Overview

This slide deck addresses the interaction between partnership and international tax rules related to the following provisions in “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act” or the “TCJA”):

1. Expansion of US Shareholder Ownership Rules
2. Global Intangible Low-Taxed Income (“GILTI”)
3. Foreign-Derived Intangible Income (“FDII”)
4. Base Erosion and Anti-Abuse Tax (“BEAT”)
5. Section 163(j) Interest Expense Limitation
6. Foreign Tax Credits
7. Section 245A Participation Exemption
8. Disposition of Interests in Partnerships Engaged in a US Trade or Business
1. Expansion of US Shareholder Ownership Rules
Change to Rules for Constructive Stock Ownership of Foreign Corporations
Repeal of Section 958(b)(4)

- A US Shareholder is a US person who owns (within the meaning of section 958(a)) or is considered to own (under the attribution rules of section 958(b)) at least 10% of the voting power or value of the stock of a foreign corporation.

- Section 958(b) generally imports, and in part modifies, the attribution rules under section 318.
  - Under prior law, section 958(b)(4) barred section 318(a)(3)(C) attribution where the result would be to treat stock owned by a foreign person as owned by a US person.
  - The TCJA repealed section 958(b)(4) effective for the last taxable year of foreign corporations beginning before 2018 (and for all years thereafter) and for taxable years of US Shareholders with or within which such taxable years of foreign corporations end.

- The Senate Finance Committee explanation stated that the expanded attribution rules under section 958(b) are not intended to cause a foreign corporation to be treated as a CFC with respect to a US Shareholder as a result of section 318(a)(3) attribution to a US person that is not a related person (under section 954(d)(3)) to such US Shareholder. See H.R. Conf. Rep. No. 115-466, at 633-34 (2017).

- The section 965 proposed regulations provided a special rule that, for purposes of section 965, stock owned by a partner will not be considered as owned by a partnership under sections 958(b) and 318(a)(3)(A) if the partner owns less than 5% of the interests in the partnership’s capital and profits (taking into account the partner’s direct, indirect, and constructive ownership of interests in the partnership). See Prop. Reg. § 1.965-1(f)(45)(ii).

- Notice 2018-13 addressed reporting obligations relating to the modifications of section 958(b)(4).
Change to Rules for Constructive Stock Ownership of Foreign Corporations

Examples of Expanded CFC Definition

**Example A**
- Foreign Parent
- USCo
  - 90%
- FP
- FC
- Foreign Parent’s 90% interest in FC is attributed to USCo and FC is now a CFC. In addition, USCo is a US Shareholder of the CFC.

**Example B**
- US Individual
- Foreign Person
- USCo
  - 50% Vote & Value
- FP
  - 10%
- FC
- Foreign Person’s 90% interest in FC is attributed to USCo and FC is now a CFC. In addition, US Individual is subject to subpart F and GILTI with respect to FC because US Individual is a US Shareholder of the CFC.

**Example C**
- USCo
- ForCo
  - 10%
- FC
- USP
  - 10%
- ForCo’s 90% interest in FC is attributed to USP and FC is now a CFC. In addition, USCo is subject to subpart F and GILTI with respect to FC because USCo is a US Shareholder of the CFC.
2. Global Intangible Low-Taxed Income ("GILTI")
GILTI
General Rules

• In general, section 951A provides that a US Shareholder of a CFC includes GILTI in its gross income.
  − A US Shareholder’s GILTI is generally equal to the US Shareholder’s net CFC tested income for such taxable year, less its net
deemed tangible income return (“DTIR”) for such taxable year.
  − A US Shareholder’s DTIR is generally equal to 10% of the aggregate of such US Shareholder’s pro rata share of the qualified
business asset investment (“QBAI“) of each of its CFCs, less interest expense taken into account in determining net CFC tested
income.
  − Tested income/loss generally includes all items of a CFC’s income, deduction, gain, or loss other than certain specified types of
income, such as items included in subpart F or dividends received from a related person.

• With regard to pass-through entities, the proposed regulations under sections 951 and 951A provide, in part, that:
  − A domestic partnership that is a US Shareholder of a CFC generally has a GILTI inclusion (under the general rules for US
Shareholders of CFCs);
  − A partner of a US Shareholder partnership that is itself a US Shareholder of a CFC owned by the partnership does not take into
account its distributive share of GILTI from the partnership and instead takes into account its pro rata share of the CFC’s tested
items and determines GILTI at the partner level;
  − Non-US Shareholder partners of a US Shareholder partnership take into account their distributive share of the partnership’s
GILTI;
  − Certain domestic partnerships are treated as foreign partnerships for purposes of sections 951-964; and
  − The adjusted basis of specified tangible property of a partnership is included in the QBAI of a partner that is a tested income CFC
(and rules are provided to determine the partner’s share of such basis).
Facts
- US1 and US2 each own 5% and 95%, respectively, of a foreign partnership, FP.
- FP owns 100% of the single class of stock of FC1, a CFC.
- US2 owns 100% of the single class of stock of FC2, a CFC.
- In Year 1, FC1 has $100 of tested income, and FC2 has $25 of tested loss.

Analysis
- No partnership-level calculations are performed because FP is not a US Shareholder.
- US1 is not a US Shareholder with respect to either FC1 or FC2. Therefore US1 has no GILTI inclusion for the year.
- US2 is a US Shareholder with respect to both FC1 and FC2. Therefore US2 computes its GILTI inclusion by taking into account its pro rata share of the CFC tested items of FC1 and FC2.
  - Under section 958(a)(2), US2 owns stock of FC1 in proportion to its interest in FP (95%). Accordingly, US2’s pro rata share of FC1’s tested income is $95 ($100 x 95%).
  - US2’s pro rata share of FC2’s tested loss is $25 ($25 x 100%).
  - US2’s net CFC tested income is $70 ($95 - $25), and US2’s GILTI inclusion amount is $70.
- US2 increases the basis of its interest in FP by $70 under section 961(a).
- May FP increase its basis in FC1 stock for the GILTI amount included by US2 with respect to its interest in FC1 that is held indirectly through FP?
  - The proposed regulations under section 965 provided for a specified basis adjustment to be made by a foreign partnership, with respect to the US Shareholder partner, to the foreign corporation stock. See Prop. Reg. § 1.965-2(h)(5)(ii).
  - The proposed regulations under section 951A are silent as to section 961 basis adjustments with respect to foreign partnerships.
  - The preamble requested comments on the application of section 961 to domestic partnerships with US Shareholder partners.

*All entities have taxable years ending on 12/31
GILTI
Domestic Partnerships with US Shareholder Partners

• A domestic partnership that is a US Shareholder of a CFC (a “US Shareholder Partnership”) determines its GILTI inclusion amount under the general rules applicable to US Shareholders.

• However, the proposed regulations rules apply special rules to the partners’ distributive shares of the US Shareholder Partnership’s GILTI inclusion amount depending on whether each partner is itself a US Shareholder of the CFC owned by the US Shareholder Partnership.
  - Each partner of a US Shareholder Partnership that is not a US Shareholder of the CFC takes into account its distributive share of the US Shareholder Partnership’s GILTI inclusion amount.
  - If the partner is a US Shareholder of the CFC (a “US Shareholder Partner”):
    ◦ Section 958(a) stock owned by the US Shareholder Partnership is treated as section 958(a) stock owned by the US Shareholder Partner (in the same manner as if the US Shareholder Partnership was treated as a foreign partnership under section 958);
    ◦ The US Shareholder Partner determines its pro rata share of any CFC tested item (e.g., tested income, tested loss, QBAI, etc.) by reference to the section 958(a) stock owned by the US Shareholder Partner (based on application of the previous rule); and
    ◦ The US Shareholder Partner’s distributive share of the GILTI inclusion amount of the US Shareholder Partnership is determined without regard to the partnership’s pro rata share of any CFC tested item of the CFC.

• The rules apply to tiered US Shareholder Partnerships.

• The proposed regulations requested comments on adjustments to the partner’s basis in its partnership interest, the partner’s section 704(b) capital account, the partnership’s basis in CFC stock under section 961, and a CFC’s previously taxed earnings and profits with respect to the partner or partnership under section 959.
**Facts**

- US1 and US2 each own 5% and 95%, respectively, of a domestic partnership, PRS.
- PRS owns 100% of the single class of stock of FC1, a CFC.
- US2 owns 100% of the single class of stock of FC2, a CFC.
- In Year 1, FC1 has $100 of tested income, and FC2 has $25 of tested loss.

**Analysis**

- **Partnership-level calculation**
  - PRS is a US Shareholder partnership with respect to FC1.
  - PRS’s pro rata share of FC1’s tested income is $100 ($100 x 100%).
  - PRS’s GILTI inclusion amount is $100.

- **Partner-level calculation – US1**
  - US1 is not a US Shareholder partner with respect to FC1.
  - US1 includes in income its distributive share ($5) of PRS’s GILTI inclusion amount.

- **Partner-level calculation – US2**
  - Because US2 is a US Shareholder of FC1:
    - US2 is treated as owning section 958(a) stock of FC1 proportionately as if PRS were a foreign partnership.
    - Thus, US2’s pro rata share of FC1’s tested income is $95 ($100 x 95%).
    - US2’s distributive share of PRS’s GILTI inclusion amount is determined without regard to PRS’s pro rata share of any item of FC1.
  - US2’s pro rata share of FC2’s tested loss is $25 ($25 x 100%). Accordingly, US2’s net CFC tested income is $70 ($95 - $25).
  - US2’s GILTI inclusion amount is $70.
  - This result is the same as if the partnership was a foreign partnership.

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**GILTI Example: US Shareholder Partner**

*All entities have taxable years ending on 12/31*
GILTI
Example: Capital Accounts and Basis Adjustments for US Shareholder Partners

Facts
• Same facts as the prior example.

Analysis
• Capital Accounts
  – Under the general rule, PRS has a GILTI inclusion of $100 and allocates that amount to its partners.
  – US1’s capital account is increased by its share of PRS’s GILTI ($5).
  – However, the special rule for US Shareholder partners provides that US2 does NOT take into account its distributive share of PRS’s GILTI ($95).
  – Is there an increase to US2’s capital account for the share of GILTI that it would have included in the absence of the US Shareholder Partner rule?
  – If US2’s capital account is not increased, how do the partners maintain the economics of the partnership?

• Outside Basis
  – US1 increases its basis in PRS by the amount of its allocation of GILTI ($5) under section 705(a).
  – Does US2 have any adjustment to the basis of its interest in PRS under section 705?
  – Does US2 treat PRS as a foreign partnership for purposes of section 961 such that it increases its basis in the partnership under section 961(a)?
  – Section 951A(f)(1)(A) and Prop. Reg. § 1.951A-6(b)(1) provide that a GILTI inclusion is treated as a subpart F inclusion for purposes of section 961.

• Inside Basis
  – By what amount does PRS increase its basis in FC1 stock under section 961(a)?
    ▪ Under the general rule, PRS has a GILTI inclusion of $100.
    ▪ However, as a result of the US Shareholder Partner rule, the portion of PRS’s GILTI inclusion allocated to US2 ($95) is not included in any partner’s income.
  – If the basis adjustment to FC1 stock is $5, is the adjustment attributable only to US1 in the event of a disposition or PTI distribution?

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GILTI
Example: Indirect Individual U.S. Shareholders and Section 962 Elections

Facts
• A and B (each a US individual) own 5% and 95%, respectively, of a domestic partnership, PRS.
• PRS owns 100% of the single class of stock of FC1, a CFC.
• FC1 has $100 of tested income in Year 1.

Analysis
• Similar to the corporate shareholder example –
  – A has a distributive share of $5 of GILTI from PRS; and
  – B has GILTI of $95 (equal to B’s pro rata share of FC1 tested income, $95).
• In general, the section 250 deduction and section 960(d) foreign tax credits are not allowed for an individual taxpayer.
• However, an individual US shareholder that makes a section 962 election –
  – Is subject to corporate, rather than individual, tax rates on its GILTI (and subpart F income); and
  – Is eligible to claim section 960 foreign tax credits as if the CFC inclusion were received by a domestic corporation.
  – Does a section 962 election allow an individual US shareholder to take the section 250 deduction?
• In the case of a section 962 election, the section 961(a) basis adjustment is limited to the amount of tax paid with respect to the individual’s CFC inclusions.
  – Where the CFC stock is owned through a domestic partnership, does the basis adjustment limitation apply to the individual’s basis in the partnership or the partnership’s basis in the stock?
• To the extent a dividend from the CFC is not excluded from the individual’s income under section 962(d), is the taxable dividend treated as a qualified or ordinary dividend?
• Prop. Reg. § 1.962-2(a) provides that the section 962 election may be made by an individual who is a US shareholder because they are considered to own stock of a CFC under section 958(b) that is directly or indirectly owned by a domestic partnership (under section 958(a)).

*All entities have taxable years ending on 12/31
GILTI
Example: Pro Rata Share through Foreign Partnerships

Prop. Reg. § 1.951-1(e)(1)(i) provides, in general, that a US Shareholder’s pro rata share of a CFC’s subpart F income for a taxable year is the percentage of the CFC’s subpart F income equal to:
- The amount of the corporation’s current E&P that would be distributed with respect to the stock of the CFC owned, within the meaning of section 958(a), by the US Shareholder, divided by
- The total amount of the CFC’s current E&P that would be distributed with respect to the stock owned by all the shareholders if the CFC’s current E&P for the taxable year (not reduced by actual distributions) were distributed on the last day of the CFC’s taxable year.

The proposed regulations do not modify the ownership rules under section 958(a).

Treas. Reg. § 1.958-2(b) provides that stock owned by a foreign partnership shall be considered as being owned “proportionately” by its partners; and Treas. Reg. § 1.958-2(c)(2) provides that a person’s proportionate interest in a foreign partnership will be made on the basis of all facts and circumstances.

How is a partner’s proportionate interest in a foreign partnership determined for purposes of section 958(a) where the foreign partnership has common and preferred interests?
- Treas. Reg. § 1.958-2(c)(2) suggests a person’s proportionate interest in a foreign entity, for purposes of determining the amount of stock owned for subpart F inclusions, should generally be determined based on the person’s interest in the income of the foreign entity.
- A preferred interest with first priority to net income could shift proportionate ownership to the preferred equity owner in years with net income. If net income fluctuates over multiple tax years, proportionate ownership would also fluctuate.
- How would a year with an overall net loss affect proportionate ownership?
- If the preferred interest is payable on gross income and, as a result, the common owners receive a net loss, is it appropriate for the preferred equity owner to be treated as owning all stock owned by the foreign partnership?

Would it be appropriate to treat the partnership’s capital structure similar to a situation in which the foreign corporation has multiple classes of stock?
- The proposed regulations provide special rules for CFCs with more than one class of stock.
- The proposed regulations purport to take into account “any agreement among the shareholders.” Could a foreign partnership be treated as such an agreement?

*All entities have taxable years ending on 12/31
GILTI
Special Rule for Partnership Blocker Structures

- For purposes of sections 951 through 964, certain controlled domestic partnerships are treated as foreign partnerships for purposes of determining the stock of a CFC owned within the meaning of section 958(a) by a US person. See Prop. Reg. § 1.951-1(h).

- This rule is similar to the controlled domestic partnership rule in the proposed section 965 regulations, but it applies to GILTI and subpart F inclusions.

- A controlled domestic partnership is treated as foreign for the purposes described above if:
  - The controlled domestic partnership owns section 958(a) stock of a CFC; and
  - If the controlled domestic partnership is treated as foreign –
    - The CFC would continue to be a CFC within the meaning of section 957; and
    - At least one US Shareholder of the CFC would be treated as owning section 958(a) stock of the CFC through another foreign corporation that is a direct or indirect partner in the controlled domestic partnership.

- A controlled domestic partnership is a domestic partnership that is controlled by:
  - The US Shareholder (that would be treated as owning section 958(a) stock through a foreign corporation that is a direct or indirect partner in the domestic partnership if the domestic partnership were treated as foreign); and
  - Persons related to that US Shareholder within the meaning of section 267(b) or 707(b)(1).

- There is a presumption that a domestic partnership is controlled if the US Shareholder and related persons own (directly or indirectly through partnerships) more than 50 percent of the interests in the partnership’s capital or profits.
GILTI
Determining a CFC Partner’s Share of Partnership QBAI

• A tested income CFC partner generally increases its QBAI by the CFC’s “partnership QBAI” for the CFC inclusion year.

• Partnership QBAI means the CFC’s share of the partnership’s adjusted basis in partnership specified tangible property (“PSTP”) as of the close of the partnership’s taxable year that ends with or within the CFC inclusion year.

• PSTP is tangible property of a partnership that is used in the partnership’s trade or business, subject to depreciation under section 167, and used in the production of tested income.

• The partnership’s adjusted basis in PSTP is based on the average of the partnership’s adjusted basis in the property as of the close of each quarter in the partnership taxable year.

• The CFC partner’s share of the partnership’s adjusted basis in PSTP is determined separately for each item of PSTP by multiplying (1) the CFC’s partnership QBAI ratio with respect to the property and (2) the partnership’s adjusted basis in the property.

• The Partnership QBAI ratio, with respect to an item of PSTP is equal to either:
  - If the PSTP produces directly identifiable income, the ratio of (1) the CFC partner’s distributive share of the gross income produced by the property that is included in the gross tested income of the CFC to (2) the total gross income produced by the property; or
  - If the PSTP does not produce directly identifiable income, the ratio of (1) the CFC partner’s distributive share of the gross income of the partnership that is included in the gross tested income of the CFC to (2) the total gross income of the partnership.

• The partnership QBAI ratio is determined separately for each PSTP for each partnership taxable year.

• Note that a tested loss CFC has no partnership QBAI for a CFC inclusion year.
Partnership QBAI
Example: General Rules

Facts
- USP owns FC, a tested income CFC. FC is a partner in FP, a foreign partnership.
- FP owns two assets, Asset A and Asset B, both of which are tangible property used in FP’s trade or business that it depreciates under section 168.
- The average of FP’s adjusted basis as of the close of each quarter of FP’s taxable year in Asset A is $100 and the average of FP’s adjusted basis as of the end of each quarter of FP’s taxable year in Asset B is $50.
- Asset A produces $10 of directly identifiable gross income in Year 1, and FC’s distributive share of the gross income from Asset A is $8. Asset B produces $50 of directly identifiable gross income in Year 1, and FC’s distributive share of the gross income from Asset B is $10.
- FC’s entire distributive share of income from Asset A and Asset B is included in FC’s gross tested income for Year 1.

Analysis
- Each of Asset A and Asset B is partnership specified tangible property because each is tangible property, of a type with respect to which a deduction is allowable under section 167, used in FP’s trade or business, and used in the production of tested income.
- **Is the proportion of gross income determined by reference to taxable income or section 704(b) income?**
  - FC’s share of the average of FP’s adjusted basis of Asset A is $80, which is equal to FP’s adjusted basis in Asset A of $100 multiplied by FC’s partnership QBAI ratio for Asset A of 80% (because FC is allocated $8 of the $10 of gross tested income produced by Asset A for the year).
  - FC’s share of the average of FP’s adjusted basis of Asset B is $10, which is equal to FP’s adjusted basis in Asset B of $50 multiplied by FC’s partnership QBAI ratio for Asset B of 20% (because FC is allocated $10 of $50 of gross tested income produced by Asset B for the year).
- Therefore, FC’s partnership QBAI with respect to FP is $90 ($80 + $10). Accordingly, under Prop. Reg. § 1.951A-3(g)(1), FC increases its qualified business asset investment for Year 1 by $90.

*All entities have taxable years ending on 12/31
Partnership QBAI
Example: Mid-Year Dispositions

**Facts**
- USP owns FC, a CFC. FC owns a 50% interest in FP, a foreign partnership.
- On 6/30, FC sells all of its interest in FP. For the period 1/1 – 6/30, FP allocates $120 of income to CFC. None of FP’s income is of a type that would be excluded from tested income.
- FP’s average adjusted basis in partnership specified tangible property (“PSTP”) for the year is $600.

**Analysis**
- The proposed regulations define partnership QBAI as a CFC’s share of the partnership’s adjusted basis in PSTP as of the close of the partnership’s taxable year that ends with or within the CFC inclusion year.
- However, Prop. Reg. § 1.951A-1(g)(1) provides that a tested income CFC’s QBAI is increased by its partnership QBAI only if the tested income CFC “holds an interest in one or more partnerships as of the close of the CFC inclusion year.”
- Section 951A(d)(3) [sic] has similar language requiring the CFC to hold a partnership interest at the close of the CFC’s taxable year.
- **Does FC take into account any partnership QBAI with respect to FP?**
  - FC does not own an interest in FP as of the close of the CFC inclusion year (12/31).
  - Under section 706(c)(2)(A), FP’s taxable year closes with respect to FC on 6/30. Thus, FP’s taxable year, with respect to FC, ends within the CFC inclusion year.
  - The partnership QBAI could be computed by reference to FC’s share of gross income of the relevant items of PSTP (or FC’s share of the partnership’s gross income for PSTP without directly identifiable income).
- **FC’s distributive share of income from FP ($120) is included in FC’s tested income.**
  - FP’s tested income has a direct connection to the adjusted basis of FP’s PSTP, but FC may be required to include tested income and exclude QBAI with respect to its interest in FP.

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*All entities have taxable years ending on 12/31*
Partnership QBAI
Example: Section 743(b) Adjustments

Facts

• USP owns FC, a CFC. On 1/1, FC purchases a 50% interest in FP, a foreign partnership, and FP makes a section 743(b) adjustment of $100 with respect to FC as a transferee partner.

• The section 743(b) adjustment is allocated to property of the partnership that is partnership specified tangible property (“PSTP”). FP’s common basis in PSTP for the year is $600.

Analysis

• Is the section 743(b) adjustment included in FC’s partnership QBAI?
  − PSTP is tangible property that is (1) used in the partnership’s trade or business, (2) depreciable under section 167, and (3) used in the production of tested income. Prop. Reg. § 1.951A-3(g)(2)(iii).
  − If the property to which the section 743(b) adjustment is allocated under section 755 is PSTP, the adjusted basis attributable to the adjustment may be considered adjusted basis of PSTP.
  − A parenthetical in the anti-abuse rule of the proposed regulations suggests that the government thinks section 743(b) adjustments can give rise to partnership QBAI.
    ◦ The anti-abuse rule provides, in part, that a disqualified transfer is a transfer of specified tangible property during the disqualified period.
    ◦ For purposes of determining whether a disqualified transfer occurred, the rules take into account “an indirect transfer (for example, a transfer of an interest in a partnership is treated as a transfer of the assets of the partnership and transfer by or to a partnership is treated as a transfer by or to its partners).” Prop. Reg. § 1.951A-3(h)(2)(ii)(C).
  − Partnership QBAI is a function of the partnership’s adjusted basis in PSTP. Is a section 743(b) adjustment included in the partnership’s basis of property?

• If the section 743(b) adjustment gives rise to QBAI, how is the partner’s share determined?
  − Because the adjustment is made only with respect to one partner, it should be QBAI for that partner. However, there is no mechanism to ensure that the section 743(b) partner benefits from the QBAI.
  − The general rule for attributing QBAI to partners based on relative gross income does not clearly align with the framework of section 743(b).
    ◦ Would the gross income of the property to which the section 743(b) adjustment is allocated take into account all gross income of the property, or only the gross income attributable to the section 743(b) adjustment?
    ◦ What if the section 743(b) adjustment is positive and its recovery produces no gross income?

743(b) adjustment with respect to FC: $100
Avg. adjusted basis of PSTP: $600
Income (included in tested income): $120

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3. Foreign-Derived Intangible Income ("FDII")
FDII
Example: QBAI Through Partnerships

• The deemed tangible income return (“DTIR”) for purposes of FDII is determined using the rules for determining the DTIR for purposes of GILTI.
  - Section 250(b)(2)(B) cross-references to section 951A(d).
  - As discussed on prior slides, the proposed regulations under section 951A provided special rules for determining a partner’s share of basis in specified tangible property owned by a partnership.
  - Similar to GILTI, it is expected that the rules for attributing QBAI to a partner will generally apply to domestic and foreign partnerships.

• Similar QBAI issues/questions appear to be present for FDII as for GILTI, including:
  - Whether the proportion of QBAI attributable to a partner is based on the partner’s share of section 704(b) or taxable income;
  - Whether a section 743(b) adjustment gives rise to QBAI (and how it is attributable to the partner(s)); and
  - Whether a partner has a share of QBAI from a partnership the interest of which the partner does not own at the close of the partner’s taxable year.

• In addition, determining QBAI for purposes of FDII introduces new issues, such as:
  - Coordination with foreign branch income rules under section 904(d)(2)(J) because deduction eligible income (“DEI”) does not include foreign branch income.
    ◦ The proposed foreign tax credit regulations provide that a partnership may be treated as holding a foreign branch if the partnership carries on trade or business activities in a foreign country.
  - Whether a domestic corporate partner takes into account its distributive share of items that would be DEI and foreign derived DEI if earned directly by the partner for purposes of computing the FDII of the domestic corporate partner.
    ◦ If a domestic corporate partner does not take into account DEI earned through a partnership, but does take into account its share of QBAI from a partnership, there would generally be an increase to the partner’s DTIR without any corresponding effect on the partner’s DEI and foreign derived DEI.
    ◦ The JCT Blue Book suggests that the section 250 deduction is available to a domestic corporate partner. General Explanation of P.L. 115-97, Joint Committee on Taxation, at 377 fn 1727.

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4. Base Erosion and Anti-Abuse Tax ("BEAT")
BEAT and Partnerships
Overview

• Section 59A uses the terms –
  – “Taxpayer” which is not defined in section 59A, and
  – “Applicable taxpayer” which refers only to a corporation.

• A base erosion payment includes (but is not limited to) any amount paid or accrued by a “taxpayer” to a foreign person which is a related party of the taxpayer –
  – With respect to which a deduction is allowable under Chapter 1 of the Code, or
  – For property that is subject to the allowance for depreciation or amortization.

• A base erosion tax benefit generally includes (but is not limited to) –
  – Any deduction allowed with respect to a base erosion payment, or
  – Any depreciation or amortization allowed for depreciation or amortization with respect to property acquired with a base erosion payment.

• For BEAT purposes, a “related party” is defined by its relationship to “the taxpayer.” See section 59A(g).

• A foreign person is defined as any person other than a US person and apparently includes a foreign partnership.
BEAT and Partnerships
Overview of Proposed Regulations

• The proposed BEAT regulations generally adopt an aggregate approach to partnerships.

• For purposes of determining whether a base erosion payment is made –
  – A payment made BY a partnership is treated as paid or accrued by the partners (in proportion to their distributive share of the deductions with respect to the payment), and
  – A payment made TO a partnership is treated as paid or accrued to the partners (in proportion to their distributive share of the income with respect to the payment).

• For purposes of computing base erosion tax benefits, a partner takes into account their distributive share of a partnership’s base erosion tax benefits unless –
  – The partner own less than 10% of the capital and profits interests in the partnership,
  – The partner receives less than 10% of each partnership item, and
  – The partner’s interest in the partnership has a FMV less than $25 million (the “de minimis exception”).

• The determination of related party status is made at the partner level.

• Other special partnership rules include the following:
  – For purposes of determining a partner’s gross receipts, the partner takes into account their share of the partnership’s gross receipts in proportion to the partner’s distributive share of gross income.
  – If a partnership is a registered securities dealer, each partner is treated as a registered securities dealer unless the de minimis exception applies.
Proposed Regulations under Section 59A
Example: Aggregate Approach to Partnerships

Facts
- PRS, a partnership, makes a $100 cash payment to FC1, a CFC, for depreciable property worth $100.
- US1 owns 95% of the capital and profits interests in PRS; US2 owns the remaining 5% of the interests.
- USP is an applicable taxpayer.

Analysis
- **US1**:
  - US1 is treated as paying $95 to FC1 because US1’s distributive share of the deductions with respect to the payment of $100 by PRS is expected to be $95. Prop. Reg. § 1.59A-7(b)(2).
  - Query how to determine the extent to which US1 is treated as making the payment if the allocation of the depreciation deductions will occur over multiple tax years and partnership allocations of the depreciation may change over time (e.g., as a result of special or regulatory allocations).
- The related party test is applied at the partner level and US1 is related to FC1 within the meaning of section 267(b). Prop. Reg. §§ 1.59A-1(b)(17)(i)(B) and 1.59A-7(c).
- Therefore, the $95 payment that is treated as made by US1 to FC1 is a base erosion payment.
- US1’s amount of base erosion tax benefits includes its distributive share of the depreciation deductions “with respect to the property acquired with [the base erosion payment].”
  - Query if 100% of US1’s distributive share of depreciation is considered to be depreciation “with respect to” the $95 payment that is treated as made by US1. In other words, is any portion of the $95 of base erosion tax benefit treated as allocated (in part) to any other partner?

*All entities have taxable years ending on 12/31*
Proposed Regulations under Section 59A
Example: Aggregate Approach to Partnerships (continued)

**Facts**
- PRS, a partnership, makes a $100 cash payment to FC1, a CFC, for depreciable property worth $100.
- US1 owns 95% of the capital and profits interests in PRS; US2 owns the remaining 5% of the interests.
- USP is an applicable taxpayer.

**Analysis (continued)**
- **US2:**
  - US2 is treated as paying $5 to FC1 because US2’s distributive share of the deductions with respect to the payment of $100 by PRS is expected to be $5. Prop. Reg. § 1.59A-7(b)(2). Note there is no de minimis exception for the aggregate approach to determining base erosion payments (as opposed to base erosion tax benefits).
  - The related party test is applied at the partner level and US2 is not related to FC1 within the meaning of section 267(b). Prop. Reg. §§ 1.59A-1(b)(17)(i)(B) and 1.59A-7(c).
  - Therefore, the $5 payment that is treated as made by US2 to FC1 is not a base erosion payment.
  - In addition, US2 may qualify for the de minimis exception to taking into account its share of PRS’s base erosion tax benefits if the value of its PRS interest is less than $25 million.

**Takeaways:**
- The aggregate approach generally results in the application of section 59A to transactions that would have been subject to BEAT if the partners had engaged in them directly, rather than through a partnership.
- There is uncertainty regarding the determination of each partner’s proportionate amount of a payment by or to a partnership.

*All entities have taxable years ending on 12/31*
Proposed Regulations under Section 59A
Example: Contribution by a Foreign Partner

Facts
- FC1, a CFC, and US1, a domestic corporation, own 25% and 75%, respectively, of PRS, a partnership.
- FC1 acquires depreciable property for $100 and immediately contributes the property to PRS in exchange for an additional interest in the partnership. The contribution increases FC1’s ownership from 25% to 40% and dilutes US1’s ownership from 75% to 60%.
- The contribution is not part of any disguised sale of property or partnership interests.

Analysis
- The proposed regulations provide that transfers of cash and non-cash consideration can be payments for purposes of determining base erosion payments. The preamble cites transactions under sections 351, 332, and 368 as examples of non-cash payments.
- The preamble also provides that “if a foreign related party and a taxpayer form a partnership, and the foreign related party contributes depreciable property, deductions for depreciation of the property generally are base erosion tax benefits, in part, because the partnership is treated as acquiring the property in exchange for an interest in the partnership under section 721.”
  - It appears the construct is that the “payment” by the partnership (in the form of issuing an equity interest) may be treated as made, in part, by a domestic partner under the general rules for applying the aggregate approach to base erosion payments. Then, the depreciation deductions of the property that are taken with respect to the base erosion payment are treated as base erosion tax benefits.
  - Alternatively, because each partner is treated as owning its share of partnership assets, it may be that US1 is treated as purchasing, directly from FC1, the portion of the property contributed by FC1 that is treated as owned by US1.
- The proposed regulations generally apply to tax years beginning after 12/31/2017, so 2018 transactions may be affected if this rule if finalized and applied retroactively.
- Query if this result is appropriate. Consider that (1) the contributing partner’s interest in the partnership and the partnership’s income is increased as a result of the contribution, (2) the non-contributing partner has experienced dilution which may not be economically equivalent to a “payment,” and (3) a section 721 transaction may be distinguished from the corporate examples cited by the preamble because the taxpayer (US1) is not the entity that issues equity in exchange for the depreciable property.

*All entities have taxable years ending on 12/31
Proposed Regulations under Section 59A
Example: Taxpayer Aggregation Rule

- For purposes of defining an “applicable taxpayer” and computing the base erosion percentage, all persons treated as a single employer under section 52 are treated as a single person. Section 59A(e)(3).
- Generally, corporations in the same section 1563 controlled group are treated as a single employer.
- For purposes of section 59A(e)(3), the exclusion of foreign corporations from a section 1563 controlled group does not apply.
- Under section 1563(a)(2), two or more corporations are in a “brother-sister controlled group” if 5 or fewer persons who are individuals, estates, or trusts own more than 50% of the total combined vote or value of the stock of each corporation.
  - **For purposes of section 59A(e)(3), does the modified “brother-sister controlled group” definition under section 1563(f)(5) apply?** Under the modified definition, 5 or fewer individuals, estates, or trusts must own at least 80% of the vote and more than 50% of the value of stock.
- For purposes of determining section 1563 stock ownership, stock owned by a partnership is treated as owned by a partner who has an interest in the partnership’s capital or profits of 5% or more (in proportion to the partner’s capital or profits interest, whichever is greater). Section 1563(e)(2).
  - **How is voting stock determined when it is held by a partnership that has a general partner (or a partner with effective managerial control)?**
  - **In this example, is GP treated as owning all of the voting stock of FC1, FC2, US1, and US2?**

*All entities have taxable years ending on 12/31*
5. Section 163(j) Interest Expense Limitation
In General

- Prop. Reg. § 1.163(j)-7(b)(4)(i) provides that if one or more CFC group members of the same CFC group, in the aggregate, own more than 80 percent of the interests in the capital or profits in a partnership, then the partnership is treated as a CFC group member. This provision, moreover, applies to foreign and domestic partnerships.

- However, the Proposed Regulations also provide an exception for certain partnerships that are engaged in a U.S. trade or business. Specifically, Prop. Reg. § 1.163(j)-7(b)(4)(ii) provides that a partnership is not treated as a CFC group member "if the partnership is engaged in a trade or business in the United States, directly or indirectly through another pass-through entity, and one or more partners has income that is effectively connected with the conduct of a trade or business in the United States . . . and at least one of the partners is not exempt from U.S. tax by reason of a U.S. income tax treaty."

CFC Group Member’s Business Interest Expense

- The amount of a CFC group member’s business interest expense that is subject to section 163(j) is equal to the CFC group member’s allocable share of the CFC group’s applicable net business interest expense. Prop. Reg. § 1.163(j)-7(b)(3). A CFC group member will have an allocable share only if the CFC group member actually incurred business interest expense. Prop. Reg. § 1.163(j)-7(f)(1)(i).

- Query what results when a CFC owned partnership only incurs investment interest expense.
International Provisions of Section 163(j)  
Examples: CFC Owned Partnerships – ETI and ATI

**Scenario A**

Even though CFC owned partnerships are treated as CFC group members, they still have excess taxable income (“ETI”) (as opposed to CFC group ETI).

- Prop. Reg. § 1.163(j)-7(b)(4)(i) provides that “if a partnership is treated as a CFC group member, then an interest in the partnership is treated as stock for purposes of applying this section.”
- The preamble of the Proposed Regulations, however, clarifies that a CFC owned partnership cannot have CFC group ETI because “under the statute and proposed § 1.163(j)-6, the partnership has excess taxable income and such excess taxable income is allocated to partners of the partnership.”
- Accordingly, if a CFC owned partnership has ETI and allocates a portion of that ETI to a partner that is a CFC group member, the allocated ETI presumably increases CFC group ETI. See Prop. Reg. § 1.163(j)-7(c)(3)(ii), which provides that “[i]f an upper-tier member is a partner in a lower-tier member that is a partnership, which is an entity that does not have CFC excess taxable income but that may have excess taxable income (as defined in §1.163(j)-1(b)(15)), see § 1.163(j)-6(f) [i.e., the eleven step process] for determining the upper-tier member’s share of the lower-tier member’s excess taxable income (if any).”

**Scenario B**

If a CFC owned partnership owns another CFC group member, the CFC owned partnership increases its ATI by its pro rata share of the lower-tier CFC group member’s CFC ETI.

- The preamble to the Proposed Regulations provides that “a higher-tier member that is a partnership may take into account a pro rata share of the CFC excess taxable income of a lower-tier member, other than a partnership, which does not have CFC excess taxable income, for purposes of computing the higher-tier member partnership’s ATI and determining if the higher-tier member partnership has excess taxable income that may be allocated to CFC group members that are partners.”

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**Diagram:**

- **Scenario A**
  - CFC owned partnership (USP) with ETI
  - CFC group member
  - ETI allocation to CFC group member

- **Scenario B**
  - CFC owned partnership (USP) with ETI
  - CFC group member
  - ETI allocation to another CFC group member
International Provisions of Section 163(j)
Examples: CFC Group ETI and Partnerships with Domestic Partners

Scenario A - Foreign Partnership:
- If
  - a domestic corporate partner (i.e., a U.S. shareholder) holds an interest in a foreign partnership, and
  - the foreign partnership owns a top-tier CFC group member
- then, the domestic corporate partner increases its ATI by eligible CFC group ETI (which is determined under a three-part formula in the proposed regulations).
- Said simply, some portion of the CFC group ETI passes over the foreign partnership. See Prop. Reg. § 1.163(j)-7(d)(2)(i).

Scenario B - Domestic Partnership:
- If a domestic corporate partner holds an interest in a domestic partnership (i.e., a U.S. shareholder) and the domestic partnership owns a top-tier CFC group member, the domestic partnership is treated as foreign.
- In other words, some portion of the CFC group ETI passes over the domestic partnership as well. See Prop. Reg. § 1.163(j)-7(d)(3).
International Provisions of Section 163(j)
Examples: Domestic Partnership GILTI Not Included in ATI

- If a U.S. shareholder owns a CFC, the U.S. shareholder is required to increase its taxable income each year by the amount of its GILTI inclusion. Thus, if a U.S. shareholder’s GILTI inclusion is attributable to a trade or business, the U.S. shareholder would include its GILTI inclusion in its ATI absent a rule to the contrary.

- This approach, however, could result in the double counting of income. Prop. Reg. § 1.163(j)-7(d)(1)(i) therefore provides that a U.S. shareholder’s ATI is computed without respect to its GILTI inclusion that is attributable to a trade or business. Accordingly, a domestic partnership’s GILTI that is attributable to a trade or business does not increase its ATI. This applies regardless whether the domestic partnership is a CFC owned partnership (Scenario A) or has domestic partners (Scenario B).

- Moreover, even if a domestic partnership’s GILTI inclusion is attributable to investment, Prop. Reg. § 1.163(j)-7(d)(1)(ii) further provides that a corporate partner’s distributive share of the GILTI inclusion is still not attributable to a trade or business and, therefore, cannot increase the corporate partner’s ATI. Cf. Prop. Reg. § 1.163(j)-4(b)(3), which provides, in part, that any investment income, within the meaning of section 163(d), that a partnership receives or accrues and that is allocated to a corporate partner is treated by the corporate partner as properly allocable to a trade or business of that partner.
6. Foreign Tax Credits
Facts
• US1 and US2 are the only partners of FP, a foreign partnership. US1 and US2 are in the affiliated group of which USP is the parent.
• USP lent money to FP and FP makes annual interest payments of $100 to USP.

Analysis
• In general, a partner’s distributive share of interest expense is apportioned among statutory and residual groupings for purposes of the foreign tax credit limitation under section 904. See Treas. Reg. §§ 1.861-8(e)(2), 1.861-8(f), and 1.861-9.
• The proposed regulations under section 861 provide special rules for the treatment of specified partnership loans. A specified partnership loan is a loan to a partnership for which the loan receivable is held, directly or indirectly (through one or more other partnerships), either by –
  − A person that owns an interest, directly or indirectly, in the obligor partnership, or
  − A person in the same affiliated group as that person. See Prop. Reg. § 1.861-9(e)(8).
  − If a loan receivable is transferred (with a principal purpose of avoiding the specified partnership loan rules) to a CFC with respect to which a U.S. shareholder owns an interest, directly or indirectly, in the obligor partnership, the loan is treated as held directly by the U.S. shareholder.
• If the person that holds a specified partnership loan (or a person in the same affiliated group) takes into account a distributive share of the partnership’s interest expense on that specified partnership loan –
  − The matching amount of interest income is included in the same statutory and residual groupings from which the specified partnership loan interest expense is deducted;
  − The specified partnership loan is not treated as an asset of the person for purposes of apportioning interest expense that is not directly allocable under other provisions of the section 861 regulations.
• The principles of the specified partnership loan rules also apply to transactions involving interest equivalents.
Facts
• US1 and US2 are the only partners of FP, a foreign partnership.
• FP owns 100% of DRE1, a foreign company that is disregarded for U.S. federal income tax purposes.
• DRE1 engages in a trade or business in a foreign country (the “Foreign Business”) and does not earn any income effectively connected with a U.S. trade or business.

Analysis
• US2’s distributive share of income from FP is generally passive under Prop. Reg. § 1.904-4(n) because US2 owns less than 10% of the value of the partnership.
• Because US1 owns at least 10% of the value of FP, US1’s distributive share of income from FP may be characterized on a look-through basis. Generally, look-through applies to treat the income –
  – First, as passive category income to the extent the distributive share is a share of passive income earned by the partnership as determined under Prop. Reg. § 1.904-5(h) or other provisions; and
  – Then, as foreign branch, section 951A, general, or other (e.g., treaty) category income under the rules of Prop. Reg. § 1.904-4.
• Assuming there is no passive income, US1’s distributive share of income from FP is foreign branch income to the extent it is attributable to a foreign branch held by the partnership directly or indirectly through a disregarded entity. Prop. Reg. § 1.904-4(f)(1)(B).
  – The Foreign Business is a foreign branch within the meaning of Prop. Reg. § 1.904-4(f)(3)(iii) because the activities comprise a foreign branch and constitute a trade or business and the proposed regulations deem the satisfaction of the books and records requirement. See Prop. Reg. § 1.904-4(f)(3)(iii)(C)(1).
  – In general, gross income is attributable to a foreign branch to the extent the gross income is reflected on the books and records of the foreign branch. Prop. Reg. § 1.904-4(f)(2)(i).
  – US1’s distributive share of income from FP is therefore foreign branch income to the extent it is reflected on the books and records of the Foreign Business.
• Query whether section 704(c) allocations of remedial income and deduction are considered to be “attributable to” a foreign branch.

Foreign Tax Credit Separate Limitation Categories
Example: Foreign Branch
7. Section 245A Participation Exemption
Participation Exemption for Foreign Corporations Owned through Partnerships

Overview

General Rules

- Section 245A provides for a dividends received deduction ("DRD") for foreign-source dividends received by a domestic corporation from a "specified 10-percent owned foreign corporation" if the domestic corporation is a US Shareholder with respect to such foreign corporation.
- A “specified 10-percent owned foreign corporation” is a foreign corporation with respect to which any domestic corporation is a US Shareholder with respect to such corporation.
- The Conference Report provides that the meaning of “dividend received” is intended to be interpreted broadly and consistent with sections 243 and 245.
  - “For example, if a domestic corporation indirectly owns stock of a foreign corporation through a partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the partnership’s dividend from the foreign corporation.” H.R. Conf. Rep. No. 115-466, at 599 (2017).
  - Section 245A(g) provides regulatory authority to address the treatment of US Shareholders owning stock of a specified 10-percent owned foreign corporation through a partnership.

Holding Period Requirement

- Under section 246(c)(5), the section 245A DRD is available only if stock of the specified 10-percent owned foreign corporation is held by the “taxpayer” for more than 365 days within the 731-day period beginning 365 days before the dividend and ending 365 days after the dividend (the "Holding Period Requirement”).
  - For example, for a dividend paid on December 31, 2018, the 731-day period is December 31, 2017 through December 31, 2019.
  - For purposes of the Holding Period Requirement, the “taxpayer” is treated as holding stock for a period only if, for the entire period –
    - The “taxpayer” is a US Shareholder with respect to the foreign corporation; and
    - The foreign corporation is a specified 10-percent owned foreign corporation.
- Section 246(c)(3) provides that a taxpayer’s holding period includes date of disposition but not date of acquisition and does not include holding period described in section 1223(3).
  - The cross-reference to section 1223(3) arguably implies that the section 246 holding period takes into account the application of other provisions of section 1223.
- **Query who is the “taxpayer” in a situation where stock of the foreign corporation is held indirectly through a partnership?**
Participation Exemption for Foreign Corporations Owned through Partnerships
Application of Holding Period Requirement

- The Conference Report provides that US1 and US2 are expected to be eligible for the section 245A DRD on their distributive share of dividends received by PRS from FC1 if US1 and US2 had actually owned the stock of FC1 directly.
  - Therefore it must be determined whether US1 and US2 meet the Holding Period Requirement under section 246(c).

- **Should the Holding Period Requirement be tested with respect to the domestic corporate partners’ holding periods in PRS or PRS’s holding period in FC1?**
  - Rev. Rul. 68-79 provides that character is determined at the partnership level.
  - Section 735(b) provides that a partner’s holding period in property distributed from a partnership includes the partnership’s holding period in the property.
  - Sections 1223(1) and (2) also generally support the tacking of a partnership’s holding period to the partner’s holding period of property received in a distribution from the partnership.
  - If PRS is foreign and PRS’s holding period in FC1 is relevant, it appears US1 and US2 still need to be US Shareholders of FC1 for the duration of the holding period to qualify for the section 245A DRD.
  - **If PRS is a domestic partnership, can the domestic partnership satisfy the US Shareholder component of the Holding Period Requirement?**
**Facts**

- A domestic partnership, PRS, acquires 100% of FC on December 1, 2018, at which point US2 already owns 50% of PRS.
- US1 acquires its 50% interest in PRS on December 25, 2018.
- FC pays a dividend to PRS on December 31, 2018.
- PRS sells all of its FC stock to a third party on December 10, 2019.

**Analysis**

- The relevant testing period is December 31, 2017 through December 31, 2019.
- If the Holding Period Requirement is tested by treating PRS as the “taxpayer,” US1 and US2 qualify for the section 245A DRD because the stock of FC is held for 374 days (from December 2, 2018 to December 10, 2019, excluding acquisition date) while FC was a specified 10-percent owned foreign corporation and PRS was a US Shareholder of FC.
- If the Holding Period Requirement is tested by treating each domestic corporate partner as the “taxpayer” –
  - **US1 does not qualify** for the section 245A DRD because the stock of FC is held for less than 366 days (from December 26, 2018 to December 10, 2019, excluding the acquisition date) while FC was a specified 10-percent owned foreign corporation and US1 was a US Shareholder of FC.
  - **US2 qualifies** for the section 245A DRD because the stock of FC is held for 374 days (from December 2, 2018 to December 10, 2019, excluding the acquisition date) while FC was a specified 10-percent owned foreign corporation and US2 was a US Shareholder of FC.
- **Would the same results occur if PRS was a foreign partnership?**
  - PRS would not be a US Shareholder of FC. Therefore, it appears US1 could not qualify for the section 245A DRD because it was not a US Shareholder with respect to FC for at least 366 days as US1 was a US Shareholder with respect to FC for only 350 days (December 26, 2018 to December 10, 2019, excluding the acquisition date).
Participation Exemption and Section 956 Inclusion
General Rule and Request for Comment

• Proposed regulations under section 956 generally reduce the section 956 inclusion of a US Shareholder that is a domestic corporation by the amount which would be allowed as a section 245A DRD if the amount of the section 956 inclusion were distributed to the US Shareholder by the CFC with the investment in US property.

• Prop. Reg. § 1.956-1(a)(2)(ii) provides special rules that implement the reduction to a domestic corporation’s section 956 inclusion in situations where the domestic corporation is a US Shareholder of a CFC and owns the stock of the CFC indirectly by application of section 958(a)(2).

• The proposed regulations make no provision for any reduction to the section 956 inclusion of a domestic partnership that has a domestic corporate partner who would be eligible for a section 245A DRD on its distributive share of dividends paid by a CFC to the domestic partnership.

• The preamble to the proposed regulations requested comments as to the appropriate coordination of section 956 with domestic partnerships that have domestic corporate partners. The preamble proposed two approaches for comment:
  − The first approach would reduce the amount otherwise determined under section 956 with respect to a domestic partnership to the extent that a domestic corporate partner would be entitled to a section 245A deduction if the partnership received the amount as a distribution.
  − The second approach would determine a domestic partnership’s section 956 amount and section 956 inclusion without regard to the status of its partners, but then provide that a corporate US Shareholder partner’s distributive share of the section 956 inclusion is not taxable.
Participation Exemption and Section 956 Inclusion

Examples

• USP has a section 956 inclusion equal to an amount ($40) that is less than the section 956 inclusion that would be taken into account if none of its partners were domestic corporations that are US Shareholders of CFC ($100).

• Similar to the impact of having a GILTI inclusion at the domestic partnership that is reduced by the amount of tested items taken into account by US Shareholder partners, it appears that this result –
  – Would require a special allocation of the section 956 income to partners other than domestic corporations that are US Shareholders of CFC;
  – May distort the capital accounts (and economic arrangement) of the partners; and
  – Creates uncertain inside and outside basis adjustments.

Hypothetical distribution of section 956 amount ($100)

<table>
<thead>
<tr>
<th>Hypothetical section 245A DRD on hypothetical distribution ($60)</th>
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<tbody>
<tr>
<td>Hypothetical distribution of section 956 amount ($100)</td>
</tr>
</tbody>
</table>

Approach #1

USCo

60%

USP

60%

CFC

Investment in US property: $100

USP has a section 956 inclusion equal to $40 ($100 less $60)

Approach #2

USCo

60%

USP

60%

CFC

Investment in US property: $100

Distributive share of section 956 inclusion ($60) is not taxable

• USP has a section 956 inclusion ($100) that is equal to the section 956 inclusion that would be taken into account if none of its partners were domestic corporations that are US Shareholders of CFC ($100).

• This approach has the advantage of maintaining capital accounts and basis (inside and outside) within the well-understood framework of subpart F and domestic partnerships.

• Under the proposed foreign tax credit regulations, no deemed paid taxes are available with respect to a section 956 inclusion. See Prop. Reg. § 1.960-2(b)(1).
8. Disposition of Interests in Partnerships Engaged in a US Trade or Business
Dispositions of Interests in Partnerships Engaged in a US Trade or Business

General Provisions

- Section 864(c)(8) applies to the sale or exchange, by a nonresident alien individual or foreign corporation, of an interest in a partnership that is engaged in a US trade or business.

- If a nonresident alien individual or foreign corporation sells or exchanges an interest in a partnership engaged in a US trade or business, gain or loss on the sale or exchange of the interest is treated as income effectively connected with the conduct of a US trade or business (“ECI”) to the extent of the selling partner’s distributive share of gain or loss that would be treated as ECI if the partnership sold all of its assets at FMV immediately before the sale or exchange of the partnership interest.

- Section 864(c)(8) applies to gain or loss “on the sale or exchange of a partnership interest.”
  - The term “sale or exchange” means any sale, exchange, or other disposition.
  - Regulatory authority is granted to coordinate the ECI rules with nonrecognition transactions.
  - Proposed regulations were released on December 20, 2018.

- The rule is coordinated with the FIRPTA rules such that gain from the sale of FIRPTA assets is not double counted by section 864(c)(8) as well as section 897(g).
  - Section 864(c)(8)(C) provides that any tax on FIRPTA gain under section 897(g) reduces the tax under section 864(c)(8)(A). Notwithstanding section 864(c)(8)(C), proposed regulations to sections 864 and 897 provide that when a partnership disposition is subject to both section 864(c)(8) and section 897(g), the foreign person determines its ECI pursuant to section 864(c)(8) and not pursuant to section 897(g), so no reduction is made under section 864(c)(8)(C).
  - The proposed regulations do not include an express exemption for sales of PTP interests by less than 5% shareholders under section 864(c)(8) that would be analogous to the exemption under section 897.
Dispositions of Interests in Partnerships Engaged in a US Trade or Business

Withholding

• Under section 1446(f), if any portion of the gain on the sale or exchange of a partnership interest is treated as ECI under section 864(c)(8), the transferee is generally required to withhold 10% of the amount realized.

  – The withholding is applied to the entire amount realized on the disposition of the partnership interest. It does not appear to be limited to only the amount that is treated as ECI. Regulatory authority is granted to provide for reduced withholding.

  – An exemption from withholding is provided if the transferor signs an affidavit, under penalties of perjury, that states that the transferor is not a foreign person and includes the transferor’s taxpayer identification number.

• If a transferee fails to withhold under the general rule, the partnership is required to withhold on distributions to the transferee partner in an amount equal to the amount the transferee failed to withhold (plus interest).
Dispositions of Interests in Partnerships Engaged in a US Trade or Business
Additional Guidance on Withholding

• Notice 2018-8 suspends withholding under section 1446(f) on the transfer of PTPs (as defined in section 7704(b)) until regulations or other guidance have been issued.

• Notice 2018-29 provides that transferees required to withhold under section 1446(f)(1) must generally use the rules under section 1445 to report and deposit withholding until regulations or other guidance have been issued.

• Notice 2018-29 also announces intentions to issue regulations that, among other things:
  − Modify or suspend withholding under section 1446(f) on the sale or disposition of interests in non-publicly traded partnerships in certain circumstances (such as nonrecognition transfers or transfers in which no gain is realized);
  − Modify the amount of withholding required if 10% of the amount realized exceeds the difference of the amount realized, minus the transferor partner’s share of partnership liabilities;
  − Apply section 1446(f) to distributions by a partnership to a partner;
  − Provide that a partnership’s obligation to withhold on distributions to a transferee under section 1446(f)(4) will not apply until regulations or other guidance have been issued under that section;
  − Apply section 1446(f) to dispositions by tiered partnerships.

• No provision of either Notice affects a transferor’s tax liability under section 864(c)(8).

• The proposed regulations released on December 20, 2018, do not address the withholding requirements under section 1446(f).