Foreign Tax Credits 2.0

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New Orleans
Foreign Tax Credits
Panelists

- **Caren Shein**, Deloitte LLP, Moderator
- **Barbara Felker**, Branch Chief, Office of Associate Chief Counsel (International), Internal Revenue Service
- **Micah Gibson**, PwC LLP
- **Lindsay Kitzinger**, Attorney Advisor, Office of International Tax Counsel, Department of the Treasury
- **Dirk Suringa**, Covington & Burling LLP
Agenda

General overview

Foreign tax credit limitation

Expense apportionment

Deemed paid foreign taxes and PTEP

Other provisions
Overview of Proposed Regulations
## Proposed regulations
### Key highlights

<table>
<thead>
<tr>
<th>Issue</th>
<th>Observations</th>
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</table>
| **Effective dates** | • Generally applicable to taxable years beginning after December 22, 2017  
• Exceptions for proposed regulations that do not relate directly to the TCJA |
| **Section 78 Gross Up** | • §78 gross-up is not treated as a dividend for §245A purposes, with respect to any distribution or inclusion after December 31, 2017  
• §78 gross-up is allocated to the same category as the underlying taxes |
| **“Look-through” rules** | • Only applies to payments that are attributable to passive category income of CFC. Otherwise, basket income at US level other than passive  
• Effectively, no “GILTI look-through” |
| **Expense allocation and apportionment** | • Rules for characterizing CFC stock into categories based on current year items, including subpart F, tested income, and §245A subgroups within each §904(d) category  
• US shareholder’s GILTI or FDII offset by §250 deduction is treated as exempt income, and assets giving rise to that income are treated as partially exempt  
• Rules implementing §904(b)(4) |
### Proposed regulations

**Key highlights (cont.)**

<table>
<thead>
<tr>
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<th>Observations</th>
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</table>
| FTC carryforwards and carrybacks | • Allows for carryback of post-2017 general and branch category taxes to pre-2018 general basket  
• Election to carryforward certain pre-2018 general category taxes to branch category in post-2017 years |
| SLL/OFL and ODL recapture      | • Confirms that SLL and OFL accounts are carried forward to post-2017 tax years in the same category, except general SLL, OFL, and ODL accounts recaptured out of branch income if applying branch carryover exception |
| Foreign branch basket          | • Defines income attributable to a foreign branch  
• Rules for taking into account disregarded payments, including rules addressing IP transfers to/from a foreign branch |
| Deemed paid taxes              | • Defines taxes “properly attributable” to categories of income, including timing rule addressing different US and foreign taxable years and timing differences  
• Allows deemed paid taxes only on sub F and GILTI inclusions  
• No deemed paid taxes with respect to a §956 inclusion or distribution of §959(c)(3) E&P |
Foreign Tax Credit Limitation
Schematic of § 904 Categories

Look-through Payments
• Passive to extent attributable to passive income of a CFC
• Include:
  • Dividends
  • Interest
  • Rents
  • Royalties

FTC Baskets
• General: 100% FTCs
• Passive: 100% FTCs
• §951A: 80%, no carryovers
• Foreign Branch: 100% FTCs

QBU

FTC Baskets
• General: various income groups within
• Passive: various income groups within

USP

CFC1

CFC2
Look-through Rules

- Non-passive look-through payments, such as interest, rents, royalties, cannot be assigned to the GILTI category. Instead are assigned to the general or foreign branch category.

- § 904(d)(1) applies to characterize income as in the general, foreign branch, GILTI, or passive limitation category.

- However, under a limited exception in §904(d)(3), dividends, interest, rents, and royalties paid from a related CFC to a US Shareholder may be treated as passive limitation income to the extent such amounts are allocable against passive limitation income of the CFC.

- This exception is proposed to apply to an amount included as a GILTI inclusion.

- Distributive shares from less than 10% owned pass-through entities also treated as passive.
Transition Rules
Section 904(c)

• § 1.904-2(j) provides as a general rule that general category excess credits from pre-2018 year carry over to the general category post-2017, and excess credits in the general or branch categories post-2017 carry back to the pre-2018 general category

• Elective exception: A taxpayer may elect to allocate pre-2018 general category excess credits to the foreign branch category in post-2017 years to the extent that those pre-2018 taxes would have been allocated to the branch category if those taxes were paid in a post-2017 taxable year

• No carry over to or carry back from GILTI category
Transition Rules
Foreign Losses

- Treas. Reg. § 1.904(f)-12 provides similar transition rules for SLL, OFL, and ODL accounts. Pre-2018 passive and general accounts retain their character and are recaptured out of passive and general category income in post-2017 years.

- **Exception**: If the foreign branch election is made for excess credit carryovers, a pre-2018 SLL or OFL account balance is allocated to general and foreign branch categories based on foreign tax allocation.

- Recapture pre-2018 losses in subsequent taxable years as income in the post-2017 general category or, if foreign branch election made for excess credit carryovers, recapture as income in the post-2017 general and foreign branch categories based on foreign tax allocation.

- If no excess general basket credits from pre-2018 years, election to carry over to branch basket is not available, and the foreign loss exception cannot apply.

- Similar rules apply to foreign losses that are part of a NOL carry over.
Foreign Branch Category Income
Fundamental Concepts

- A foreign branch is a QBU (determined generally under section 989) operating a trade or business outside the United States.

- Determination of whether a QBU operates a trade or business outside the United States relies on Treas. reg. § 1.989(a)-1(c) definition of “trade or business” – facts and circumstances, specific unified group of activities that constitutes an independent economic enterprise carried on for profit. US activities not included. Foreign PE deemed to qualify.

- Subject to certain exceptions, gross income is attributable to a foreign branch to the extent the gross income (as adjusted to conform to Federal income tax principles) is reflected on the separate set of books and records of the foreign branch.
  - Excludes items arising from activities conducted in the United States.
  - Special rules apply for items associated with stock and an interest in a partnership or pass through.
  - Anti-abuse rule
  - Treatment of related person interest income
  - Special rules for disregarded payments
  - Treatment of section 987 gains and losses

- Passive category income exclusion
- Financial services income coordination rule
Foreign Branch Category Income
Disregarded Payment Rule – By Foreign Branch to Foreign Branch Owner

If a foreign branch makes a disregarded payment to its foreign branch owner and the disregarded payment is allocable to non-passive category gross income of the foreign branch reflected on the foreign branch’s separate books and records (adjusted to conform with Federal tax principles) then two adjustments are required:

<table>
<thead>
<tr>
<th>Adjustment 1</th>
<th>The gross income attributable to the foreign branch is adjusted downward to reflect the allocable amount of the disregarded payment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment 2</td>
<td>The general category gross income attributable to the foreign branch owner is adjusted upward by the same amount.</td>
</tr>
</tbody>
</table>

Adjustments are translated, as necessary, from the foreign branch’s functional currency to USD at the spot rate (within the meaning of Treas. reg. § 1.988-1(d)) on the date of the disregarded payment.
Foreign Branch Category Income
Disregarded Payment Rule – By Foreign Branch Owner to Foreign Branch

If a foreign branch owner makes a disregarded payment to its foreign branch and the disregarded payment is allocable to general category gross income of the foreign branch owner that was not reflected on the separate set of books and records of any foreign branch of the foreign branch owner then two adjustments are required:

<table>
<thead>
<tr>
<th>Adjustment 1</th>
<th>The gross income attributable to the foreign branch owner is adjusted downward to reflect the allocable amount of the disregarded payment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment 2</td>
<td>The gross income attributable to the foreign branch is adjusted upward by the same amount.</td>
</tr>
</tbody>
</table>

Adjustments are translated, as necessary, from the foreign branch’s functional currency to USD at the spot rate (within the meaning of Treas. reg. § 1.988-1(d)) on the date of the disregarded payment.
Foreign Branch Category Income
Disregarded Payment Rule – By Foreign Branch to Another Foreign Branch

Prop. reg. § 1.904-4(f)(2)(vi)(A) states “similar rules apply in the case of disregarded payments between a foreign branch and another foreign branch with the same foreign branch owner.”

If a foreign branch (paying foreign branch) makes a disregarded payment to another foreign branch (recipient foreign branch) with the same foreign branch owner as the paying foreign branch and the disregarded payment is allocable to non-passive category gross income of the paying foreign branch then two adjustments are required:

<table>
<thead>
<tr>
<th>Adjustment 1</th>
<th>The gross income attributable to the paying foreign branch is adjusted downward to reflect the allocable amount of the disregarded payment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment 2</td>
<td>The gross income attributable to the recipient foreign branch is adjusted upward by the same amount.</td>
</tr>
</tbody>
</table>

Adjustments are translated, as necessary, from the paying foreign branch’s functional currency to USD (or perhaps the functional currency of the recipient foreign branch?) at the spot rate (within the meaning of Treas. reg. § 1.988-1(d)) on the date of the disregarded payment.
Foreign Branch Category Income
Disregarded Payment Rule – Certain Transfers of Intangible Property

• The disregarded payment rules apply to all transactions that are disregarded for Federal income tax purposes in which section 367(d)(4) property is transferred to or from a foreign branch.

• The regulations clarify if a foreign branch owner transfers section 367(d)(4) property to a foreign branch then the principles of section 367(d) are applied by treating the foreign branch as a separate corporation in receipt of property in a section 351 transaction.

• Do the disregarded payment rules apply only to disregarded payments associated with transfers of section 367(d)(4) property occurring after the effective date of the regulations or also to disregarded payments occurring after such effective date but in relation to transfers of section 367(d)(4) property occurring prior to the effective date of the regulations?
Foreign branch example

CFC1

HoldCo

DE

OpCo

USP

Customers

Subpart F income: $500

Interest: $200

Services income: $1,800

Operating expenses: $600

Royalty: $600

Interest: $300

Foreign branch example

Royalty

Local Country Books

Income

Operating income $1,800

Interest $200

Gross Income $2,000

Expense

Operating expenses $600

Interest $300 ($270/$30)

Royalty $600

Gross Expenses $1,500

Net Income $500

Foreign Tax at 25% $125
Foreign branch example

Royalty

US Tax Books

<table>
<thead>
<tr>
<th>Income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income</td>
<td>$1800</td>
</tr>
<tr>
<td>Interest</td>
<td>$200</td>
</tr>
<tr>
<td>Gross Income</td>
<td>$2000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expense</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating expenses</td>
<td>$600</td>
</tr>
<tr>
<td>Interest</td>
<td>$300</td>
</tr>
<tr>
<td>Royalty</td>
<td>$600</td>
</tr>
<tr>
<td>Gross Expenses</td>
<td>$600</td>
</tr>
<tr>
<td>Net Income</td>
<td>$1400</td>
</tr>
<tr>
<td>Foreign Tax (25% of $500)</td>
<td>$125</td>
</tr>
</tbody>
</table>
Foreign branch example

Royalty

<table>
<thead>
<tr>
<th>USP</th>
<th>Royalty: $600</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC1</td>
<td>Royalty: $200</td>
</tr>
<tr>
<td>HoldCo</td>
<td>Services income: $1,800, Operating expenses: $600</td>
</tr>
<tr>
<td>DE OpCo</td>
<td>Royalty: $300, Interest: $200</td>
</tr>
<tr>
<td>CFC2</td>
<td>Subpart F income: $500</td>
</tr>
</tbody>
</table>

§1.904-4(f) Adjusted US Tax Books

<table>
<thead>
<tr>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income (adjusted by disregarded royalty)</td>
</tr>
<tr>
<td>Interest</td>
</tr>
<tr>
<td>Gross Foreign Branch Income</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating expenses (allocated/apportioned under §1.861-8)</td>
</tr>
<tr>
<td>Royalty</td>
</tr>
<tr>
<td>Interest</td>
</tr>
<tr>
<td>Total Expenses</td>
</tr>
<tr>
<td>Net Foreign Branch Income</td>
</tr>
</tbody>
</table>

Tax on Foreign Branch Income?

Option 1 – all tax on operating income attributable to branch: $1800 - $600 - 600 - 270 x 25% = $82.50
Option 2 – prorate foreign tax between branch and general (67/33): 67% x 82.50 = $55
Expense Apportionment
Expense allocation and apportionment
Overview

The most significant modifications address the apportionment of expenses to GILTI and impact of the §250 deduction for GILTI and FDII on the foreign tax credit limitation under §904(a):

• **In general:** Interest expense still apportioned between US and foreign source income based on the relative value of US and foreign assets (calculated either using TBV or ATBV method) and to FTC baskets based on the character of foreign assets.

• **§951A:** Prop. Reg. §1.861-13 characterizes CFC stock in various groupings, including as a §951A category asset. These rules are needed to determine the degree to which CFC stock is a §951A category asset.

• **§864(e)(3):** In order to address the “over allocation” of interest expense to the §951A category, the proposed regulations treat a portion of CFC stock as an “exempt asset” under §864(e)(3) by treating income qualifying for the §250 deduction as “exempt income.”

• **§904(b)(4):** Special rules for expenses allocable to dividend income qualifying for the §245A DRD and portion of CFC stock attributable to non-currently included §959(c)(3) earnings (“§245A subgroup earnings”).
## Tax-exempt assets vs. disregarded deductions

### §250 deduction and §245A DRD

<table>
<thead>
<tr>
<th>Overview</th>
<th>§864(e)(3)</th>
<th>§904(b)(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overview</strong></td>
<td>Tax exempt assets and income they generate are <em>not taken into account</em> for purposes of allocating and apportioning deductible expenses</td>
<td>Income eligible for the §245A DRD, and expenses allocable or apportioned to such dividend income and the §245A subgroup stock are <em>not taken into account</em> for purposes of §904(a)</td>
</tr>
</tbody>
</table>

| Application | §§243, 245(a), and 250 (gross income offset by §250 deduction is *exempt income*; stock/asset giving rise to that income is *partially exempt asset*) | §245A subgroup stock, whether or not income is distributed, and §245A dividends draw expenses away from other categories and worldwide taxable income in FTC limitation fraction |

| Result | Reduce value of the portion of the CFC stock characterized as GILTI inclusion stock | Adjustment to taxpayer’s *foreign source income* (numerator) in the relevant separate category and *worldwide taxable income* (denominator) under §904(a) |
New rules for characterizing CFC stock
Prop. Reg. §1.861-13

• Preexisting rules characterize CFC stock as an asset in one or more FTC limitation categories based on (1) gross income generated by the CFC, or (2) the CFC’s assets (i.e., based either on the MGI or TBV method). New rules needed to address:

• §951A category income “applies only to an inclusion by a United States person.” Thus, a CFC’s gross income can not constitute §951A category income, but instead is “generally assigned to the general category.”

• Designating CFC stock as in the residual grouping or the treaty resourced grouping.

• Guidance was also required on the application of §904(b)(4) for the apportionment of interest expense to stock.

• Prop. Reg. §1.861-13 provides a step-by-step approach to characterize CFC stock as a §951A category asset, treaty asset, and as an asset in the residual grouping. Subgroups are also designated under §245A to coordinate with the application of §904(b)(4).
New rules for characterizing CFC stock
Prop. Reg. §1.861-13 (cont.)

Overview:
Proposed regulations create a multi-step process to characterize CFC stock (under TBV or MGI method) for purposes of interest expense apportionment

Step 1: Characterize CFC stock into 10+ separate statutory groupings:

<table>
<thead>
<tr>
<th>General</th>
<th>Passive</th>
<th>General</th>
<th>Passive</th>
<th>General</th>
<th>Passive</th>
<th>General</th>
<th>Passive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross tested income</td>
<td>Gross subpart F income</td>
<td>Gross §245(a)(5) income</td>
<td>Other gross income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign</td>
<td>Treaty</td>
<td>US</td>
<td>Foreign</td>
<td>Treaty</td>
<td>US</td>
<td>Foreign</td>
<td>US</td>
</tr>
</tbody>
</table>

Step 2: Assign stock to §951A category

Step 3: Assign stock to a treaty category

Step 4: Aggregate stock within each separate category (general or passive) and the residual grouping (US)

Step 5: Subdivide CFC stock between §245A and non-§245A subgroups within a category
Characterization of CFC stock
Modified gross income method

• CFC applies the MGI method
• USP’s inclusion percentage: **90%**
• CFC has no interest expense

**Analysis:**
• Characterize CFC stock based on gross income of CFC:
  • General foreign source gross tested income statutory grouping: 1000
    • 900 assigned to the **§951A general category** and **non-§245A subgroup**
    • 100 assigned to general category and **§245A subgroup**
  • General foreign source gross subpart F income statutory grouping: 500
  • Assigned to the subpart F general category and non-§245A subgroup

**Comments:**
• No portion of the §951A category stock can be assigned to a §245A subgroup
• §245A subgroup includes income that is not included under subpart F or GILTI, e.g., NDTIR, high-taxed subpart F income for which the high-tax election is made, FOGEI
Interest expense apportionment
§864(e)(3) and impact of §250 deduction

Analysis:
• CFC’s stock is characterized as follows:
  • §951A category (non-§245A) 900
  • Sub F general category (non-§245A) 500
  • General category (§245A) 100
• USP’s §250 deduction results in the §951A category stock being treated as 50% exempt under §864(e)(3)
  → Adjusted TBV of §951A category stock
    50% x 900 = **450**
  → Total worldwide assets 3050

Comments:
• Portion of exempt stock depends on the portion of stock treated as a §951A category asset, inclusion percentage, and whether the §250 deduction is taxable-income limited

• CFC applies the MGI method
• USP is not taxable-income limited for the §250 deduction
• USP’s inclusion percentage is 90%
Interest expense apportionment
§904(b)(4) & Impact of §245A Sub-Group

Analysis:
- CFC’s stock is characterized as follows:
  - §951A category (non-§245A) 450
  - Sub F general category (non-§245A) 500
  - General category (§245A) 100
- Interest apportioned to US
  - 2,000 / 3050 x 500 = 328
- Interest apportioned to §951A
  - 450 / 3050 x 500 = 74
- Interest apportioned to general
  - 500 / 3050 x 500 = 82
- Interest expense disregarded pursuant to §904(b)(4)
  - 100 / 3050 x 500 = 16
- FTC limitation
  - §951A category income
    - (450 – 74) / (2950 – 500 + 16) x 515 = 77
  - General category income
    - (500 – (82 + 16) + 16) / (2950 – 500 + 16) x 515 = 87
- Note limitation-reducing impact of §904(b)(4) (add-back of 16 to denominator even in determining GILTI limitation)
Deemed Paid Foreign Taxes
Deemed paid foreign taxes
Key items in the proposed regulations

<table>
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</table>
| **Current Year Deemed Paid Foreign Taxes** | • Deemed paid foreign taxes are allocated to the same separate category to which the related subpart F or GILTI inclusion is assigned  
• Prop. Reg. §1.960-1 provides computational and grouping rules for associating a CFC’s current year foreign income taxes with the CFC’s current year income |
| **Historic ("pooled") taxes** | • The historic foreign income taxes of CFCs are unavailable to be deemed paid under §960 |
| **§956 inclusions** | • Prop. Reg. §1.960-2(b)(1) provides that no foreign income taxes are deemed paid under §960 with respect to a §956 inclusion |
| **CFC and US Shareholder Tax Year-End Mismatches** | • Confirms that foreign income taxes should not be permanently lost or disallowed due to year-end mismatches  
• Accrued current year foreign income taxes of CFC are eligible to be deemed paid in the taxable year of the United States shareholder with or within which the U.S. taxable year of the CFC ends |
| **Distributions of PTI/PTEP** | • Taxes available with distributions of PTI/PTEP  
• Require establishment of separate, annual accounts ("annual PTEP account") for CY CFC E&P to which subpart F or GILTI inclusions of the CFC are attributable, and tracking of multiple separate PTEP accounts on annual basis |
Deemed paid foreign taxes
The “properly attributable” standard

Under the Proposed Regulations, foreign income taxes paid or accrued by a foreign corporation are properly attributable to subpart F or tested income and thus available to be deemed paid under §960(a) or (d) only if:

1. allocable and apportioned (by reference to foreign law) to subpart F or tested income within a grouping,

2. paid or accrued in the CFC’s year ending with or within the US taxable year in which subpart F or tested income is included (current year taxes), and

3. in proportion to the CFC’s subpart F or tested income within the grouping that is included in a US shareholder’s gross income.

**NOTE:** Special rules addressing interaction with §952(c). Further, **no tax can be deemed paid with respect to taxes properly attributable to non-subpart F or GILTI earnings** (NDTIR, high-taxed subpart F income for which the high-tax election is made), or **taxes imposed at CFC level on a base difference.**
Foreign tax credits
Taxes properly attributable to tested income

A US shareholder with a calendar year end owns a CFC with an 11/30 US tax year end and calendar foreign tax year end

Proposed regulations generally indicate that taxes are not lost as a result of a foreign/US year-end mismatch, but this may not always be the case.
Base Differences

The scope of base differences is extremely limited under the proposed regulations

- A **base difference** is an amount that is not treated as income for US federal tax principles

- Examples provided by the proposed regulations
  - Life insurance proceeds or gifts exempt under US federal tax but may be taxed under foreign law

- Current year taxes attributable to a base difference are treated as related to income in the residual income group
  - No allocation or apportionment to any subpart F, tested income or previously taxed E&P (PTEP group)
  - No credit for foreign taxes
Timing Differences

• A **timing difference** occurs when a foreign country imposes tax currently on an item of income that is also an item of income for US federal income tax purposes, but which is not recognized in the current year by US federal income tax law.
  
  – Proposed regulations interpret this rule very broadly, apparently treating a foreign tax as imposed on a timing difference if there is any income for US purposes (in any year) to which the tax can be traced

• Generally current year taxes attributable to a timing difference are matched to the limitation category and income group if the income on which the foreign tax is imposed as if the income was recognized under US federal tax law in the year the foreign tax was imposed
Deemed paid foreign taxes

Overview

• §960(a) and (d) deem a corporate US shareholder of a CFC to have paid the portion of the CFC’s foreign income taxes that are properly attributable to income of the CFC that the US shareholder takes into account in computing its subpart F or GILTI inclusions.

• §960(b) applies similar rules for taxes deemed paid in connection with certain distributions by a CFC of previously taxed earnings and profits.

• Prop. Reg. §§ 1.960-1 through -3 provide computational and grouping rules for calculating taxes deemed paid under §960, including rules that—
  - assign CFC gross income to certain categories and income groups,
  - allocate and apportion deductions at the CFC level, and
  - determine the amount of deemed paid taxes at the CFC level and the US shareholder level.

• Generally only applicable to current year taxes:
  - Foreign income taxes (calculated on the basis of income recognized in a foreign taxable year) accrue on the last day of the foreign taxable year.
  - Foreign tax redeterminations relate back to the foreign year to which they relate.
Deemed Paid Taxes - § 1.960-1(c)

CFC makes high-tax election under §954(b)(4)

**Analysis:**

**Step 1**
Assignment of CFC income to §904 categories:
- General tested income group: 2000
- General residual group: 1000

**Step 2**
Allocation and apportionment of deductions (other than taxes):
- General tested income group: <400>
- General residual group: <200>

**Step 3**
Allocation and apportionment of taxes:
- General tested income group: 300
- General residual group: 150

**Step 4**
USP’s §960 deemed paid taxes:
- General tested income group: 240 [300 x 100% inclusion % x 80%]
- General residual group: 0

Gross tested income 2000
High-taxed subpart F 1000
CFC deductions <600>
Country X tax 450
Inclusion percentage 100%

CFC makes high-tax election under §954(b)(4)

Result: Of 450 taxes paid, only 240 are potentially available as credits before applying FTC limitation at US level
Section 960(b) Tiered CFCs

**Anticipated Consequences:**

- $20x of Country D taxes paid by DRE2 should be properly attributable to CFC2’s $180x of subpart F income (Section 960(a))
- What about the $10x Country D withholding tax on Distribution 1?
  - Attributable to the subpart F income under Section 960(a) if paid in the same year as the inclusion?
  - What if paid after CFC2 distributes the PTEP from the subpart F income inclusion? Can the withholding tax be properly attributable to any amount? Timing Difference?
- Country C withholding tax on Distribution 2: Section 960(b)(2); CFC1 has 10 of PTEP taxes.
- Country B withholding tax on Distribution 3; Considered paid by CFC1 on PTI distribution from CFC2? Timing Difference?
- Country A withholding tax on Distribution 4:
  - Section 960 does not apply to foreign taxes directly paid by USP.
  - Distribution triggers 960(b)(1) – 10 taxes deemed paid on PTEP distribution. Is section 78 gross-up required?
<table>
<thead>
<tr>
<th>Groups</th>
<th>PTEP groups within an annual PTEP account and §904 category</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §965(a)</td>
</tr>
<tr>
<td>2</td>
<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §965(b)(4)(A)</td>
</tr>
<tr>
<td>3</td>
<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §951(a)(1)(B)</td>
</tr>
<tr>
<td>4</td>
<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §951A(f)(2)</td>
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<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §245A(e)(2)</td>
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<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §964(e)(4)</td>
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<td>§959(c)(1)(A) E&amp;P initially described in §959(c)(2) by reason of §951(a)(1)(A) (other than listed above)</td>
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<td>9</td>
<td>§959(c)(1)(B) E&amp;P</td>
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<td>16</td>
<td>§959(c)(2) E&amp;P by reason of §951(a)(1)(A) (other than listed above)</td>
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PTEP Distributions
Ordering Rules

• Proposed regulations follow § 959(c) ordering rules with modifications to address new groupings
  – Distributions come first LIFO out of § 959(c)(1) PTEP, then LIFO out of § 959(c)(2) PTEP, then LIFO out of § 959(c)(3) E&P.
  – If a CFC has more than one § 904(d) category of PTEP within the § 959(c)(1) or (c)(2) groupings in the same annual layer (e.g., general and passive subpart F and/or GILTI PTEP from same year), distribution comes pro rata out of each grouping.

• Notice 2019-1 provides an exception to the LIFO ordering rule for § 965 PTEP.
  – Within each broad category of PTEP (§ 959(c)(1) and (c)(2)), § 965 PTEP is distributed first (§ 965(a) then § 965(b)).
  – Helpful in reducing number of PTEP categories to be tracked, but taxes deemed paid on a distribution of § 965 PTEP are haircut
Appendix:
Issues not Addressed by Proposed Regulations
Expense allocation and apportionment
R&E and Stewardship

• No substantive changes provided with respect to the allocation and apportionment of R&E, stewardship, and supportive function expenses
  - Taxpayers subject to the 5-year binding election to use a method for R&E apportionment may nevertheless make a one-time change in method for its first taxable year beginning after December 31, 2017 without Commissioner consent
  - Note comments in preamble (pp. 30-31): “[B]ecause the look-through rules in section 904(d)(3)(C) do not assign interest, rents, or royalties that reduce tested income to the section 951A category, royalties paid by a CFC to a U.S. shareholder are generally general category income even though the sales by the CFC to which the royalties relate may generate income in the section 951A category to the U.S. shareholder. This could result in R&E expenditures being apportioned under the sales method solely to the section 951A category, even though the royalty income is assigned to the general category. However, under the gross income method, R&E expenditures would be apportioned to both the general and section 951A category.”

• § 1.861-8(e)(4) provides for allocation of stewardship expense based on dividends received or that could be received. Does this mean all stewardship expense is allocable to § 904(b)(4) category because dividends would qualify for § 245A DRD?
§ 905(c)  
Foreign Tax Redeterminations

• As a result of the repeal of § 902
  
  - Regulations under § 905(c) providing for pooling adjustments in lieu of amended returns for redeterminations of foreign taxes paid by CFCs are no longer operative
  
  - The § 905(c)(2)(B) statutory rule mandating pooling adjustments for foreign taxes paid more than two years after the year to which they relate has been repealed
  
  - All foreign tax redeterminations in taxable years of foreign corporations beginning after 2017 are now taken into account in the year to which the foreign taxes relate

• Consider
  
  - Foreign tax redeterminations with respect to section 902 taxes arising in post-tax reform years but relating to pre-tax reform years
  
  - Methods of reporting foreign tax redeterminations short of a full amended return, which may then necessitate amended state tax returns