specifically, Prop. Reg. § 1.163(j)-7(d)(1) provides, in part: “If for a taxable year a United States shareholder with respect to one or more applicable CFCs includes amounts in gross income under section 78, 951(a), or 951A(a) that are properly allocable to a non-excepted trade or business (each amount, a specified deemed inclusion and such amounts, collectively specified deemed inclusions), then, for purposes of computing ATI of the United States shareholder, there is subtracted from taxable income an amount equal to the specified deemed inclusions, reduced by the portion of the deduction allowed under section 250(a)(1), without regard to the taxable income limitation of section 250(a)(2), by reason of the specified deemed inclusions (such a deduction, a specified section 250 deduction).”
\textsuperscript{65} There is an election available under Prop. Reg. § 1.163(j)-7(b)(3) (the CFC group election) to increase the ATI of a United States shareholder by a certain amount (the eligible CFC group ETI). However, the eligible CFC group ETI does not take into account the section 250 deduction and the CFC group election cannot affect a partnership’s ATI. Prop. Reg. §§ 1.163(j)-7(d)(2) and (3).
\textsuperscript{66} Prop. Reg. § 1.250(b)-1, 84 Fed. Reg. 8,188, at 8,191.
for purposes of determining the ATI of a partnership and its partners. Treasury and the Service concluded that taking Partner-Level Adjustments into account at the partnership level would have been “contrary to the intent of section 743(b), section 704(c)(1)(C), and remedial allocations.” Instead, the Proposed Regulations under section 163(j) would take the Partner-Level Adjustments into account for purposes of determining the ATI of the partners of the partnership (and would not take the Partner-Level Adjustments into account for purposes of determining the ATI of the partnership). Treasury and the Service determined “that this approach strikes the best balance between the entity-level calculation under section 163(j) and the aggregate nature of section 743(b) adjustments, as well as other partner-level adjustments.”

The Proposed Regulations under section 163(j) also indicate that the status of the partners is not relevant for purposes of applying section 163(j) to the partnership. Although a corporation cannot have investment interest expense under section 163(d), Proposed Regulation section 1.163(j)-6(j) provides that a partnership with investment interest expense would not treat the investment interest expense as business interest subject to section 163(j), even if the only partners of the partnerships are corporations. In the preamble to the Proposed Regulations under section 163(j), Treasury and the Service observed that this approach was adopted because “[s]ection 163(j)(4) does not require the partnership to look beyond its own tax attributes to that of its partners when making a determination as to whether a section 163(j) calculation is necessary.” Moreover, the proposed regulations under section 163(j) would provide that any investment interest expense allocated by a partnership to a corporate partner would be treated as business interest expense that is subject to section 163(j) at the corporate partner level.

Thus, in situations where the deduction for interest expense could be limited for a corporate partner, but not for a partnership, the proposed regulations under section 163(j) adopted a partner-level approach. Whereas section 163(d) does not apply to corporations, section 250 only applies to domestic corporations. In this sense, a corporate partner’s section 163(j) limitation with regard to its distributive share of a partnership’s investment interest expense is analogous to a domestic corporate partner’s section 250 deduction with regard to its distributive share of a partnership’s DEI and FDDEI (and related deductions). For this reason, we believe that it would be appropriate to determine a partnership’s ATI without regard to the section 250 attributes of any domestic corporate partner, similar to the approach adopted in the context of investment interest expense.

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73 Id.
74 Prop. Reg. § 1.163(j)-6(j).
75 In the preamble to the Proposed Regulations under section 163(j), Treasury and the Service also indicated that complex notional computations could be required if the corporate status of a partner were taken into account in determining the section 163(j) limitation of a partnership, potentially requiring “two section 163(j) calculations: one for any corporate partners and one for non-corporate partners.” Prop. Reg.
Additionally, each of the Partner-Level Adjustments are governed by subchapter K, computed by a partnership, and taken into account by the particular partner or partners for whom the partnership makes the computation. Thus, the Partner-Level Adjustments addressed by the Proposed Regulations under section 163(j) are amounts that are known to the partnership. In contrast, a partnership generally will not know the amount of the section 250 deduction allowed to any of its domestic corporate partners because, among other things, a domestic corporate partner could have FDII from sources other than the partnership or section 250(a)(2) could limit the amount of the domestic corporate partner’s section 250 deduction. Moreover, subchapter K does not contemplate the section 250 deduction. It therefore appears that the section 250 deduction has even more characteristics of a “partner-level” item than the Partner-Level Adjustments described above.

Finally, taking section 250 into account for determining a partnership’s ATI could impose a rigorous administrative burden on a partnership. As described above, a partnership may not know the country of organization or entity classification of each of its direct or indirect partners, such information could change, and it could be difficult for the partnership to obtain that information on a timely basis.

Based on the foregoing, we believe that it would be inappropriate to take a domestic corporate partner’s section 250 deduction into account for purposes of determining a partnership’s ATI under section 163(j)(4)(A). Similar to the Partner-Level Adjustments addressed by the Proposed Regulations under section 163(j), the section 250 deduction should be taken into account for purposes of determining the ATI of a domestic corporate partner that has a distributive share of gross DEI, gross FDDEI, or deductions related to gross DEI and gross FDDEI from a partnership. We therefore recommend that the section 250 deduction with regard to the FDII of any direct or indirect domestic corporate partner of a partnership not be taken into account for purposes of determining the partnership’s ATI under section 163(j)(4)(A).

F. General Services Provided to Business Recipients

Under the statute, FDDEI generally includes income derived in connection with services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, located outside the United States. The Proposed Regulations divide FDDEI services into five mutually

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76 For example, under Reg. §§ 1.743-1 and 1.755-1, the partnership determines the amount of a transferee partner’s section 743(b) basis adjustment, allocates the section 743(b) basis adjustment among partnership property, and adjusts the transferee partner’s distributive share of partnership income for the effects of the section 743(b) basis adjustments.

77 This recommendation is similar to the recommendation above regarding a domestic corporate partner’s section 250 deduction with regard to GILTI. In other words, our recommendation is that any section 250 deduction of a domestic corporate partner (whether attributable to GILTI or FDII) not be taken into account for purposes of computing a partnership’s ATI under section 163(j)(4)(A).

exclusive categories, including general services provided to a business recipient located outside the United States.

Under Proposed Regulation section 1.250(b)-5(e), general services provided to a business recipient are FDDEI services only to the extent provided to a business recipient located outside the United States. A service is provided to a business recipient located outside the United States to the extent the gross income derived by the service provider (the “renderer”) from providing the service is allocated to the business recipient’s operations outside the United States. For this purpose, a “business recipient” includes any related party of the business recipient.

A business recipient is treated as having operations in any location where it maintains an office or fixed place of business. If the service provides a benefit to the operations of the business recipient in specific locations, then the services income is allocated to operations outside the United States to the extent the benefit of the service is conferred on operations that are located outside the United States. A service is provided to a location outside the United States only to the extent the renderer obtains (generally from the service recipient) documentation described in the Proposed Regulations, and, as of the due date for filing the return that includes the services income, the renderer does not know or have reason to know that the services are provided to a location in the United States. If the renderer is unable to obtain reliable information regarding the specific locations that benefit from the service, or if the service benefits all locations of the business recipient, then the services income is allocated ratably to all of the business recipient’s operations at the time the service is provided. The amount of the benefit conferred on a location is determined under any reasonable method.

79 If the business recipient is a related party, then the related party service rules in Prop. Reg. § 1.250(b)-6(d) also would apply to determine the extent to which the income is FDDEI. For purposes of the Proposed Regulations, related party means, with respect to any person, any member of a modified affiliated group that includes such person. Prop. Reg. § 1.250(b)-1(c)(19). The term “modified affiliated group” means an affiliated group as defined in section 1504(a), determined by substituting “more than 50 percent” for “at least 80 percent” each place it appears, and without regard to section 1504(b)(2) and (3), relating to insurance companies and foreign corporations. Any person (other than a corporation) that is controlled by one or more members of an affiliated group or that controls any such member is treated as a member of the modified affiliated group. Prop. Reg. § 1.250(b)-1(c)(17).
80 Prop. Reg. § 1.250(b)-5(e)(2).
83 As discussed infra, the term “benefit” has the meaning set forth in Reg. § 1.482-9(l)(3). Prop. Reg. § 1.250(b)-1(c)(1). Under Reg. § 1.482-9(l)(3), an activity is considered to provide a benefit to the recipient if the activity directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient’s commercial position, or that may reasonably be anticipated to do so.
85 Prop. Reg. § 1.250(b)-5(e)(1). In addition, the documentation would need to satisfy the reliability requirements in Prop. Reg. § 1.250(b)-3(d).
87 Prop. Reg. § 1.250(b)-5(e)(2)(i)(B). In determining whether a method is reasonable, the principles of Reg. § 1.482-9(k) apply, treating the business recipient’s operations in different locations as if they were
In general, the Proposed Regulations provide four types of documentation that can establish that a business recipient is located outside the United States: (i) a written statement from the business recipient that specifies the locations of the operations of the business recipient that benefit from the service; (ii) a binding contract that specifies the locations of the operations of the business recipient that benefit from the service; (iii) documentation obtained in the ordinary course of the provision of the service that specifies the locations of the operations of the business recipient that benefit from the service; and (iv) publicly available information that establishes the locations of the operations of the business recipient.88 In addition, a renderer that receives less than $10,000,000 in gross receipts during a prior taxable year can establish that a business recipient is located outside the United States based on the renderer’s billing address for the business recipient (the “small business” rule).89 Further, a renderer that receives less than $5,000 in gross receipts during a taxable year from services provided to a particular business recipient in the taxable year can establish that the business recipient is located outside the United States based on the renderer’s billing address for the business recipient (the “small transaction” rule).90

We agree that taxpayers should be required to demonstrate entitlements to FDII benefits. We believe, however, that a few adjustments to the relevant definitions would increase consistency and ease administrative burden in implementing the rules without detrimentally affecting compliance.

1. The “Benefit” Requirement for Unrelated Parties

For FDII purposes, “benefit” is defined by reference to the transfer pricing rules, under which a benefit is provided to a recipient if the activity “directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient’s commercial position, or that may reasonably be anticipated to do so.”92 While the concept is relatively clear, this benefit inquiry seems more appropriate when the parties are members of the same controlled group or otherwise related, and where income shifting is a greater concern.93 Nonetheless, for FDII purposes, the benefit analysis applies equally to related party transactions and unrelated party transactions. It is unclear why transfer pricing standards developed for transactions within a controlled group should be applied to evaluate FDII transactions that involve parties that are unrelated. Further, as discussed in the next section, the benefit standard can be more difficult to apply in an unrelated context than a related context because a renderer often will not have

92 Reg. § 1.482-9(l)(3).
93 It could be argued that the cross-reference in Reg. § 1.482-9(l)(3) is inherently difficult to apply to unrelated party transactions because it presupposes the existence of the controlled group. As an example, Reg. § 1.482-9(f)(3)(iii) denies “benefit” treatment where one controlled group member duplicates an activity that is performed by another controlled group member on or for its own account.
the necessary information to undertake the benefit inquiry for an unrelated business recipient. Thus, the use of a transfer pricing concept to measure benefit in an unrelated context could have the effect of limiting FDII benefit in unrelated transactions. As a result, we believe the benefit concept should be revised to take into account unrelated party transactions by allowing for a rebuttable presumption of a “benefit” provided outside the United States when service is provided to an unrelated foreign person.

As a result, we recommend that the term “benefit” should reference Regulation section 1.482-9(l)(3)(i), with a rebuttable presumption of a “benefit” provided to a location outside the United States in the case of general services provided to a foreign person.

2. Recipients Without an Office or “Fixed Place of Business”

As discussed above, the analysis of whether general services are provided to a business recipient located outside the United States generally requires an identification of the locations of the business recipient, as well as a determination of the extent to which the service “benefits” a specific location. The Proposed Regulations define location as an office or other fixed place of business, but do not further define the term “fixed place of business.” As a result, it is not clear whether “fixed place of business” has the same meaning for FDII purposes as it does for section 864(c) purposes. Also, the Proposed Regulations do not address situations in which business recipients do not have an office or other fixed place of business. Finally, the requirement to take into account the locations of affiliated entities, rather than just the locations of the entity contracting to receive the services, expands the potential locations that can benefit from services, but does not necessarily address the range of factual issues.

The following example illustrates some of the limitations posed by these definitions: Consider a U.S. corporation that provides back-office (e.g., tax return preparation) services to a foreign partnership (“FPship”), which derives only passive income and does not have an office or other fixed place of business. FPship is 50 percent owned by a German corporation and 50 percent owned by a U.K. corporation. The first issue in this case is whether any “benefit” is being conveyed by the renderer. While the partnership is better off complying with its tax return filing obligations than not, it is unclear whether the tax return preparation services directly or indirectly result in a “reasonably identifiable increment” of value; the benefit would be even less clear, for example, if the services satisfied compliance requirements applicable to the U.K. partner rather than the partnership. In addition, the renderer may not be able to claim FDII benefits under the Proposed Regulations, as FPship has no office or fixed place of business and therefore has no location outside the United States. Even if FPship’s partners had offices of their own, because neither partner owns greater than a 50 percent partnership interest, neither would be treated as an affiliated entity under the Proposed Regulations.94 Similar to the partnership itself, although the services generically convey some value to the partners, it is not clear if they have received a “benefit” as defined in

94 Prop. Reg. § 1.250(b)-5(e)(4); 1.250(b)-1(c)(19) and -1(c)(17).
the Proposed Regulations. As a result, the partners’ locations cannot be used and documented for purposes of the renderer obtaining FDII benefits for the services income.

In cases where a recipient, such as a foreign partnership, does not have an office or “fixed place of business” (however this concept is defined for FDII purposes), we recommend that the final Regulations presume that such recipient have operations where it is formed or incorporated.

3. **Identification of Recipient’s Non-U.S. Location**

Even in cases where there is a clear recipient of benefits, application of the location rules could require the implementation of new systems to analyze whether a service benefits specific locations outside the United States. However, it does not appear necessary for the appropriate operation of section 250 for the renderer to document specific non-U.S. benefitted locations. There appears to be no difference between one non-U.S. location and another; rather, all that is required is that the location be non-U.S. It would be simpler—and not inconsistent with the statutory objectives—for the recipient to ascertain the benefits conveyed to its non-U.S. locations as a whole.

For this reason, we recommend that the final Regulations provide that, rather than documentation identifying the specific non-U.S. location of benefits, a certification that the benefits are accruing to non-U.S. locations be sufficient.

4. **Documentation Requirements**

With respect to the documentation requirements, the Proposed Regulations require documentation that could be difficult or impossible to obtain. For example, two of the types of documentation can be obtained only from the service recipient: (i) a written statement from the business recipient that specifies the locations of the operations that benefit from the service; and (ii) a binding contract that specifies the locations of the operations of the business recipient that benefit from the services. The business recipient may not want to undertake the analysis that would be needed to make the determinations necessary to provide these types of documentation, or the internal stakeholders engaging in transactions with the taxpayer may have no access to the relevant information. Moreover, a service recipient may have valid business reasons for not wanting to share this type of information with an unrelated service provider.

In the absence of information on the specific locations that benefit from a service, the Proposed Regulations treat the services as benefiting all of the locations of the business recipient, based on publicly available information. “Publicly available information,” however, could be very limited or largely non-existent for a business recipient that is not publicly traded. Even publicly traded entities would not necessarily publish location-specific information for all of their affiliated entities, or do so consistently with other public companies. For example, an annual report may list material subsidiaries, but would not necessarily list all of its non-material entities or branches. Some of the entities listed may not have offices or fixed places of business. Moreover, groups may not publish enough revenue, transactional, or other information that would allow a rendered to determine how benefits should be allocated among locations. As a result, it is not clear that taxpayers reasonably could be expected to obtain the
documentation listed in the Proposed Regulations in many situations, in which case they would be unable to take advantage of the FDII deduction solely as a result of the documentation rules.

The Proposed Regulations provide helpful rules for small businesses and small transactions that allow the renderer to use information—the recipient’s billing address—that the renderer would have obtained in the ordinary course of business. Nonetheless, the thresholds for applying these special rules are low, so may not apply to many taxpayers.

With respect to the documentation rules, we recommend that the final regulations permit any reasonable documentation that the renderer is able to obtain, and provide safe harbors for the service provider to determine the foreign benefit of certain types of transactions (e.g., the foreign tax return preparation services in the example discussed above). We also note that Proposed Regulation section 1.250(b)-4(d)(3)(iii), which applies in the case of sales of a “fungible mass” of general property, allows the establishment of foreign use through market research, including statistical sampling, economic modeling, and other similar models. We respectfully recommend that this rule be expanded to include additional types of transactions. Finally, we respectfully recommend that the dollar thresholds for the small business and small transaction exceptions be increased to allow for broader application.