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DEPARTMENT OF THE TREASURY

Internal Revenue Service

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Guidance under Sections 951A and 954 Regarding Income Subject to a High Rate of Foreign Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under the global intangible low-taxed income and subpart F income provisions of the Internal Revenue Code regarding the treatment of income that is subject to a high rate of foreign tax. The final regulations affect United States shareholders of foreign corporations. This guidance relates to changes made to the applicable law by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017.

DATES: Effective date: These regulations are effective on September 21, 2020.

Applicability dates: For dates of applicability, see §§1.951A-7(b) and 1.954-1(h)(1) and (3).

FOR FURTHER INFORMATION CONTACT: Jorge M. Oben or Larry R. Pounders at (202) 317-6934 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

Section 951A, which contains the global intangible low-taxed income (“GILTI”)

rules, was added to the Internal Revenue Code (the “Code”) by the Tax Cuts and Jobs Act, Pub. L. 115-97, 131 Stat. 2054, 2208 (December 22, 2017) (the “Act”). On October 10, 2018, the Department of the Treasury (“Treasury Department”) and the IRS published proposed regulations (REG-104390-18) under sections 951, 951A, 1502, and 6038 in the **Federal Register** (83 FR 51072). On June 21, 2019, the Treasury Department and the IRS published final regulations (T.D. 9866) in the **Federal Register** (84 FR 29288, as corrected at 84 FR 44693) under sections 951, 951A, 1502, and 6038, and proposed regulations (REG-101828-19) under sections 951, 951A, 954, 956, 958, and 1502 in the **Federal Register** (84 FR 29114, as corrected at 84 FR 37807) (“2019 proposed regulations”). Terms used but not defined in this preamble have the meaning provided in these final regulations.

The Treasury Department and the IRS received written comments with respect to the 2019 proposed regulations. A public hearing on the 2019 proposed regulations was not held because there were no requests to speak.

This rulemaking finalizes the portion of the 2019 proposed regulations under sections 951A and 954 regarding the treatment of income subject to a high rate of foreign tax but does not finalize the portions of the 2019 proposed regulations under sections 951, 956, 958, and 1502 regarding the treatment of domestic partnerships. The Treasury Department and the IRS plan to finalize those regulations separately.

Comments outside the scope of this rulemaking are generally not addressed but may be considered in connection with future guidance projects. All written comments received in response to the 2019 proposed regulations are available at [www.regulations.gov](http://www.regulations.gov) or upon request.

## Summary of Comments and Explanation of Revisions

### I. Overview

The 2019 proposed regulations apply the high-tax exclusion set forth in section 951A(c)(2)(A)(i)(III) (the “GILTI high-tax exclusion”), on an elective basis, to certain high-taxed income of a controlled foreign corporation (as defined in section 957) (“CFC”) regardless of whether the income would otherwise be foreign base company income (as defined in section 954) (“FBCI”) or insurance income (as defined in section 953). See proposed §1.951A-2(c)(6). The final regulations retain the basic approach and structure of the 2019 proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions discusses those revisions as well as comments received.

As discussed in part IV of this Summary of Comments and Explanation of Revisions, numerous comments recommended that the application of the GILTI high-tax exclusion be conformed with the high-tax exception of section 954(b)(4) and §1.954-1(d)(5) (the “subpart F high-tax exception”). The Treasury Department and the IRS agree that the GILTI high-tax exclusion and the subpart F high-tax exception should be conformed but have determined that the rules implementing the GILTI high-tax exclusion better reflect the policies underlying section 954(b)(4) in light of the changes made by the Act. As a result, a separate notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register** (REG-127732-19) (the “2020 proposed regulations”) proposes to generally conform the rules implementing the subpart F high-tax exception to the rules implementing the GILTI high-tax exclusion set

forth in these final regulations, and provides for a single election under section 954(b)(4) for purposes of both subpart F income and tested income.

## II. Calculation of Effective Foreign Tax Rate

### A. QBU-by-QBU determination

The 2019 proposed regulations apply based on the effective foreign tax rate imposed on the aggregate of all items of tentative net tested income of a CFC attributable to a single qualified business unit (as defined in section 989(a)) (“QBU”) of the CFC that would be in a single tested income group. See proposed §1.951A-2(c)(6)(i)(B) and (c)(6)(ii)(A). The 2019 proposed regulations apply on a QBU-by-QBU basis to minimize the “blending” of income subject to different foreign tax rates and, as a result, more accurately identify income subject to a high rate of foreign tax such that low-taxed income continues to be subject to the GILTI regime in a manner consistent with its underlying policies.

The Treasury Department and the IRS received several comments regarding the determination of the effective foreign tax rate on a QBU-by-QBU basis. One comment supported the QBU-by-QBU determination. Other comments requested that the effective foreign tax rate test apply on a CFC-by-CFC basis and asserted that this approach would better align the GILTI high-tax exclusion with the subpart F high-tax exception. The comments also stated that a CFC-by-CFC approach would be consistent with the principles used to determine foreign income taxes deemed paid under proposed regulations under section 960 and would reduce complexity and compliance burdens. One comment noted that taxpayers are not required to conduct this type of QBU-level analysis for any other U.S. tax purpose and, thus, they may lack

the systems, data, or personnel to do so. Other comments stated that nonconformity with the subpart F high-tax exception would encourage taxpayers to structure into the subpart F high-tax exception and questioned the authority to adopt a QBU-by-QBU approach given the general mechanics of the GILTI regime, which compute certain items at the CFC level before aggregating such items at the United States shareholder (as defined in section 951(b)) (“U.S. shareholder”) level.

Some comments suggested that there is not a significant risk of blending foreign income subject to different tax rates and asserted that such blending should not give rise to policy concerns. Other comments stated that applying the effective foreign tax rate test on a CFC-by-CFC basis would ameliorate issues caused by differences between U.S. and foreign tax accounting methods.

Consistent with the rules set forth in the 2019 proposed regulations, the Treasury Department and the IRS have determined that calculating the effective foreign tax rate on a CFC-by-CFC basis would inappropriately allow the blending of high-taxed and low-taxed income in a manner that is inconsistent with the purpose of section 951A, which is to limit potential base erosion incentives created by a participation exemption regime. Such blending would allow low-taxed income, which poses a significant base-erosion risk, to be excluded from the GILTI regime. While the legislative history indicates that high-taxed income does not present base erosion concerns, the policy rationale underlying that view does not extend to excluding low-taxed income from GILTI merely because it may be earned by an entity that also earns high-taxed income. See S. Comm. on the Budget, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Print. No. 115-20, at 371 (2017) (“The Committee believes that certain items of

income earned by CFCs should be excluded from the GILTI [regime], either because they should be exempt from U.S. tax—as they are generally not the type of income that is the source of the base erosion concerns—or are already taxed currently by the United States. Items of income excluded from GILTI because they are exempt from U.S. tax under the bill include foreign oil and gas extraction income (which is generally immobile) and income subject to high levels of foreign tax.”).

The QBU-by-QBU approach is also consistent with the legislative history to section 954(b)(4), which directs the Treasury Department and the IRS to allow reasonable groupings of items of income that are substantially taxed at the same rate in a single country. See H.R. Rep. No. 99-426, at 400-01 (1985) (“Although this rule applies separately with respect to each ‘item of income’ received by a [CFC], the committee expects that the Secretary will provide rules permitting reasonable groupings of items of income that bear substantially equal effective rates of tax in a given country. For example, all interest income received by a [CFC] from sources within its country of incorporation may reasonably be treated as a single item of income for purposes of this rule, if such interest is subject to uniform taxing rules in that country.”). Therefore, consistent with this legislative history, generally only high-taxed income, and not low- or zero-taxed income, should be excluded from gross tested income. The GILTI high-tax exclusion carries out this purpose by determining the effective rate of tax on an item of income at a granular enough level to preclude inappropriate blending without imposing undue compliance burdens on taxpayers.

Although greater blending of income subject to different rates of foreign tax may be permitted within a separate category under section 904, a section 904 separate

category is not an appropriate standard for determining an item of income under section 954(b)(4) because section 904 applies, by its terms, to separate categories of income while section 954(b)(4) applies to items of income. Moreover, the purposes of sections 951A and 954(b)(4), which are primarily intended to address base erosion concerns, differ from the purposes of sections 901 and 904, which are tailored to the avoidance of double taxation of foreign source income. The ability to credit foreign taxes against a broader class of income at the U.S. shareholder level does not compel a CFC-by-CFC effective foreign tax rate computation for purposes of the GILTI high-tax exclusion. In addition, determining whether an item of income is high-taxed by grouping similar items at a QBU level has historically been required for certain passive income under §§1.904-4(c) and 1.954-1(c)(1)(iii)(B). Consistent with the 2019 proposed regulations, §1.904-4(c) groups passive income items for purposes of determining whether they are subject to a high rate of tax on a QBU-by-QBU basis.

Finally, because the GILTI high-tax exclusion applies on an elective basis, taxpayers may choose not to make the election if the compliance burdens of the computation outweigh the benefits.

For these reasons, the final regulations do not adopt a CFC-by-CFC approach. However, the final regulations replace the QBU-by-QBU approach with a more targeted approach based on “tested units” (as discussed in part III.A of this Summary of Comments and Explanation of Revisions), permit some additional blending of income under the tested unit combination rule (as discussed in part III.B of this Summary of Comments and Explanation of Revisions), and allow taxpayers additional flexibility by permitting the GILTI high-tax exclusion election to be made on an annual basis (as

discussed in part IV.C of this Summary of Comments and Explanation of Revisions). Further, as noted in part I of this Summary of Comments and Explanation of Revisions, the separate notice of proposed rulemaking published concurrently with these final regulations conforms the rules implementing the subpart F high-tax exception with the GILTI high-tax exclusion, thereby eliminating the disparity between the two elections and the incentive for taxpayers to structure into the subpart F high-tax exception.

B. CFC-level determination of foreign taxes

For purposes of the subpart F high-tax exception, the final regulations under §1.954-1(d)(3) (before modification by this Treasury decision) determined, for each U.S. shareholder, the foreign income taxes paid or accrued with respect to an item of income based on the amount of foreign income taxes that would be deemed paid under section 960 if the item of income were included in the gross income of the U.S. shareholder under section 951(a)(1)(A). The 2019 proposed regulations modify this determination, for purposes of both the subpart F high-tax exception and the GILTI high-tax exclusion, by referencing the amounts of income and taxes at the CFC level, rather than the amount of taxes that would be deemed paid at the U.S. shareholder level. See proposed §1.954-1(d)(3)(i) and proposed §1.951A-2(c)(6)(iv). Specifically, foreign income taxes of the CFC for the current year are allocated and apportioned to the CFC's gross income based on the rules under §1.960-1(d), which determine foreign income taxes "properly attributable" to income. The 2019 proposed regulations modify this calculation because the determination of income and taxes at the CFC level is more consistent with the text of section 954(b)(4), which refers to items of income (and tax imposed on such items) of the CFC. In addition, deemed paid credits for taxes properly

attributable to tested income under section 960(d) are determined on an aggregate basis, which does not provide an accurate basis to determine the effective foreign tax rate on particular items of income of a CFC under the GILTI high-tax exclusion provided under section 954(b)(4).

A comment requested that the effective foreign tax rate test be based on the shareholder's deemed paid credit for taxes properly attributable to tested income, as defined in section 960(d), over the shareholder's net CFC tested income, as defined in section 951A(c). The comment asserted that such an aggregate determination, which would mirror the calculation of the GILTI inclusion, would be consistent with the GILTI legislative history, would produce more equitable results than those provided under the 2019 proposed regulations, and would significantly reduce compliance and administrative burdens for taxpayers and the government.

The Treasury Department and the IRS have concluded that this approach for calculating the effective foreign tax rate would be inconsistent with section 954(b)(4). Unlike a GILTI inclusion, which is based on the aggregate amounts of a U.S. shareholder's pro rata shares of certain items from all the CFCs in which the shareholder is a U.S. shareholder, section 954(b)(4) applies by its terms to items of income of a single CFC. That is, section 954(b)(4) applies with respect to "any item of income received by a CFC" that is subject to a sufficiently high rate of foreign tax. Moreover, section 951A(c)(2)(A)(i), which provides exclusions from tested income including the high-tax exclusion, refers to "the gross income of such corporation." Nothing in section 954(b)(4), or section 951A(c)(2)(A)(i)(III), suggests that the aggregate approach of the GILTI regime should or could apply for purposes of determining

whether an item of income received by a CFC is subject to a sufficiently high level of foreign tax under section 954(b)(4). Thus, the final regulations do not adopt this comment.

### C. Effective foreign tax rate

#### 1. Threshold Rate of Tax

Consistent with section 954(b)(4), the 2019 proposed regulations apply the GILTI high-tax exclusion by comparing the effective foreign tax rate with 90 percent of the rate that would apply if the income were subject to the maximum rate of tax specified in section 11 (currently 18.9 percent, based on a maximum rate of 21 percent). See proposed §1.951A-2(c)(6)(i)(B).

Several comments requested that the GILTI high-tax exclusion instead be applied if the effective foreign tax rate is at least 13.125 percent. One comment requested that it be based on a tax rate of 13.125 percent for taxable years beginning on or before December 31, 2025, and 16.406 percent for taxable years beginning after such date. The comments asserted that using a 13.125 percent rate would be consistent with the legislative history indicating that no residual tax should be due on GILTI subject to an effective foreign tax rate in excess of 13.125 percent, which takes into account the 80 percent foreign tax credit allowance in section 960(d) and the 50 percent deduction under section 250, and that the rate should be adjusted for taxable years beginning after December 31, 2025, to correspond to the reduction in the amount of deduction allowed with respect to GILTI as provided in section 250(a)(3)(B).

The Treasury Department and the IRS disagree with these comments. The GILTI high-tax exclusion is based on section 954(b)(4), which refers to a tax rate that is

greater than 90 percent of the rate that would apply if the income were subject to the maximum rate of tax specified in section 11. The rate set forth in section 954(b)(4) does not vary depending on whether it applies for purposes of determining FBCI, insurance income, or tested income. Furthermore, the legislative history describing a 13.125 percent foreign tax rate addresses situations in which income is included in tested income and, consequently, subject to GILTI and the associated foreign tax credit rules under section 960(d).<sup>1</sup> Those rules do not apply to income excluded from tested income by reason of the GILTI high-tax exclusion. Accordingly, the final regulations do not adopt these comments.

## 2. Safe Harbors

One comment asserted that the “mechanical snapshot” rule for determining the effective foreign tax rate under the 2019 proposed regulations can produce results that are unreasonable given timing differences between the U.S. and foreign tax bases. The comment stated that if an item is accounted for in one period for U.S. tax purposes, but in another period for foreign tax purposes, the CFC may appear to have a high effective foreign tax rate in one period, and a low effective foreign tax rate in the other period, when in fact it is simply subject to a rate of tax comparable to the U.S. rate on its foreign tax base over both periods. To address these timing differences, the comment suggested that the final regulations include two new methods, in addition to the method

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<sup>1</sup> In addition, the assertion made by certain commenters that the law categorically provides that no residual U.S. tax is owed under GILTI at foreign effective tax rates of 13.125% is incorrect. See Joint Comm. on Tax'n, General Explanation of Public Law 115-97, at 381 & n.1753.

set forth in the 2019 proposed regulations, for calculating the effective foreign tax rate, each of which could be safe harbors applied at the discretion of the taxpayer.

Under the first suggested method, the GILTI high-tax exclusion would apply if the foreign statutory income tax rate to which a QBU's income is subject is sufficiently high and there is no special tax regime to which a material percentage of the QBU's income is subject. In such a case, the safe harbor would apply and all the income of the QBU would be eligible for the GILTI high-tax exclusion. The comment indicated that the foreign statutory rate could be determined by reference to publications maintained by the OECD and a special tax regime could be determined in a manner consistent with the 2016 U.S. Model Income Tax Treaty.

The second suggested method would allow taxpayers to determine a QBU's effective foreign tax rate by reference to the average effective foreign tax rate in the current and preceding four taxable years. The comment asserted that this approach would smooth out timing differences and more accurately determine whether the QBU's income was in fact subject to relatively high rates of tax. The comment also noted that although the GILTI regime generally operates on an annual basis, the determination of whether the income of a QBU is subject to a rate of foreign tax comparable to the U.S. rate may be better determined over a longer period based on the facts and circumstances.

The Treasury Department and the IRS have concluded that identifying special tax regimes, or determining the extent to which income would be subject to special tax regimes, would give rise to considerable complexity and administrative and compliance burdens for both taxpayers and the government. Similarly, the Treasury Department

and the IRS have determined that using an average effective foreign tax rate over multiple taxable years would give rise to additional complexity and increase the burden on taxpayers and the government due, for example, to foreign tax redeterminations with respect to a QBU's income, such as an adjustment for a loss carryback. Such adjustments would not only affect the year of the redetermination, but also every other year that took the redetermination year into account in calculating the average effective foreign tax rate, potentially resulting in multiple amended returns attributable to a foreign tax redetermination for a single taxable year. A prior year averaging approach would also lead to distortive results, such as when the CFC had losses or volatile earnings. Accordingly, the final regulations do not adopt these safe harbors. As described in Part III.B. of this Summary of Comments, the tested unit combination rule should ameliorate some of the concerns raised by the comment.

#### D. Base and timing differences

##### 1. In General

The 2019 proposed regulations generally provide that the effective rate at which taxes are imposed for a taxable year is the U.S. dollar amount of foreign income taxes paid or accrued with respect to a tentative net tested income item,<sup>2</sup> over the sum of the U.S. dollar amount of the tentative net tested income item and the amount of foreign income taxes paid or accrued with respect to the tentative net tested income item. See proposed §1.951A-2(c)(6)(iii). A tentative net tested income item is generally determined by taking into account certain items of gross income (determined under

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<sup>2</sup> The final regulations adopt the term "tentative tested income item," instead of the term "tentative net tested income item." See §1.951A-2(c)(7)(iii).

federal income tax principles) attributable to a QBU, less deductions (also determined under federal income tax principles) allocated and apportioned to such gross income. See 1.951A-2(c)(6)(ii)(A) and (B). Thus, the effective foreign tax rate is based on the amount of foreign income taxes paid or accrued on income attributable to the QBU as determined for federal income tax purposes, without regard to how the income is determined for foreign income tax purposes.

The preamble to the 2019 proposed regulations requested comments on whether additional rules are needed to properly account for cases (other than disregarded payments) in which the income base upon which foreign tax is imposed does not match the items of income reflected on the books and records of the QBU determined for federal income tax purposes. The preamble cites examples of possible adjustments to address circumstances in which QBUs are permitted to share losses or determine tax liability based on combined income for foreign tax purposes.

## 2. Disregarded Payments

The proposed regulations generally provide that gross income is attributable to a QBU if it is properly reflected on the books and records of the QBU, determined under federal income tax principles, except that such income is adjusted to account for certain disregarded payments. See proposed §1.951A-2(c)(6)(ii)(A)(2). The adjustments for disregarded payments are made under the principles of §1.904-4(f)(2)(vi) (rules attributing gross income to a foreign branch), without regard to the exclusion for interest described in §1.904-4(f)(2)(vi)(C)(1). See id.

One comment suggested that a disregarded payment should not result in the reallocation of income between QBUs for purposes of computing the GILTI high-tax

exclusion. The Treasury Department and IRS understand the comment's concern to be the potential inability to claim the GILTI high-tax exclusion in scenarios where a disregarded payment was made from a high-taxed CFC to a disregarded entity that paid no tax.

The Treasury Department and the IRS have determined that, if a tested unit<sup>3</sup> makes a disregarded payment to another tested unit, gross income should be reallocated among the tested units to appropriately associate the income with the tested unit in which it is subject to tax. This reallocation promotes conformity between the income attributed to a tested unit and the income of that tested unit that is subject to tax in the foreign country, and, therefore, this rule results in a more accurate grouping of items of income that are generally subject to the same or similar rates of foreign tax. In addition, treating disregarded payments in this manner is consistent with the treatment of regarded payments. For example, if a tested unit of a CFC were to make a regarded deductible payment that is taken into account by another tested unit of the CFC (such as a tested unit that is an interest in a partnership), the payment would be an item of gross income of the payee tested unit that may qualify for the GILTI high-tax exclusion based on the foreign taxes attributable to that tested unit. Moreover, the regarded deduction would be reflected in a reduced tentative net tested income item (relative to the result in the absence of adjustment for disregarded payments) – and, consequently, the denominator of the effective foreign tax rate fraction – with respect to the payor

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<sup>3</sup> As discussed in part III of this Summary of Comments and Explanation of Revisions, the final regulations adopt a “tested unit” standard that replaces the QBU standard used in the 2019 proposed regulations.

tested unit for purposes of assessing whether its gross income is subject to a high rate of foreign tax. For these reasons, the comment is not adopted.

The final regulations provide additional rules addressing disregarded payments, including providing additional detail on how the principles of §1.904-4(f)(2)(vi) should be applied. See §1.951A-2(c)(7)(ii)(B)(2). For example, the final regulations provide that a disregarded payment of interest is allocated and apportioned ratably to all of the gross income attributable to the tested unit that is making the disregarded payment. See §1.951A-2(c)(7)(ii)(B)(2)(iv). The final regulations also provide special ordering rules for reallocations with respect to multiple disregarded payments. See §1.951A-2(c)(7)(ii)(B)(2)(iv).

### 3. Foreign Net Operating Losses and Other Timing Differences

Some comments requested that the final regulations allow taxpayers to elect to adjust either the numerator or denominator of the effective foreign tax rate fraction to take into account foreign net operating loss (“NOL”) carryforwards and other similar items. One comment asserted that, while the effective foreign tax rate calculation generally serves as an appropriate test, CFCs with a foreign NOL carryover may fail the test even though the rate of tax in the foreign country exceeds 18.9 percent. Another comment indicated that a CFC could fail the mechanical test in a single year although the same income is subject to a foreign tax that is substantially higher than the U.S. corporate tax rate because of timing differences (that is, differences in when income or deductions are taken into account for U.S. and foreign tax purposes).

The Treasury Department and the IRS have determined that adjusting the numerator or denominator of the effective foreign tax rate fraction for foreign NOL

carryforwards or other timing differences would result in considerable complexity and would impose a significant burden on both taxpayers and the government. It would require the application of foreign tax accounting rules, and complex coordination rules to reconcile their application with U.S. tax accounting rules, both in the current taxable year and other taxable years, to prevent an item of income, gain, deduction, loss, or credit from being duplicated or omitted. Accordingly, this comment is not adopted.

### III. Adoption of Tested Unit Standard

#### A. In general

As discussed in part II.A of this Summary of Comments and Explanation of Revisions, the 2019 proposed regulations propose a QBU-by-QBU approach to identify the relevant items of income that may be eligible for the GILTI high-tax exclusion. For this purpose, the proposed regulations reference the definition of a QBU in section 989(a), which provides that a QBU is any separate and clearly identifiable unit of a trade or business of a taxpayer that maintains separate books and records. See proposed 1.951A-2(c)(6)(ii)(A). Regulations under section 989(a) provide guidance as to activities that constitute a trade or business (based on a facts-and-circumstances analysis) and the determination of separate books and records. See §1.989(a)-1(c) and (d). The preamble to the 2019 proposed regulations requested comments on whether the definition of a QBU should be modified for purposes of the GILTI high-tax exclusion, including the requirements to carry on activities that constitute a trade or business and to maintain books and records.

One comment asserted that it is unclear whether certain activities constitute a trade or business under the facts-and-circumstances test set forth in the regulations

under section 989(a) and that making such determinations would frequently be administratively burdensome. The comment indicated that in other cases it is also difficult to determine whether certain interrelated activities constitute a single QBU or multiple QBUs (for example, different functions performed by separate divisions operating within a single CFC). In addition, the comment suggested that taxpayers may engage in affirmative tax planning to avoid the QBU rule by, for example, breaking up the operations of a single large QBU of a CFC into smaller components that would not constitute trades or businesses, or by choosing to no longer maintain books and records for such sub-lines of business. Another comment criticized the QBU approach because some taxpayers may track business activities differently than other taxpayers, which may result in the inconsistent application of the QBU rules. Finally, a comment noted that not all companies have sufficient systems in place to accurately track items at the QBU level.

The 2019 proposed regulations propose the QBU standard as a proxy for determining the type of entity, or level of activities, that would likely be subject to tax in a particular foreign country either on an entity basis or as a taxable presence, and, as a result, would likely result in items of income attributable to the QBU being subject to a different rate of foreign tax than that imposed on other income of the CFC. In response to these comments, the Treasury Department and the IRS have concluded that a more targeted approach should be applied for identifying income that is likely to be subject to foreign tax rates different from those imposed on other income earned by the CFC. This approach will generally limit the scope of the factual analysis necessary to apply these rules – for example, it does not depend on whether activities constitute a trade or

business, or whether books and records are maintained – and thereby addresses many of the concerns raised in these comments. Accordingly, in lieu of the QBU standard in the 2019 proposed regulations, the final regulations generally apply the GILTI high-tax exclusion based on the gross tested income of a CFC that is attributable to a “tested unit.” See §1.951A-2(c)(7)(ii). Unlike the QBU standard that serves as a proxy for being subject to foreign tax, the tested unit approach generally applies to the extent an entity, or the activities of an entity, are actually subject to tax, as either a tax resident or a permanent establishment (or similar taxable presence), under the tax law of a foreign country.

The final regulations provide three categories of a tested unit. First, and consistent with the 2019 proposed regulations, a tested unit includes a CFC. See §1.951A-2(c)(7)(iv)(A)(1). Thus, if a CFC, which itself is a tested unit, has no other tested units, the GILTI high-tax exclusion is applied with respect to all the tentative gross tested income items (determined under §1.951A-2(c)(7)(ii)) of the CFC.

Second, and also consistent with the 2019 proposed regulations, a tested unit generally includes an interest in a pass-through entity held, directly or indirectly, by a CFC. See §1.951A-2(c)(7)(iv)(A)(2). For this purpose, a pass-through entity is defined to include, for example, a partnership or a disregarded entity. See §1.951A-2(c)(7)(ix)(B).

More specifically, a CFC’s interest in a pass-through entity is a tested unit if the pass-through entity meets one of two requirements. First, the CFC’s interest in the pass-through entity is a tested unit if the pass-through entity is a tax resident of a foreign country because, in these cases, income earned by the CFC indirectly through

the pass-through entity may be subject to tax at a rate different than the rate at which income earned by the CFC directly is subject to tax. See §1.951A-2(c)(7)(iv)(A)(2)(i). Second, the CFC's interest in the pass-through entity is a tested unit if the pass-through entity is not subject to tax as a resident, but is treated as a corporation (or as another entity that is not fiscally transparent) for purposes of the CFC's tax law, because in these cases income earned by the CFC indirectly through the pass-through entity may not be subject to tax in the foreign country of which the CFC is a tax resident; thus, for example, an interest in a domestic limited liability company that is a partnership for federal income tax purposes would typically be a tested unit. See §1.951A-2(c)(7)(iv)(A)(2)(ii). A CFC's interest in a pass-through entity (or the activities of a branch) that is not a tested unit is a "transparent interest." See §1.951A-2(c)(7)(ix)(C); see also the discussion on transparent interests in part III.C.3 of this Summary of Comments and Explanation of Revisions.

This treatment of interests in pass-through entities in the final regulations is consistent with a comment suggesting that a pass-through entity should be treated as a tested unit if the entity is treated as a separate entity for purposes of a foreign tax law, but not if the entity is fiscally transparent (and thus not a tax resident) for purposes of the tax law of a foreign country.

An interest in an entity, rather than the entity itself, is treated as a tested unit (or a transparent interest) because the entity may have multiple owners and the characterization of the interest as a tested unit may depend on each holder's tax treatment with respect to the interest. As a result, less than the entire entity may be characterized as a tested unit or a transparent interest. In addition, different interests in

an entity held directly or indirectly by the same CFC may be characterized differently. The final regulations include an example that illustrates the application of this rule. See §1.951A-2(c)(8)(iii)(D) (Example 4).

Finally, a tested unit includes a branch, or a portion of a branch, the activities of which are carried on directly or indirectly by a CFC, provided that either (i) the branch gives rise to a taxable presence in the country in which the branch is located, or (ii) the branch gives rise to a taxable presence under the owner's tax law, and the owner's tax law provides an exclusion, exemption, or other similar relief (such as a preferential rate) for income attributable to the branch. See §1.951A-2(c)(7)(iv)(A)(3). In these cases, the income indirectly earned by the owner through the branch is likely subject to tax at a rate different than the rate at which income directly earned by the owner is subject to tax. The Treasury Department and the IRS have determined that this branch tested unit rule addresses blending concerns related to an owner's taxable presence in another country in a more targeted manner than the "activities" QBU standard from the 2019 proposed regulations. In addition, the Treasury Department and the IRS have determined that the branch tested unit rule will likely reduce compliance burdens, as compared to the QBU standard from the 2019 proposed regulations, because the tested unit rule depends on how activities are treated under foreign tax law, an analysis of which in most cases would be conducted independently of the final regulations (for example, to determine whether a tax return must be filed because activities in that country give rise to a taxable presence).

For purposes of the tested unit rules, references to the tax law of a foreign country include statutes, regulations, administrative or judicial rulings, and treaties of the

country. See §1.951A-2(c)(7)(iv)(A)(2) and (3) (cross-referencing definitions in regulations under section 267A that incorporate the definition of the tax law of a country in §1.267A-5(a)(21)).

The final regulations make clear that tested units are determined independently of one another. For example, even though a CFC is itself a tested unit, the CFC may have other tested units, such as a permanent establishment or an interest in a disregarded entity that, subject to the application of the combination rule discussed in part III.B of this Summary of Comments and Explanation of Revisions, must be treated separately for purposes of the GILTI high-tax exclusion. See §1.951A-2(c)(8)(iii)(D) (Example 4).

The final regulations also provide a rule that addresses cases where the same item is attributable to more than one tested unit in a tier of tested units. This may occur, for example, if an item is properly reflected both on the separate set of books and records of one tested unit, and on the separate set of books and records of a lower-tier tested that is owned (directly or indirectly) by the first tested unit, because the books and records of the two tested units were prepared under different accounting standards. In such a case, the final regulations provide that the item is considered to be attributable only to the lowest-tier tested unit. See §1.951A-2(c)(7)(iv)(B).

#### B. Combined tested units

The 2019 proposed regulations apply separately to each QBU of a CFC. See proposed §1.951A-2(c)(6)(ii)(A)(1). However, the preamble to the 2019 proposed regulations requested comments as to whether all of a CFC's QBUs located within a single foreign country should be combined.

Several comments recommended combining “same-country” QBUs, on an elective basis, noting it would reduce complexity and compliance burdens. Some comments asserted that a combined same-country QBU approach would be more consistent with congressional intent for the GILTI regime to target income in low- and zero-tax countries, would reduce certain variances (for example, due to business cycle fluctuations or differences between the U.S. and foreign tax bases), and would reduce incentives for tax-motivated restructuring. Another comment recommended that the final regulations include rules that would allow taxpayers to take into account a fiscal unity or similar grouping in determining the effective foreign tax rate.

The Treasury Department and the IRS generally agree that a combination rule would reduce compliance burdens and would be consistent with the policies underlying the GILTI high-tax exclusion. Moreover, a combination rule may minimize the effect of timing and other differences between the U.S. and foreign tax bases. Accordingly, the final regulations generally provide that tested units of a CFC (including the CFC tested unit), other than certain nontaxed branch tested units, are treated as a single tested unit if the tested units are tax residents of, or located in, the same foreign country. See §1.951A-2(c)(7)(iv)(C)(1). In general, a nontaxed branch tested unit is a branch tested unit that does not give rise to a taxable presence under the tax law of the foreign country where the branch is located, but gives rise to a taxable presence under the tax law of the foreign country where the home office of the branch is a tax resident and such tax law provides an exclusion, exemption, or similar relief for purposes of taxing income attributable to the branch. See §1.951A-2(c)(7)(iv)(A)(3). The tested unit combination rule does not apply to a nontaxed branch tested unit because such a tested

unit typically would not be subject to tax (or to any meaningful level of tax) in any foreign country and thus combining it with other tested units (the income of which may be subject to a meaningful level of tax) could give rise to inappropriate blending. See §1.951A-2(c)(7)(iv)(C)(2).

The combination rule applies without regard to whether the tested units are subject to the same foreign tax rate because it would be inconsistent with the purpose of the combination rule to require taxpayers to determine the effective foreign tax rate imposed on the tested units separately, and simply comparing the statutory foreign tax rates may not be meaningful. In addition, the combination rule is not conditioned on the tested units having the same functional currency because the effective foreign tax rate is calculated in U.S. dollars and any differences in functional currency are unlikely to have a material effect on whether income qualifies for the GILTI high-tax exclusion. Finally, the combination rule is mandatory, and not elective, because providing an election would give rise to additional complexity, and related administrative and compliance burdens.

#### C. Books and records

##### 1. In General

Under the 2019 proposed regulations, gross income is attributable to a QBU if it is properly reflected on the books and records of the QBU. See proposed §1.951A-2(c)(6)(ii)(A)(2). For this purpose, gross income is determined under federal income tax principles with certain adjustments to reflect disregarded payments. Id.

As discussed in part III.A of this Summary of Comments and Explanation of Revisions, the final regulations adopt a tested unit standard, rather than a QBU

standard, for purposes of determining a tentative gross tested income item.

Nevertheless, the final regulations retain the general approach set forth under the 2019 proposed regulations of relying on a separate set of books and records (as modified to apply to tested units, rather than QBUs) as the starting point for determining gross income attributable to a tested unit. The Treasury Department and the IRS have concluded that applying the books-and-records approach for tested units is appropriate because it serves as a reasonable proxy for determining the amount of gross income that the foreign country of the tested unit is likely to subject to tax. In addition, relying on a separate set of books and records is consistent with the approach taken under other provisions and, therefore, should promote administrability for both taxpayers and the government. See, for example, §§1.904-4(f) (foreign branch category rules), 1.987-2(b) (rules for determining items attributable to a QBU branch), and 1.1503(d)-5(c) (dual consolidated loss rules).

The final regulations generally provide that items of gross income of a CFC are attributable to a tested unit of the CFC to the extent they are properly reflected on the separate set of books and records of the tested unit, or of the entity an interest in which is a tested unit (for example, in the case of certain partnerships). See §1.951A-2(c)(7)(ii)(B). This rule starts with the items of gross income of the CFC for federal income tax purposes and then attributes those items to the CFC's tested units to the extent the items are properly reflected on the separate set of books and records of the tested units (with certain adjustments, such as to account for disregarded payments). For example, if a CFC owns a partnership interest that is a tested unit, the items of gross income that the CFC derives through the partnership interest are attributed to the

CFC's interest in the partnership to the extent that the items are properly reflected on the separate set of books and records of the partnership. Thus, this approach first gives effect to the rules that determine the items of gross income of the CFC, such as the rules under section 704 for purposes of determining a CFC partner's distributive share of items of a partnership, and then attributes those items to the tested units of the CFC depending on whether the items are properly reflected on the separate set of books and records. The final regulations include examples that illustrates the application of this rule. See §1.951A-2(c)(8)(D) (Example 4).

## 2. Separate Set of Books and Records

The Treasury Department and the IRS have determined that a tested unit, or an entity an interest in which is a tested unit, generally will maintain a separate set of books and records that would be readily available for purposes of the final regulations. This is expected to be the case for a branch tested unit under §1.951A-2(c)(7)(iv)(A)(3) (involving a taxable presence), for example, because a separate set of books and records would ordinarily be required to compute the foreign tax liability arising in the taxing country (or for not taking into account items attributable to the taxable presence if determined only under the owner's tax law). Accordingly, the final regulations retain the general approach taken in the 2019 proposed regulations by defining a "separate set of books and records" by reference to §1.989(a)-1(d). See §1.951A-2(c)(7)(v)(A).<sup>4</sup>

## 3. Booking Rule for Transparent Interests

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<sup>4</sup> The 2020 proposed regulations, however, replace the reference to "books and records" with a more specific standard based on items properly reflected on an "applicable financial statement," and request comments.

The final regulations provide a special booking rule that applies to a transparent interest, which, as noted in part III.A of this Summary of Comments and Explanation of Revisions, is an interest in a pass-through entity (or the activities of a branch) that is not a tested unit. This rule, which is consistent with the rule in §1.1503(d)-5(c)(3)(ii) (addressing similar interests for purposes of the dual consolidated loss rules), generally treats items properly reflected on the separate set of books and records of an entity an interest in which is a transparent interest as being properly reflected on the books and records of a tested unit that holds interests (directly or indirectly through other transparent interests) in the entity. See §1.951A-2(c)(7)(v)(C). This treatment is appropriate because income earned by the tested unit directly, as well as income earned by the tested unit indirectly through the transparent interest, is expected to be subject to residence-based tax in only the tested unit's country of residence (or location) and, as a result, it is unlikely that blending of income subject to different foreign tax rates would occur by reason of the tested unit's ownership of the transparent interest.

#### 4. Tested Units that Fail to Maintain a Set of Books and Records

The final regulations include a rule that applies if a separate set of books and records is not prepared for a tested unit or transparent interest. In such a case, items required to apply the GILTI high-tax exclusion that would be reflected on a separate set of books and records of the tested unit or transparent interest must be determined and treated as properly reflected on the separate set of books and records. See §1.951A-2(c)(7)(v)(B). This rule is intended to address cases where a separate set of books and records is not maintained, and to prevent the avoidance of the rules by choosing to not maintain a separate set of books and records.

## 5. Items of Gross Income Not Taken into Account for Financial Accounting Purposes

In some cases, items of gross income (determined under federal income tax principles) may not be properly reflected on a separate set of books and records because they are not taken into account for financial accounting purposes. This may occur when items are taken into account for federal income tax purposes and financial accounting purposes in different taxable years, or when items are taken into account for federal income tax purposes but are not taken into account for financial accounting purposes (for example, due to the mark-to-market method of accounting). To ensure that these items of gross income are attributable to a tested unit in a CFC inclusion year, the final regulations clarify that the items are treated as properly reflected on a separate set of books and records if they would be so reflected if they were taken into account for financial accounting purposes in the CFC inclusion year in which they are taken into account for federal income tax purposes. See §1.951A-2(c)(7)(v)(D). No inference should be drawn from this clarification with respect to other similar rules that attribute items based on books and records, including under §1.904-4(f), §1.987-2(b), or §1.1503(d)-5(c).

### D. De minimis rules

A comment recommended that the final regulations adopt two de minimis rules to simplify the application of the QBU-by-QBU approach. First, the comment suggested that taxpayers should be permitted to elect to treat all CFCs with income below a specified threshold as a single QBU. The Treasury Department and the IRS have determined that aggregating CFCs for this purpose would be inconsistent with section

954(b)(4), which applies with respect to items of income of a single CFC. Accordingly, this recommendation is not adopted.

Second, the comment suggested that taxpayers should be permitted to elect to aggregate QBUs within the same CFC that have a small amount of tested income (measured either in absolute terms or based on a percentage of the CFC's income). However, it is uncertain whether aggregating QBUs with small amounts of tested income will result in a significant amount of simplification because, for example, gross income would still have to be attributed to each QBU (taking into account disregarded payments) to determine whether the de minimis rule applies. The final regulations do not adopt the recommendation, but a de minimis rule is included in the 2020 proposed regulations to allow an opportunity for additional notice and comment.

#### IV. Rules Regarding the Election

##### A. Consistency requirement

The 2019 proposed regulations generally provide that if a CFC is a member of a controlling domestic shareholder group ("CFC group"),<sup>5</sup> a GILTI high-tax exclusion election (or revocation) is either made with respect to each member of the CFC group or is not made for any member of the CFC group. See proposed §1.951A-2(c)(6)(v)(E)(1) and part IV.B of this Summary of Comments and Explanation of Revisions. The preamble to the 2019 proposed regulations requested comments on whether the consistency rule should be modified or removed, for example, by allowing the election to be made on an item-by-item or a CFC-by-CFC basis.

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<sup>5</sup> The final regulations adopt the shorter and more descriptive term "CFC group," instead of the term "controlling domestic shareholder group." See §1.951A-2(c)(7)(viii)(E)(2).

Several comments requested that the final regulations eliminate the consistency requirement such that the GILTI high-tax exclusion election can be made on a CFC-by-CFC basis, which would conform the exclusion to the subpart F high-tax exception. Some comments asserted that the consistency requirement is too restrictive because the GILTI regime generally applies to both low- and high-taxed income and the consistency requirement has the effect of applying the GILTI regime only to low-taxed income since all high-taxed income is excluded. Comments further asserted that determining whether making the election for all CFCs is beneficial, especially when involving multiple foreign countries, is a complex and difficult task and would increase taxpayers' compliance burden. Some comments stated that the elimination of the consistency requirement would enable taxpayers to minimize the unfavorable interaction between the GILTI regime and the rules for allocating and apportioning deductions. Other comments asserted that the consistency requirement would encourage taxpayers to implement structures that would convert tested income into subpart F income, which is contrary to one of the purposes of the GILTI high-tax exclusion. Finally, comments suggested that if the consistency requirement is included in the final regulations, it is likely that many taxpayers will not make the GILTI high-tax exclusion election.

The Treasury Department and the IRS have determined that the consistency requirement is necessary due to the collateral effect that the GILTI high-tax exclusion has on the allocation and apportionment of deductions. Specifically, allowing CFC-by-CFC or tested unit-by-tested unit elections would encourage the selective use of the GILTI high-tax exclusion to inappropriately manipulate the section 904 foreign tax credit

limitation. In this regard, deductions allocated and apportioned to income excluded under section 954(b)(4) will be subject to section 904(b)(4), as described in Part V.A of this Summary of Comments and Explanation of Revisions, and thereby disregarded for purposes of determining a taxpayer's foreign tax credit limitation under section 904. Without a consistency requirement, taxpayers may be able to include high-taxed income in GILTI to claim foreign tax credits up to the amount of their section 904 limitation, while electing to exclude the remainder of such income under the GILTI high-tax exclusion. Consequently, the taxpayer's section 904 limitation would not take into account all the deductions attributable to investments generating high-taxed income, resulting in a distortive application of the foreign tax credit limitation under section 904. A consistency requirement prevents this result by ensuring that a taxpayer that seeks to cross-credit the foreign tax imposed on high-taxed tentative tested income against low-taxed tentative tested income must take all of its high-taxed tentative tested income into account along with all of the deductions allocated and apportioned to that category of income. This concern does not arise with respect to other types of income that are excluded from tested income (for example, foreign oil and gas extraction income) because such items are always excluded (that is, there is no electivity as to whether they are included in tested income), and the foreign taxes attributable to that income can never be claimed as a credit against the U.S. tax imposed on section 951A inclusions.

The Treasury Department and the IRS agree that the GILTI high-tax exclusion election and the subpart F high-tax exception election should apply consistently and, as noted in part I of this Summary of Comments and Explanation of Revisions, have

determined that the subpart F high-tax exception should be conformed to the GILTI high-tax exclusion, as discussed in the preamble to the 2020 proposed regulations. This is appropriate, in part, due to changes made by the Act. Before the Act, a consistency requirement would have had minimal effect because post-1986 earnings and profits (including income excluded from subpart F income under section 954(b)(4)) could be distributed and would be included in income of the U.S. shareholder, and foreign taxes would be deemed paid under section 902, subject to the limitations imposed by section 904, which is a result consistent with a subpart F inclusion. Further, before the Act, an amount excluded under section 954(b)(4) largely resulted only in the deferral of income and deemed paid foreign taxes, rather than an exclusion of those items from the U.S. tax base, and deductions allocated and apportioned to such income would limit a taxpayer's ability to claim foreign tax credits in the future. After the Act, an election under section 954(b)(4) will result in a permanent change in the treatment of high-taxed income and the associated foreign taxes and deductions, increasing the significance, from a policy perspective, of inconsistent treatment.

Thus, the Treasury Department and the IRS have determined that the policy underlying section 954(b)(4) is best furthered through a single election to exclude all high-taxed income from GILTI (and, subject to finalization of the 2020 proposed regulations, subpart F income) because that income does not pose a base erosion concern and is therefore not the type of income that Congress intended to include in tested income. However, because the application of section 954(b)(4), and the additional administrative burden associated with identifying high-taxed items of income, has always been elective, the Treasury Department and the IRS have determined that

the exclusion of such income (and to the extent possible any additional burden associated with identifying such income) should continue to be limited to cases where a taxpayer elects the application of section 954(b)(4).

The Treasury Department and the IRS have determined that it would be inappropriate to allow a taxpayer to selectively exclude and include income, once it makes an election under section 954(b)(4). Section 951A generally does not permit electivity in the determination of tested income. For example, a taxpayer cannot choose to include in tested income amounts that would be subpart F income but for the application of section 954(b)(4) (regardless of whether the election is made), nor may a taxpayer choose to include foreign oil and gas extraction income in tested income. Further, contrary to some comments, the Treasury Department and the IRS anticipate that the additional electivity is more likely to increase, rather than reduce, compliance burden as a result of the need for more numerous calculations. As a result, the Treasury Department and the IRS have concluded that the consistency rule should be retained; accordingly, this recommendation is not adopted.

#### B. Definition of CFC group

The 2019 proposed regulations define a CFC group based on two tests. Under the first test, a CFC group means two or more CFCs if more than 50 percent of the total combined voting power of the stock of each CFC is owned (within the meaning of section 958(a)) by the same controlling domestic shareholder (as defined in §1.964-1(c)(5)). See proposed §1.951A-2(c)(6)(v)(E)(2). The second test applies only if no single controlling domestic shareholder satisfies the first test. Under the second test, the 2019 proposed regulations provide that a CFC group means two or more CFCs if

more than 50 percent of the total combined voting power of the stock of each CFC is owned (within the meaning of section 958(a)) by the same controlling domestic shareholders and each such shareholder owns (within the meaning of section 958(a)) the same percentage of stock in each CFC. See id. For purposes of both tests, a controlling domestic corporate shareholder includes a related person (within the meaning of section 267(b) or 707(b)(1)) (the “related party rule”). See id.

One comment raised several issues with the definition of a CFC group. For example, the comment stated that the application of the related party rule is circular because it requires the already-determined existence of a controlling domestic shareholder to apply the rule that a controlling domestic shareholder includes persons related to the controlling domestic shareholder. In addition, the comment requested clarification as to whether, for purposes of determining the CFC group, section 958(a) ownership is limited to ownership by U.S. persons. The comment also raised several issues related to changes in ownership of CFCs, including issues arising in connection with simultaneous acquisitions of CFCs and acquisitions of controlling domestic shareholders.

In response to these comments, the final regulations revise the definition of a CFC group. Under the final regulations, a CFC group is an affiliated group, as defined in section 1504(a), with certain modifications that broaden the definition. See §1.951A-2(c)(7)(viii)(E)(2)(i). First, the affiliated group rules in section 1504(a) apply without regard to section 1504(b)(1) through (6) (which exclude certain corporations, such as foreign corporations, from the definition of an “includible corporation”). See id. Second, for purposes of determining whether a CFC is a member of a CFC group, the final

regulations incorporate a “more than 50 percent” threshold instead of the “at least 80 percent” threshold in section 1504(a). See id. Stock ownership for this purpose is determined by applying the constructive ownership rules of section 318(a), with certain modifications. See id. These constructive ownership rules would, for example, cause two corporations owned directly by the same U.S. individual to be part of a CFC group.

The final regulations provide that the determination of whether a CFC is included in a CFC group is made as of the close of the CFC inclusion year of the CFC that ends with or within the taxable years of the controlling domestic shareholders. See §1.951A-2(c)(7)(viii)(E)(2)(ii). This rule is intended to address certain changes in ownership of CFCs, such as acquisitions and dispositions. The final regulations also provide that a CFC may be a member of only one CFC group and include a special tie-breaker rule for situations in which a CFC would be a member of more than one CFC group. See §1.951A-2(c)(7)(viii)(E)(2)(iii).

The final regulations also clarify that if a CFC is not a member of a CFC group, a high-tax election is made (or revoked) only with respect to the CFC and the rules regarding the election apply by reference to the CFC. See §1.951A-2(c)(7)(viii)(A). If, however, a CFC is a member of a CFC group, a high-tax election is made (or revoked) with respect to all members of the CFC group and the rules regarding the election apply by reference to the CFC group. See §1.951A-2(c)(7)(viii)(E)(1).

### C. Duration of election

The 2019 proposed regulations generally provide that the GILTI high-tax exclusion election is effective for the CFC inclusion year for which it is made and all subsequent CFC inclusion years, unless the election is revoked. See proposed

§1.951A-2(c)(6)(v)(C). The 2019 proposed regulations further provide that, subject to a “change of control” exception, if an election is revoked, then the CFC cannot make a new election for any CFC inclusion year that begins within 60 months following the close of the CFC inclusion year for which the previous election was revoked (“60-month restriction”). See proposed §1.951A-2(c)(6)(v)(D)(2). The preamble to the 2019 proposed regulations requested comments on whether the 60-month restriction should be modified or removed.

Several comments requested that the 60-month restriction be eliminated such that taxpayers would be permitted to make the GILTI high-tax exclusion election on an annual basis. Some comments reasoned that this change would be consistent with the subpart F high-tax exception, which is an annual election. Another comment asserted that taxpayers should be permitted to make the election annually to take into account significant fluctuations in foreign income that taxpayers generate from year to year, or the likely possibility that taxpayers may be subject to differing foreign tax rates from year to year as a result of economic factors and conditions beyond their control. Finally, a comment stated that taxpayers with a mix of high-taxed and low-taxed income attributable to their QBUs must evaluate various factors to determine whether an election should be made and, as those factors change from year to year, the 60-month restriction may force taxpayers to pay additional tax under the GILTI regime if future projections are incorrect.

The Treasury Department and the IRS agree with these comments and have determined that, given that the final regulations adopt a tested unit-by-tested unit approach (in lieu of the QBU-by-QBU approach) and retain the consistency requirement

set forth in the 2019 proposed regulations, the 60-month restriction is not necessary to prevent abuse. Accordingly, the final regulations do not include the 60-month restriction and, subject to the consistency requirement, taxpayers may elect the GILTI high-tax exclusion on an annual basis.

Because the final regulations eliminate the 60-month restriction, comments requesting that the restriction be clarified in certain respects are moot and therefore not discussed.

D. Effect on non-controlling U.S. shareholders

One comment requested that the final regulations include a notice of election and revocation requirement, which would require any U.S. shareholder that makes or revokes an election to notify the CFC of such action and require any CFC that receives an election or revocation notice from a U.S. shareholder for a taxable year to notify its other U.S. shareholders of the action taken by the U.S. shareholder and its ownership percentage.

The Treasury Department and the IRS agree that U.S. shareholders that are not controlling domestic shareholders of a CFC should be informed by the controlling domestic shareholders of the CFC if they make (or revoke) a GILTI high-tax exclusion election with respect to the CFC. Therefore, the final regulations clarify that the controlling domestic shareholders must provide notice of elections (or revocations), as required by §1.964-1(c)(3)(iii), to each U.S. shareholder that is not a controlling domestic shareholder. See §1.951A-2(c)(7)(viii)(A)(1)(ii), (C) and (D).

E. Treatment of domestic partnerships as controlling domestic shareholders

The proposed regulations under section 958 in the 2019 proposed regulations provide, as a general rule, that for purposes of sections 951 and 951A (and certain related provisions) a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of section 958(a). See proposed §1.958-1(d)(1). Under an exception to this general rule, a domestic partnership is treated as owning stock of a foreign corporation within the meaning of section 958(a) for purposes of determining whether any U.S. shareholder is a controlling domestic shareholder. See proposed §1.958-1(d)(2). The preamble to the 2019 proposed regulations requested comments on this exception. The Treasury Department and the IRS intend to address comments received in response to this request in connection with finalizing the proposed regulations under sections 951, 956, 958, and 1502.<sup>6</sup>

F. Elections made or revoked on amended tax returns

The 2019 proposed regulations generally allow a taxpayer to make (or revoke) the GILTI high-tax exclusion election with an amended income tax return. See proposed §1.951A-2(c)(6)(v)(A)(1) and (c)(6)(v)(D)(1). One comment indicated that it was unclear how the binding effect of the election on all U.S. shareholders of a CFC operates when the controlling domestic shareholder makes (or revokes) the election on an amended return. In particular, the comment stated that it was unclear whether a

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<sup>6</sup> Under currently applicable §1.951A-1(e)(2), a domestic partnership can be a controlling domestic shareholder—for example, for purposes of determining which party elects the GILTI high-tax exclusion under §1.951A-7(c)(7)(viii)(A), including potentially for taxable years beginning after December 31, 2017, under §1.951A-7(b), as discussed in part VIII of this Summary of Comments and Explanation of Revisions.

U.S. shareholder, other than a controlling domestic shareholder, would be required to file an amended return reflecting the election (or revocation). The comment further raised concerns about the possibility that the assessment statute of limitations may limit the government's ability to assess any additional tax due as a result of such election (or revocation). The comment recommended that the final regulations clarify whether U.S. shareholders are required to file amended income tax returns when an election is made (or revoked) on an amended return.

In general, the Treasury Department and the IRS agree with the comment that allowing the controlling domestic shareholders to make (or revoke) the GILTI high-tax exclusion election on an amended income tax return may change the amount of U.S. tax due with respect to U.S. shareholders other than the controlling domestic shareholders. Further, the election or revocation may change the amount of U.S. tax due with respect to all U.S. shareholders in intervening tax years. If the election were made (or revoked) on an amended return after some or all of these taxable years are no longer open for assessment under section 6501, it may result in the issuance of refunds for certain taxable years of shareholders when corresponding deficiencies could not be assessed or collected. As a result, the final regulations provide that the election may be made (or revoked) on an amended federal income tax return only if all U.S. shareholders of the CFC file amended federal income tax returns (unless an original return has not yet been filed, in which case the original federal income tax return may be filed consistently with the election (or revocation)) for the taxable year (and for any other taxable year in which their U.S. tax liabilities would be increased by reason of that election (or revocation)) (or in the case of a partnership if any item reported by the

partnership or any partnership-related item would change as a result of the election (or revocation)), within 24 months of the unextended due date of the original federal income tax return of the controlling domestic shareholder's inclusion year with or within which the CFC inclusion year, for which the election is made (or revoked), ends. See §1.951A-2(c)(7)(viii)(A)(2) and (c)(7)(viii)(C). For administrative purposes, the final regulations also provide that amended federal income tax returns for all U.S. shareholders of the CFC for the CFC inclusion year must be filed within a single 6-month period (within the 24-month period). See §1.951A-2(c)(7)(viii)(A)(2)(ii). The requirement that all amended federal income tax returns be filed within a 6-month period is to allow the IRS to timely evaluate refund claims or make additional assessments.

The final regulations also clarify how these rules operate in the case of a U.S. shareholder that is a domestic partnership. See §1.951A-2(c)(7)(viii)(A)(3) and (4). For example, the final regulations provide that in the case of a U.S. shareholder that is a partnership, the election may be made (or revoked) with an amended Form 1065 or an administrative adjustment request (as described in §301.6227-1), as applicable. See §1.951A-2(c)(7)(viii)(A)(3). The final regulations further provide that if a partnership files an administrative adjustment request, a partner that is a U.S. shareholder in the CFC is treated as having complied with these requirements (with respect to the portion of the interest held through the partnership) if the partner and the partnership timely comply with their obligations under section 6227 with respect to that administrative adjustment request. See §1.951A-2(c)(7)(viii)(A)(4).

## V. Foreign Tax Credit Rules

A. Allocation and apportionment of deductions with respect to CFC stock

One comment requested that the final regulations confirm that U.S. shareholder deductions properly allocated and apportioned to income excluded under the GILTI high-tax exclusion should not be taken into account for purposes of section 904 per the application of section 904(b)(4)(B). Section 904(b)(4) applies with respect to deductions properly allocated and apportioned to income (other than amounts includible under section 951(a)(1) or 951A(a)) with respect to stock of a specified 10-percent owned foreign corporation (as defined in section 245A(b)) or to such stock to the extent income with respect to such stock is other than amounts includible under section 951(a)(1) or 951A(a). Accordingly, section 904(b)(4) applies to any deduction allocated and apportioned to dividend income for which a deduction is allowed under section 245A. See §1.904(b)-3(a)(1)(ii). Similarly, section 904(b)(4) applies to any deduction allocated and apportioned to stock of specified 10-percent owned foreign corporations in the section 245A subgroup. See §1.904(b)-3(a)(1)(iii). For purposes of characterizing stock of a CFC under §1.861-13, income excluded under the GILTI high-tax exclusion should be treated as any other foreign or U.S. source gross income described in §1.861-13(a)(1)(i)(A)(9) and (10). The portion of the value of the stock of the CFC relating to such income will be assigned to the section 245A subgroup under §1.861-13(a)(5)(ii) through (iv). As a result, the Treasury Department and the IRS have determined that the regulations are clear regarding the interaction of U.S. shareholder deductions allocated and apportioned to income excluded under the GILTI high-tax exclusion and section 904(b)(4), and no further rules are necessary.

Another comment suggested that the final regulations turn off the application of section 904(b)(4) for deductions allocated and apportioned to income or stock that relates to earnings and profits arising from CFC income that is excluded by reason of the GILTI high-tax exclusion. This comment indicated that allowing the application of section 904(b)(4) could incentivize taxpayers to inappropriately locate deductions related to high-taxed income in the United States. The Treasury Department and the IRS do not agree that taxpayers will have a material incentive to relocate deductions relating to high-taxed income to the United States as a result of the application of section 904(b)(4) because the foreign tax rates required to qualify for the GILTI high-tax exclusion must generally be comparable to or higher than the U.S. corporate tax rate, and, thus, taxpayers will generally benefit from locating such deductions in the foreign country. In effect, the GILTI high-tax exclusion reduces the effect of federal income taxes on taxpayers' locational decisions with respect to investment and deductions, thereby increasing the likelihood that such decisions will be based on non-tax business considerations. Furthermore, section 904(b)(4) by its terms applies to income that is not includible under section 951(a)(1) or section 951A(a), and income excluded under the GILTI high-tax exclusion is not includible under either of those provisions. Accordingly, the comment is not adopted.

**B. Determination of taxes paid or accrued**

One comment asserted that the 2019 proposed regulations are unclear as to the determination of the foreign taxes paid or accrued and requested that the final regulations clarify that foreign income taxes include taxes imposed by a country (or countries) on the net item, as provided under current §1.954-1(d)(3)(i). The comment

specifically notes, as an example, instances where two foreign countries tax the same income.

The rules provided in §1.951A-2(c)(7)(iii) and (vii) are comparable to those provided in current §1.954-1(d)(3)(i); both sets of rules generally apply §1.904-6 to allocate and apportion foreign taxes to income. Although the GILTI high-tax exclusion requires that foreign taxes be associated with income on a narrower basis -- the tested unit rather than the CFC -- taxes imposed on the CFC that relate to income of the tested unit will generally be associated with the appropriate income under the rules in §1.904-6, regardless of whether such tax is imposed by one or more countries. The 2020 proposed regulations propose further conformity of the rules applicable for the computation of the effective foreign tax rate for both subpart F income and tested income.

Further, in response to this comment, as well as similar comments received in response to the 2019 proposed regulations, the final regulations (T.D. 9882) relating to foreign tax credits published in the **Federal Register** (84 FR 69022) (“the 2019 Final FTC Regulations”) and these final regulations clarify the rules for associating foreign taxes with income. In particular, these final regulations clarify that the amount of foreign income taxes paid or accrued by a CFC with respect to a tentative tested income item is the U.S. dollar amount of the controlled foreign corporation’s current year taxes that are allocated and apportioned to the related tentative gross tested income. See §1.951A-2(c)(7)(vii). The final regulations provide that the deductions for current year taxes are allocated and apportioned to a tentative gross tested income item under the principles of §1.960-1(d)(3), by treating each tentative gross tested income item as assigned to a

separate tested income group. See §1.951A-2(c)(7)(iii)(A). As a result, the principles of §1.904-6(a)(1) generally apply to allocate and apportion foreign income taxes to a tentative gross tested income item. However, the principles of §1.904-6(a)(2) are applied, in lieu of the principles of §1.904-6(a)(1), to associate foreign taxes with income in the case of disregarded payments between tested units. See §1.960-1(d)(3) and §1.951A-2(c)(7)(iii)(B). The final regulations provide additional rules for how the principles of §1.904-6(a)(2) should be applied for purposes of the high-tax exception. See id. In addition, a new example illustrates how foreign income taxes are associated with income in the case of disregarded payments. See §1.951A-2(c)(8)(iii)(B) (Example 2). The Treasury Department and the IRS also published proposed regulations (REG-105495-19) relating to foreign tax credits in the **Federal Register** (84 FR 69124) that contain more detailed rules for associating foreign taxes with income, including in the case of disregarded payments.

#### C. Annual accounting periods and foreign tax accruals

The proposed regulations generally provide that the amount of foreign income taxes paid or accrued with respect to a tentative net tested income item are the CFC's current year taxes (as defined in §1.960-1(b)(4)) that would be allocated and apportioned under the principles of §1.960-1(d)(3)(ii) to the tentative net tested income item by treating the item as in a separate tested income group. See proposed §1.951A-2(c)(6)(iv). Taxes accrue, and are taken into account in determining foreign taxes deemed paid under section 960(d), when all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy. See §1.960-1(b)(4). Therefore, withholding taxes accrue when the payment

from which the tax is withheld is made, and net basis taxes on income recognized during a taxable period accrue on the last day of the taxable period. Id.

Comments suggested that the final regulations provide special rules to address distortions that can arise from a mismatch between the U.S. and foreign taxable years. One comment recommended a “closing of the books election” whereby a taxpayer could elect to allocate and apportion its foreign taxes accrued in one U.S. taxable year across multiple U.S. taxable years, in proportion to the income accrued in each U.S. taxable year. Other comments recommended that taxpayers be permitted to adopt various alternative methods of accounting, including the use of the foreign taxable year to determine whether income is subject to a high rate of tax, or methods of accounting required under foreign law, such as mark-to-market.

The Treasury Department and the IRS have determined that foreign taxes should be associated with U.S. income consistently for all federal income tax purposes, and that deviating from established principles for determining when income and foreign taxes are taken into account for purposes of the GILTI high-tax exclusion would be inappropriate. Allowing foreign taxes to be taken into account in applying the GILTI high-tax exclusion in a different year than the year in which the foreign taxes accrue could lead to double counting, or double-non-counting, of the foreign taxes. This could occur, for example, if a foreign tax that accrued in one year both caused a prior year tentative tested income item to be excluded as high-taxed and was creditable in the later year under section 960(d). While some comments also recommended changes to how foreign taxes are taken into account more generally, changes to the foreign tax credit regime are beyond the scope of this rulemaking. In addition, the Treasury

Department and the IRS responded to similar comments in Part V of the Summary of Comments and Explanation of Revisions in the preamble to the 2019 Final FTC Regulations.

Similar considerations would apply with respect to the adoption of alternative methods of accounting for tentative tested income items, such as the adoption of a foreign fiscal year as the testing period or mark-to-market accounting. The use of these methods would lead to potential double counting of items of income, gain, deduction, or loss in different U.S. taxable years for different purposes, or would require complex coordination rules with material changes to established rules relating to when such items accrue for federal income tax purposes. Such changes are beyond the scope of this rulemaking and, accordingly, are not adopted.

#### VI. Removal of Examples in §1.954-1(d)(7)

Current §1.954-1(d)(7) provides examples that illustrate the application of the rules set forth in §1.954-1(c) and (d). The Treasury Department and the IRS have determined that these examples need to be updated to properly reflect changes to current §1.954-1 made in the final regulations, and to other provisions referenced in the examples. Therefore, the final regulations remove the examples in current §1.954-1(d)(7). No inference is intended as to the removal of these examples. Additional examples will be considered in connection with the Treasury decision adopting the 2020 proposed regulations as final regulations in the **Federal Register**.

#### VII. Authority

The Treasury Department and the IRS are aware that questions have been raised regarding the statutory authority for the GILTI high-tax exclusion. As described in

detail in the preamble to the 2019 proposed regulations (see 84 FR 29114), the Treasury Department and the IRS have determined that the GILTI high-tax exclusion is a valid interpretation of ambiguous statutory text in section 951A(c)(2)(A)(i)(III) and, after considering assertions to the contrary, concluded that this rationale provides authority to finalize the GILTI high-tax exclusion. See Michigan v. Environmental Protection Agency, 135 S. Ct. 2699, 2707 (2015) (observing that a court must “accept an agency’s reasonable resolution of an ambiguity in a statute that the agency administers,” provided that such interpretation “operate[s] within the bounds of reasonable interpretation.”). Specifically, the regulation interprets the words “by reason of” in that provision as denoting independently sufficient causation. The assertion by some commenters to the contrary that the words “by reason of” unambiguously require “but for” causation is not supported by the case law. Terms such as “by reason of” have been equated with other causal terms, such as “because of” or “as a result of,” and have been interpreted flexibly based on the underlying context and purposes of the applicable provision. Several recent decisions have interpreted such terms as encompassing independently sufficient causation based on dicta in the Supreme Court’s recent opinion in Burrage v. United States, 134 S.Ct. 881, 890 (2014). See, e.g., United States v. Ewing, 749 Fed.Appx. 317, 327-28 (6th Cir. 2018); United States v. Seals, 915 F.3d 1203, 1206-07 (8th Cir. 2019); United States v. Feldman, 936 F.3d 1288, 1317-18 (11th Cir. 2019).

In addition, commenters have suggested that, based on the statutory structure of sections 954(b)(4) and 951A(c)(2)(A)(i)(III), the provisions can only apply to income that would otherwise qualify as FBCI or insurance income. The Treasury Department and

the IRS disagree with this assertion because it would require that income both qualify as FBCI or insurance income and be excluded from such categories of income for purposes of the same provision. Moreover, neither section 954(b)(4) nor 951A(c)(2)(A)(i)(III) contains any limitation on the category of income to which the provisions can apply, instead referring broadly to “any item of income” and “any gross income,” respectively.

Accordingly, the GILTI high-tax exclusion is a valid interpretation of section 951A(c)(2)(A)(i)(III) based on the statutory text and the legislative purposes and history underlying section 951A, each of which is described in detail in the preamble to the 2019 proposed regulations.

#### VIII. Applicability Dates

Consistent with the applicability date in the 2019 proposed regulations, the final regulations provide that the GILTI high-tax exclusion applies to taxable years of foreign corporations beginning on or after July 23, 2020, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

See §1.951A-7(b).<sup>7</sup>

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<sup>7</sup> Although this applicability date applies to §1.954-1(c)(1)(iv) (clarifying the treatment of deductions and loss attributable to disqualified basis in determining a net item of foreign base company income or insurance income), the rules in §1.951A-2(c)(5) (requiring deductions or loss attributable to disqualified basis to be allocated and apportioned solely to residual gross income) apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end. See §1.951A-7(a). See also proposed §1.951A-2(c)(6) (requiring deductions related to disqualified payments to be allocated and apportioned solely to residual CFC gross income), as proposed to be amended at 85 FR 19858 (April 8, 2020), which would apply to taxable years of foreign corporations ending on or after April 7, 2020, and to taxable years of U.S. shareholders in which or with which such taxable years end. See proposed §1.951A-7(d).

Several comments requested that taxpayers be permitted to apply the GILTI high-tax exclusion earlier than the proposed regulations would have allowed (for example, to taxable years beginning after December 31, 2017). In response to the comments, the final regulations permit taxpayers to choose to apply the GILTI high-tax exclusion to taxable years of foreign corporations that begin after December 31, 2017, and before July 23, 2020, and to taxable years of U.S. shareholders in which or with which such taxable years of the foreign corporations end. See §1.951A-7(b). Any taxpayer that applies the GILTI high-tax exclusion retroactively must consistently apply the rules in this Treasury decision to each taxable year in which the taxpayer applies the GILTI high-tax exclusion. See id.

## **Special Analyses**

### **I. Regulatory Planning and Review -- Economic Analysis**

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. For purposes of Executive Order 13771, this final rule is regulatory.

The Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) has designated these regulations as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding

review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated the final rulemaking as significant under section 1(c) of the Memorandum of Agreement. Accordingly, OMB has reviewed the final regulations.

#### A. Background

The Tax Cuts and Jobs Act (the “Act”) established a system under which certain earnings of a foreign corporation can be repatriated to a corporate U.S. shareholder without federal income tax. However, Congress recognized that, without any anti-base erosion measures, this system could incentivize taxpayers to allocate income—in particular, mobile income from intangible property that would otherwise be subject to U.S. tax—to controlled foreign corporations (“CFCs”) operating in low- or zero-tax jurisdictions. See Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 365 (the “Senate Explanation”). Therefore, Congress enacted section 951A in order to subject intangible income earned by a CFC to U.S. tax on a current basis, similar to the treatment of a CFC’s subpart F income under section 951(a)(1)(A). However, in order to protect the competitive position of U.S. corporations relative to their foreign peers, the global intangible low tax income (“GILTI”) of a corporate U.S. shareholder is effectively taxed at a reduced rate by reason of the deduction under section 250 (with the resulting federal income tax further reduced by a portion of foreign tax credits under section 960(d)). Id.

The Treasury Department and the IRS previously issued final and proposed regulations under section 951A on June 21, 2019 (“2019 proposed regulations”).

#### B. Need for regulations

The final regulations are needed to provide a framework for taxpayers to elect to apply the statutory high-tax exception of section 954(b)(4) and exclude certain high-taxed income from taxation under section 951A.

### C. Overview of regulations

The final regulations provide that the GILTI high-tax exclusion in section 951A(c)(2)(A)(i)(III) applies to high-taxed income of a CFC that is excluded from foreign base company income (“FBCI”) or insurance income under section 954(b)(4) regardless if the income would otherwise be FBCI or insurance income.

The final regulations provide rules to determine the effective rate of tax on foreign items of income for the purposes of applying the GILTI high-tax exclusion. The final regulations provide that the effective foreign tax rate is determined on a tested unit basis. They also provide rules to determine the net amount of income (in other words, the tentative tested income item) and the foreign taxes paid or accrued with respect to such net amount of income that are used to compute the effective rate of tax. In addition, the final regulations indicate how to make a GILTI high-tax exclusion election. The final regulations provide that the election, if made, must be made consistently for certain related CFCs. The final regulations also provide that taxpayers can make the election annually.

### D. Economic analysis

#### 1. Baseline

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

## 2. Summary of Economic Effects

The final regulations provide certainty and clarity to taxpayers in applying section 954(b)(4) to certain high-tax income. In the absence of this clarity, there is a higher likelihood that taxpayers will interpret the rules regarding the high-tax exclusion differently. For example, when taxpayers hold varying interpretations of statutory language, one taxpayer may undertake an investment in a particular country while another taxpayer may decline to make this investment with this difference based solely on different interpretations of how income from that investment will be treated under section 951A and related provisions. If the investment would have been more productive if undertaken by the second taxpayer, this difference in beliefs about tax treatment is economically costly. The final regulations help to minimize this outcome. Clarity and certainty over tax treatment also reduce compliance costs and the costs of tax administration.

The final regulations also work to apply the GILTI high-tax exclusion in a way that treats income similarly across all international business activity and without favoring one type of income over another. In general, such equitable treatment of income-generating activities can be expected to improve U.S. economic performance.

The Treasury Department and the IRS project that the final regulations will have annual economic effects greater than \$100 million (\$2020). This determination is based on the fact that many of the taxpayers potentially affected by these regulations are large multinational enterprises. Because of their substantial size, even modest changes in the treatment of their foreign-source income, relative to the no-action baseline, can lead to changes in patterns of economic activity that amount to at least \$100 million per year.

The Treasury Department and the IRS project that the final regulations may increase U.S. taxpayers' foreign investment in high-tax jurisdictions, since the final regulations may decrease the effective tax rate on high-tax foreign-source income for some U.S. taxpayers relative to the no-action baseline. The Treasury Department and the IRS have not undertaken more precise estimates of the economic effects of the regulations. We do not have readily available data or models to predict with reasonable precision the business decisions that taxpayers would make under the final regulations, such as the amount and location of their foreign business activities, versus alternative regulatory approaches, including the no-action baseline.

In the absence of quantitative estimates, the Treasury Department and the IRS have undertaken a qualitative analysis of the economic effects of the final regulations relative to the no-action baseline and relative to alternative regulatory approaches.

### 3. Economic Analysis of Specific Provisions

#### a. Scope of the GILTI high-tax exclusion

The GILTI high-tax exclusion in section 951A permits U.S. shareholders of CFCs to elect to exclude certain high-taxed income from gross tested income. The final regulations provide guidance on which types of high-taxed income are eligible for the high-tax exclusion.

The Treasury Department and the IRS considered a number of options for defining income that is eligible for the GILTI high-tax exclusion. The options were (i) to exclude from gross tested income only income that would be subpart F income solely but for the high-tax exception of section 954(b)(4) applying to such income; (ii) in addition to excluding the aforementioned income, to exclude from gross tested income

on an elective basis an item of gross income that is excluded by reason of another exception to FBCI or insurance income, if such income is subject to an effective foreign tax rate above the statutory threshold;<sup>8</sup> or (iii) to exclude from gross tested income on an elective basis any item of gross income subject to an effective foreign tax rate above the statutory threshold.

The first option excludes from gross tested income only income that would be FBCI or insurance income but for the high-tax exception of section 954(b)(4), which is the interpretation of the scope of the GILTI high-tax exclusion in the final 951A regulations. This approach is consistent with current regulations under section 954, which permit an election under section 954(b)(4) only with respect to income that is not excluded from subpart F income by reason of another exception (for example, section 954(c)(6) or 954(h)). However, under this approach, taxpayers with high-taxed gross tested income would have an incentive to structure their foreign operations in order to ensure that income that would otherwise qualify as gross tested income would instead qualify as subpart F income, to a greater degree than other regulatory approaches that provide a broader GILTI high-tax exclusion, such as the third option considered. For instance, under this option, a taxpayer could structure its operations to have a CFC purchase personal property from, or sell personal property to, a related person in order to generate foreign base company sales income described under section 954(d) (assuming certain other exceptions are not satisfied). The result would be that the CFC's income from the disposition of the property meets the definition of FBCI and

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<sup>8</sup> The statutory threshold is 90 percent of the maximum U.S. corporate tax rate (18.9 percent based on the current U.S. corporate tax rate of 21 percent).

hence is eligible for the high-tax exception. Because businesses are largely not currently structured in this way, such an organization would entail restructuring, which would potentially be costly and only available to certain taxpayers yet would not provide any general economic benefit. In other words, such reorganization to realize a specific tax treatment would suggest that tax instead of business considerations are determining business structures and operations. This outcome may lead to higher compliance costs and less efficient patterns of business activity relative to a regulatory approach that provides a broader GILTI high-tax exclusion.

The second option broadens the application of the GILTI high-tax exclusion, relative to the first option, to allow taxpayers to elect to exclude items of gross income that are subject to an effective foreign tax rate above the statutory threshold, if such income was also excluded from FBCI or insurance income by reason of another exception to subpart F. Under this interpretation, income such as active financing income that is excluded from subpart F income under section 954(h), active rents or royalties that are excluded from subpart F income under 954(c)(2)(A), and related party payments that are excluded from subpart F income under section 954(c)(6) could also be excluded from gross tested income under the GILTI high-tax exclusion if such items of income are high taxed within the meaning of section 954(b)(4).

Under this approach, however, taxpayers would have the ability to exclude their CFCs' high-taxed income that would be subpart F income but for an exception (for example, active financing income), while they would not be able to exclude their CFCs' high-taxed income that is not subpart F income in the first instance (for example, active business income). This may result in differential treatment of economically similar

income, which generally leads to economically inefficient decision-making.

Furthermore, taxpayers with items of high-taxed income that are not subpart F income would still be incentivized to restructure their foreign operations in order to convert their high-taxed gross tested income into subpart F income, which poses the same compliance costs and inefficiencies as the first option.

The third option, which was adopted in the proposed regulations and which these regulations finalize, provides an election to broaden the scope of the high-tax exception relative to the other two options considered. Under this option, the high-tax exception under section 954(b)(4) for purposes of the GILTI high-tax exclusion applies to any item of income that is subject to an effective foreign tax rate greater than 90 percent of the maximum corporate tax rate (currently, 18.9 percent based on a 21 percent corporate rate). The final regulations permit controlling domestic shareholders of CFCs to elect to apply the high-tax exception under section 954(b)(4) to items of gross income that would not otherwise be FBCI or insurance income. If this high-tax exception is elected, the GILTI high-tax exclusion will exclude the item of gross income from gross tested income. Under the election, an item of gross income is subject to a high rate of foreign tax if, after taking into account properly allocable expenses, the net item of income is subject to an effective foreign tax rate above the statutory threshold.

Contrary to the first two options, this approach permits similarly situated taxpayers with CFCs subject to a high rate of foreign tax to make the election to exclude such income from gross tested income and reduces the incentive for taxpayers to restructure their operations or structures to convert their high-taxed gross tested income into FBCI or insurance income for federal income tax purposes.

For taxpayers that make the election, this approach will lower U.S. tax on certain foreign income by reducing U.S. tax on a broader scope of the income of high-taxed tested units compared to the no-action baseline. If a taxpayer elects the high-tax exclusion, U.S. tax on other foreign income may increase due to complex interactions with other provisions in the corporate tax system, such as the expense allocation and foreign tax credit rules, although taxpayers will generally only make the election if this increase in tax on other foreign income is less than the decrease in tax on high-taxed income. Thus, this approach may reduce the taxpayers' cost of capital on high-taxed foreign investment, and at the margin, the lower cost of capital may increase foreign investment in high-tax jurisdictions by U.S.-parented firms relative to the baseline.

The Treasury Department and the IRS have not undertaken estimation of these effects, relative to the no-action baseline, because we do not have readily available data or models to estimate with any reasonable precision: (i) the number and attributes of the taxpayers that will find it advantageous to make the election; (ii) the relationship between the marginal effective foreign tax rate at the tested unit level and foreign investment by U.S. taxpayers; and (iii) the range of marginal effective foreign tax rates at the tested unit level that taxpayers are likely to have under the final regulations versus the baseline or other regulatory approaches.

b. Aggregation of income for determination of the effective foreign tax rate

The statute provides an exclusion from tested income for high-taxed income but does not provide sufficient detail for determining how income should be aggregated for determining the effective foreign tax rate that applies to that income, such that that income would be excluded. The Treasury Department and the IRS considered four

options to address this issue: (i) apply the determination of whether income is high-taxed on an item-by-item basis; (ii) apply the determination on a CFC-by-CFC basis; (iii) apply the determination on a qualified business unit (“QBU”)-by-QBU basis; and (iv) apply the determination on a tested unit-by-tested unit basis.

The first option is to determine whether income is high-taxed income on an item-by-item basis, based on the item-by-item determination that is generally applicable under the current regulations that implement the high-tax exception of section 954(b)(4) for purposes of subpart F income. However, this would entail high compliance costs for taxpayers and be difficult to administer because it would require taxpayers to analyze each item of income to determine whether, under federal tax principles, the item is subject to a sufficiently high effective foreign tax rate. The Treasury Department and the IRS have not estimated the higher compliance costs that might have been incurred under this regulatory option, relative to the final regulations.

The second option, to apply the determination based on all the items of income of the CFC, would minimize complexity and would be relatively easy to administer. On the other hand, this approach could permit inappropriate tax planning, such as combining operations subject to different rates of tax into a single CFC. This would have the effect of “blending” the rates of foreign tax imposed on the income, which could result in low- or non-taxed income being excluded as high-taxed income by being blended with much higher-taxed income. The low-taxed income in this scenario is precisely the sort of base erosion-type income that the legislative history describes section 951A as intending to tax, and such tax motivated planning behavior is economically inefficient.

The third option, which was proposed in the proposed regulations, is to apply the high-tax exception based on the items of gross income of a QBU of the CFC. Under this approach, the net income that is taxed by the foreign jurisdiction in each QBU must be determined and the blending of different tax rates within a CFC would be minimized. While this approach would more accurately separate high-taxed and low-taxed income, compared to applying the high-tax exception on the basis of a CFC, there were several comments to the proposed regulations that noted the difficulties in compliance and administration that would arise if the QBU standard were used, such as the difficulty in determining whether a set of activities constituted a trade or business and hence a QBU.

The fourth option, which is adopted in the final regulations, is to apply the high-tax exception on the basis of the items of gross income of a tested unit of a CFC. The tested unit standard is a more targeted measure than the QBU standard and will be more easily applied to the GILTI high-tax exclusion than the QBU standard. Moreover, the tested unit standard, similarly to the QBU standard, will minimize the blending of different tax rates within a CFC. For example, if a CFC earned \$100x of tested income through a tested unit in Country A and was taxed at a 30 percent rate and earned \$100x of tested income through another tested unit in Country B and was taxed at 0 percent, the blended rate of tax on all of the CFC's tested income is 15 percent. However, if the high-tax exception applies to each of a CFC's tested units based on the income earned by that tested unit, then the two tax rates would not be blended together. Although applying the high-tax exception on the basis of a tested unit, rather than the CFC as a whole, may be more complex and administratively burdensome under certain

circumstances and may entail somewhat higher compliance costs (although most of the data the taxpayer would use for this purpose will likely be readily available to the taxpayer and will often overlap with data necessary to meet other compliance requirements), it more accurately pinpoints income subject to a high rate of foreign tax and therefore continues to subject to tax the low-taxed base erosion-type income that the legislative history describes section 951A as intending to tax. Accordingly, the final regulations apply the high-tax exception of section 954(b)(4) based on the items of net income of each tested unit of the CFC.

The Treasury Department and the IRS have not estimated these effects, relative to the no-action baseline, because we do not have readily available data or models to estimate with any reasonable precision the compliance costs or restructuring costs affected by these provisions relative to the no-action baseline or other regulatory alternatives.

c. Grouping of tested units in same country

The statute does not specify how items of income in the same country should be treated for the purpose of applying the GILTI high-tax exclusion. To address this issue, the final regulations provide guidance on how a CFC's tested units in the same country should be treated in order to determine if income is high-taxed.

Under the proposed regulations, effective foreign tax rates are determined separately for each QBU, even if other QBUs of the same CFC are located in the same county. Testing each QBU separately would limit the blending of income taxed at different rates and thus limit the likelihood that that no-taxed or low-taxed income would qualify for the high-tax exclusion through aggregation with higher-taxed income. This

approach is consistent with the intent to subject low-taxed base erosion-type income to tax under section 951A, as described in the legislative history. However, comments noted that separate testing for each QBU would result in high compliance burdens for taxpayers and could result in tax rate calculations that do not reflect the rate of foreign tax on QBU income, especially in circumstances in which separate QBUs are able to share tax attributes through a fiscal unity, consolidation or similar means. If tax rate calculations do not properly reflect the rate of foreign tax on QBU, taxpayers may undertake inefficient business decisions when evaluated against the intent and purpose of the statute.

In the final regulations, all tested units of a CFC in the same country are generally grouped together to determine the effective foreign tax rate for the purpose of applying the high-tax exclusion. Under this approach, low-taxed and high-taxed income are unlikely to be blended, since tested units in the same country are likely to be subject to the same statutory tax rate. Relative to the approach in the proposed regulations, this approach will lower compliance burdens for taxpayers because taxpayers will less frequently have to allocate and apportion taxes paid by one tested unit to another tested unit. In addition, this approach may also reduce the effect of fluctuations in effective foreign tax rates observed in individual tested units relative to the regulatory alternative in the proposed regulations. Since multiple tested units are grouped together, outlying effective foreign tax rates due to timing and base differences between the U.S. and foreign tax rules will counterbalance each other. Finally, this averaging of tax rates will decrease the incentives taxpayers face to undertake inefficient planning activities to achieve certain tax rates in individual tested units relative to a regulatory approach in

which effective foreign tax rates were determined separately for tested units in the same country.

The Treasury Department and the IRS have not undertaken estimation of these effects, relative to the no-action baseline, because data or models are not readily available to estimate with any reasonable precision the compliance costs or patterns of business activity affected by these provisions relative to the no-action baseline or other regulatory alternatives.

d. Foreign net operating losses

The statute provides an exclusion from tested income for income that is high-taxed but does not specify whether or how foreign net operating loss (“NOL”) carryovers should be accounted for in the computation of the effective foreign tax rate. To address this issue, the final regulations provide rules governing how foreign net operating loss carryforwards should be accounted for in the computation of the effective foreign tax rate.

The proposed regulations generally provided that the effective foreign tax rate that determines whether a tested unit’s income is considered high-taxed is computed using the amount of income as determined for federal income tax purposes, without regard for how the income is determined for foreign tax purposes. Thus, under this approach, foreign NOL carryforwards do not factor into the effective foreign tax rate calculation, since foreign NOL carryforwards are not accounted for in the federal tax base under federal tax accounting principles. Some comments suggested that taxpayers should be able to make adjustments to the effective foreign tax rate calculation to account for foreign NOL carryforwards. These comments noted that

NOLs carried forward to subsequent profitable tax years of a tested unit could lead to income subject to a high statutory foreign tax rate not being classified as high-taxed for the purposes of the GILTI high-tax exclusion. The effective foreign tax rate – calculated using the federal tax base – could be lower than the statutory threshold, even if the smaller foreign base is taxed at a higher rate.

The Treasury Department and the IRS decided to maintain the approach of the proposed regulations and to not provide rules that account for the use of foreign NOL carryforwards. The Treasury and IRS determined that carried forward NOLs are an example of timing differences between foreign and federal tax bases. Since there may be differences between when certain items are recognized for federal and foreign tax purposes, the effective foreign tax rate of a given tested unit calculated for the purpose of applying the high-tax exclusion may change from year to year even if the tax rate on its foreign base remains constant. Accounting for these differences would require complex rules akin to the deferred tax asset and tax liability rules used in financial accounting. Taxpayers would need to apply rules that reconcile foreign and federal tax accounting rules over multiple years. The Treasury Department and the IRS determined that these rules would add undue complexity and impose a substantial compliance burden on taxpayers and administrative burden on the government relative to the regulatory approach of the final regulations. The Treasury Department and the IRS have not attempted to estimate the compliance burden under this alternative regulatory approach relative to the final regulations.

e. Election period

The statute provides for an election to exclude high-taxed income from gross tested income but does not specify the length of the election period. To address this issue, proposed regulations provided that the election into the high-tax exclusion would be generally made or revoked for a five-year period. The five-year election period was intended to prevent taxpayers from manipulating the timing of income, expenses, and foreign income taxes in order to achieve inappropriate results. As a simple example, under a shorter election period, a taxpayer could accelerate certain expenses that are allocable to the income of a high-taxed tested unit into a year when the taxpayer elects into the high-tax exclusion. The following year, the taxpayer could revoke its election. Thereby, in the second year, the taxpayer would be able to use the foreign income taxes paid by the high-taxed tested unit as creditable taxes against income included under section 951A without the accelerated expenses reducing the amount of the foreign tax credit that could be claimed. In order to achieve tax savings through this manipulation, taxpayers would need to manipulate a large number of items annually, and the manipulation of these items would be costly without any corresponding increase in productive economic activity.

Comments noted that the extended election period would require taxpayers to make five-year projections of a large number of variables on a tested unit-by-tested unit basis in order to determine whether to elect into the high-tax exclusion. The complexity of these projections would result in a large burden on taxpayers. Moreover, even with a shorter election period, taxpayers would likely face difficulty in engaging in tax planning by changing their election status. Existing rules limit taxpayers' discretion over the timing of recognition of income and expenses. The complexity of manipulating the

timing of different items across all of a taxpayer's tested units, which is necessary under the final regulations because the election into the high-tax exclusion must be made for all related CFCs, would also create obstacles to using frequent changes in election status as part of tax reduction strategies. Therefore, the Treasury Department and IRS determined that the reduction in taxpayer compliance burdens significantly outweighed concerns about potential tax planning, and the Treasury Department and IRS adopted a one-year election period in the final regulations.

The Treasury Department and the IRS have not undertaken estimation of these effects, relative to the no-action baseline, because data or models are not readily available to estimate with any reasonable precision the compliance costs or patterns of business activity affected by these provisions relative to the no-action baseline or other regulatory alternatives.

#### 4. Profile of Affected Taxpayers

The proposed regulations potentially affect those taxpayers that have at least one CFC with at least one tested unit (including, potentially, the CFC itself) that has high-taxed income. Taxpayers with CFCs that have only low-taxed income are not eligible to apply the high-tax exception and hence are unaffected by the proposed regulations.

The Treasury Department and the IRS estimate that there are approximately 4,000 business entities (corporations, S corporations, and partnerships) with at least one CFC that pays an effective foreign tax rate above 18.9 percent, the current high-tax statutory threshold. The Treasury Department and the IRS further estimate that, for the partnerships with at least one CFC that pays an effective foreign tax rate greater than

18.9 percent, there are approximately 1,500 partners that have a large enough share to potentially qualify as a 10 percent U.S. shareholder of the CFC.<sup>9</sup> The 4,000 business entities and the 1,500 partners provide an estimate of the number of taxpayers that could potentially be affected by guidance governing the election into the high-tax exception. The figure is approximate because the tax rate at the CFC-level will not necessarily correspond to the tax rate at the tested unit-level if there are multiple tested units within a CFC.

The Treasury Department and the IRS do not have readily available data to determine how many of these taxpayers would elect the high-tax exception as provided in these proposed regulations. Under the proposed regulations, a taxpayer that has both high-taxed and low-taxed tested units will need to evaluate the benefit of eliminating any tax under section 951 and section 951A with respect to high-taxed income against the costs of forgoing the use of foreign tax credits and, with respect to section 951A, the use of tangible assets in the computation of qualified business asset investment (QBAI).

Tabulations from the IRS Statistics of Income 2014 Form 5471 file<sup>10</sup> further indicate that approximately 85 percent of earnings and profits are reported by CFCs incorporated in jurisdictions where the average effective foreign tax rate is less than or

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<sup>9</sup> Data are from IRS's Research, Applied Analytics, and Statistics division based on E-file data available in the Compliance Data Warehouse for tax years 2015 and 2016. The counts include Category 4 and Category 5 IRS Form 5471 filers. Category 4 filers are U.S. persons who had control of a foreign corporation during the annual accounting period of the foreign corporation. Category 5 filers are U.S. shareholders who own stock in a foreign corporation that is a CFC and who owned that stock on the last day in the tax year of the foreign corporation in that year in which it was a CFC. For full definitions, see <https://www.irs.gov/pub/irs-pdf/i5471.pdf>.

<sup>10</sup> The IRS Statistics of Income Tax Stats report on Controlled Foreign Corporations can be accessed here: <https://www.irs.gov/statistics/soi-tax-stats-controlled-foreign-corporations>.

equal to 18.9 percent. The data indicate several examples of jurisdictions where CFCs have average effective foreign tax rates above 18.9 percent, such as France, Italy, and Japan. However, information is not readily available to determine how many tested units are part of the same CFC and what the effective foreign tax rates are with respect to such tested units. Taxpayers potentially more likely to elect the high-tax exception are those taxpayers with CFCs that only operate in high-tax jurisdictions. Data on the number or types of CFCs that operate only in high-tax jurisdictions are not readily available.

## II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (“PRA”) generally requires that a federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit.

The final regulations include collections of information in §1.951A-2(c)(7)(viii)(A)(1) and (2), and §1.951A-2(c)(7)(viii)(C). The collection of information in §1.951A-2(c)(7)(viii)(A)(1) requires that each controlling domestic shareholder of a CFC file an election to exclude gross income of a CFC from tested income under the high-tax exception of section 954(b)(4), with a timely original federal income tax return or Form 1065, or, subject to certain time limitations and other requirements, with an amended federal income tax return, administrative adjustment request, or amended Form 1065, as applicable. This collection of information in the final regulations generally retains the collection of information in the proposed regulations. The final regulations clarify that a controlling domestic shareholder must make this election by filing the statement

required under §1.964-1(c)(3)(ii). The collection of information in §1.951A-2(c)(7)(viii)(A)(1)(ii) requires that each controlling domestic shareholder of a CFC that files an election to exclude gross income of a CFC from tested income under the high-tax exception of section 954(b)(4) provide any notices required under §1.964-1(c)(3)(iii). The collection of information in §1.951A-2(c)(7)(viii)(C) requires each controlling domestic shareholder that revokes an election on an amended return to provide the statement and notice described in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii), respectively.

As shown in Table 1, the Treasury Department and the IRS estimate that the number of persons potentially subject to the collections of information in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii), and §1.951A-2(c)(7)(viii)(C) is between 25,000 and 35,000. The estimate in Table 1 is based on the number of taxpayers that filed a tax return that included a Form 5471, “Information Return of U.S. Persons With Respect to Certain Foreign Corporations.” The collections of information in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii), and §1.951A-2(c)(7)(viii)(C) can only apply to taxpayers that are U.S. shareholders (as defined in section 951(b)) and U.S. shareholders are required to file a Form 5471.

Table 1. Table of Tax Forms Impacted

<b>Tax Forms Impacted</b>		
<b>Collections of information</b>	<b>Number of respondents (estimated)</b>	<b>Forms to which the information may be attached</b>
§1.951A-2(c)(7)(viii)(A)(1)(i) and (ii), and §1.951A-2(c)(7)(viii)(C)	25,000 - 35,000	Form 990 series, Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series

Source: MeF, DCS, and IRS’s Compliance Data Warehouse

The reporting burdens associated with the collections of information in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) will be reflected in the Form 14029, Paperwork Reduction Act Submission, that the Treasury Department and the IRS will submit to OMB for tax returns in the Form 990 series, Forms 1120, Forms 1040, Forms 1041, and Forms 1065. In particular, the reporting burden associated with the information collection in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) will be included in the burden estimates for OMB control numbers 1545-0123, 1545-0074, 1545-0092, and 1545-0047. OMB control number 1545-0123 represents a total estimated burden time for all forms and schedules for corporations of 3.344 billion hours and total estimated monetized costs of \$61.558 billion (\$2019). OMB control number 1545-0074 represents a total estimated burden time, including all other related forms and schedules for individuals, of 1.717 billion hours and total estimated monetized costs of \$33.267 billion (\$2019). OMB control number 1545-0092 represents a total estimated burden time, including all other related forms and schedules for trusts and estates, of 307,844,800 hours and total estimated monetized costs of \$9.950 billion (\$2016). OMB control number 1545-0047 represents a total estimated burden time, including all other related forms and schedules for tax-exempt organizations, of 52.450 million hours and total estimated monetized costs of \$1,496,500,000 (\$2020). Table 2 summarizes the status of the Paperwork Reduction Act submissions of the Treasury Department and the IRS related to forms in the Form 990 series, Forms 1120, Forms 1040, Forms 1041, and Forms 1065.

The overall burden estimates provided by the Treasury Department and the IRS to OMB in the Paperwork Reduction Act submissions for OMB control numbers 1545-

0123, 1545-0074, 1545-0092, and 1545-0047 are aggregate amounts related to the U.S. Business Income Tax Return, the U.S. Individual Income Tax Return, and the U.S. Income Tax Return for Estates and Trusts, along with any associated forms. The burdens included in these Paperwork Reduction Act submissions, however, do not account for any burden imposed by §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C). The Treasury Department and the IRS have not identified the estimated burdens for the collections of information in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) because there are no burden estimates specific to §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) currently available. The burden estimates in the Paperwork Reduction Act submissions that the Treasury Department and the IRS will submit to the OMB will in the future include, but not isolate, the estimated burden related to the tax forms that will be revised for the collection of information in §1.951A-2(c)(7)(viii)(A)(1) and (ii) and §1.951A-2(c)(7)(viii)(C).

The Treasury Department and the IRS have included the burdens related to the Paperwork Reduction Act submissions for OMB control numbers 1545-0123, 1545-0074, 1545-0092, and 1545-0047 in the PRA analysis for other regulations issued by the Treasury Department and the IRS related to the taxation of cross-border income. The Treasury Department and the IRS encourage users of this information to take measures to avoid overestimating the burden that the collections of information in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C), together with other international tax provisions, impose. Moreover, the Treasury Department and the IRS also note that the Treasury Department and the IRS estimate PRA burdens on a

taxpayer-type basis rather than a provision-specific basis because an estimate based on the taxpayer-type most accurately reflects taxpayers' interactions with the forms.

The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the final regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. Proposed revisions (if any) to these forms that reflect the information collections contained in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) will be made available for public comment at <https://apps.irs.gov/app/picklist/list/draftTaxForms.html> and will not be finalized until after these forms have been approved by OMB under the PRA.

Table 2. Summary of Information Collection Request Submissions Related to Form 990 series, Forms 1120, Forms 1040, Forms 1041, and Forms 1065.

<b>Form</b>	<b>Type of Filer</b>	<b>OMB Number(s)</b>	<b>Status</b>
Forms 990	Tax exempt entities (NEW Model)	1545-0047	Approved by OIRA 2/12/2020 until 2/28/2021.
	Link: <a href="https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201912-1545-014">https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201912-1545-014</a>		
Form 1040	Individual (NEW Model)	1545-0074	Approved by OIRA 1/30/2020 until 1/31/2021.
	Link: <a href="https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201909-1545-021">https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201909-1545-021</a>		
Form 1041	Trusts and estates	1545-0092	Approved by OIRA 5/08/2019 until 5/31/2022.
	Link: <a href="https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201806-1545-014">https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201806-1545-014</a>		
Form 1065 and 1120	Business (NEW Model)	1545-0123	Approved by OIRA 1/30/2020 until 1/31/2021.

Form	Type of Filer	OMB Number(s)	Status
	Link: <a href="https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201907-1545-001">https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201907-1545-001</a>		

### III. Regulatory Flexibility Act

It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Section 951A generally affects U.S. shareholders of CFCs. The reporting burdens in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C), affect controlling domestic shareholders of a CFC that elect to apply the high-tax exception of section 954(b)(4) to gross income of a CFC. Controlling domestic shareholders are generally U.S. shareholders who, in the aggregate, own more than 50 percent of the total combined voting power of all classes of stock of the foreign corporation entitled to vote. As an initial matter, foreign corporations are not considered small entities. Nor are U.S. taxpayers considered small entities to the extent the taxpayers are natural persons or entities other than small entities. Thus, §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) generally only affect small entities if a U.S. taxpayer that is a U.S. shareholder of a CFC is a small entity.

Examining the gross receipts of the e-filed Forms 5471 that is the basis of the 25,000 – 35,000 respondent estimates, the Treasury Department and the IRS have determined that the tax revenue from section 951A estimated by the Joint Committee on Taxation for businesses of all sizes is less than 0.3 percent of gross receipts as shown in the table below. Based on data for 2015 and 2016, total gross receipts for all

businesses with gross receipts under \$25 million is \$60 billion while those over \$25 million is \$49.1 trillion. Given that tax on GILTI inclusion amounts is correlated with gross receipts, this results in businesses with less than \$25 million in gross receipts accounting for approximately 0.01 percent of the tax revenue. Data are not readily available to determine the sectoral breakdown of these entities. Based on this analysis, smaller businesses are not significantly impacted by these proposed regulations. The Small Business Administration’s small business size standards (13 CFR part 121) identify as small entities several industries with annual revenues above \$25 million or because of the number of employees.

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
JCT tax revenue	7.7 billion	12.5 billion	9.6 billion	9.5 billion	9.3 billion	9.0 billion	9.2 billion	9.3 billion	15.1 billion	21.2 billion
Total gross receipts	30727 billion	53870 billion	566676 billion	59644 billion	62684 billion	65865 billion	69201 billion	72710 billion	76348 billion	80094 billion
Percent	0.03	0.02	0.02	0.02	0.01	0.01	0.01	0.01	0.02	0.03

Source: Research, Applied Analytics and Statistics division (IRS), Compliance Data Warehouse (IRS) (E-filed Form 5471, category 4 or 5, C and S corporations and partnerships); Conference Report, at 689.

The data to assess the number of small entities potentially affected by §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) are not readily available. However, businesses that are U.S. shareholders of CFCs are generally not small businesses because the ownership of sufficient stock in a CFC in order to be a U.S. shareholder generally entails significant resources and investment. The Treasury

Department and the IRS welcome comments on whether the proposed regulations would affect a substantial number of small entities in any particular industry.

Regardless of the number of small entities potentially affected by §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C), the Treasury Department and the IRS have concluded that there is no significant economic impact on such entities as a result of §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C).

Furthermore, the requirements in §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) apply only if a taxpayer chooses to make an election to apply a favorable rule. Consequently, the Treasury Department and the IRS have determined that §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) will not have a significant economic impact on a substantial number of small entities. Accordingly, it is hereby certified that the collection of information requirements of §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) would not have a significant economic impact on a substantial number of small entities. Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public on the impact of §1.951A-2(c)(7)(viii)(A)(1)(i) and (ii) and §1.951A-2(c)(7)(viii)(C) on small entities.

#### IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. § 1532) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This

rule does not include any federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### V. Executive Order 13132: Federalism

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

#### VI. Congressional Review Act

The Administrator of the Office of Information and Regulatory Affairs of the OMB has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 *et seq.*) (“CRA”). Under section 801(3) of the CRA, a major rule generally takes effect 60 days after the rule is published in the **Federal Register**. Accordingly, the Treasury Department and IRS are adopting these final regulations with the delayed effective date generally prescribed under the Congressional Review Act.

#### **Drafting Information**

The principal authors of these regulations are Jorge M. Oben and Larry R. Ponders of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

## List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1--INCOME TAXES

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

Authority: 26 U.S.C. 7805.

#### § 1.951A-0 [Removed]

Par. 2. Section 1.951A-0 is removed.

Par. 3. Section 1.951A-2 is amended by revising paragraph (c)(1)(iii), redesignating the text of paragraph (c)(3) as paragraph (c)(3)(i), adding a subject heading to newly redesignated (c)(3)(i), and adding paragraph (c)(3)(ii), a reserved paragraph (c)(6), and paragraphs (c)(7) and (8) to read as follows:

#### §1.951A-2 Tested income and tested loss.

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(iii) Gross income excluded from the foreign base company income (as defined in section 954) or the insurance income (as defined in section 953) of the corporation by reason of the exception described in section 954(b)(4) pursuant to an election under §1.954-1(d)(5), or a tentative gross tested income item of the corporation that qualifies for the exception described in section 954(b)(4) pursuant to an election under paragraph (c)(7) of this section,

\* \* \* \* \*

(3) \* \* \*

(i) In general. \* \* \*

(ii) Coordination with the high-tax exclusion--(A) In general. In the case of a taxpayer that has made an election under paragraph (c)(7) of this section, in allocating and apportioning deductions under this paragraph (c)(3), the taxpayer must apply the rules of sections 861 through 865 and 904(d) (taking into account the rules of section 954(b)(5) and §1.954-1(c)) in a manner that achieves results consistent with those under paragraph (c)(7) of this section.

(B) Application of consistency rule to deductions allocated and apportioned to the residual grouping in applying the high-tax exclusion. Deductions that are allocated and apportioned to the residual income group under paragraph (c)(7)(iii)(A) of this section for purposes of applying the high-tax exclusion to a controlled foreign corporation's tentative gross tested income items are allocated and apportioned for purposes of determining the controlled foreign corporation's net income in each relevant statutory grouping using a method that provides for a consistent allocation and apportionment of deductions to gross income in the relevant groupings. See §§1.954-1(c) and 1.960-1(d)(3) for rules relating to the allocation and apportionment of expenses for purposes of determining subpart F income, which is included in the residual grouping for purposes of applying the high-tax exclusion of sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(7) of this section. Therefore, for example, interest expense that is apportioned under the modified gross income method to a tentative gross tested income item of a lower-tier corporation under paragraph (c)(7)(iii)(A)(1) of this section may be

allocated and apportioned to the tested income of the upper-tier corporation or to the residual grouping, depending on whether the lower-tier corporation's tentative gross tested income item is an item of gross tested income or is excluded from gross tested income under the high-tax exclusion. See paragraph (c)(8)(iii)(C) (Example 3) of this section for an example illustrating the rules of this paragraph (c)(3).

\* \* \* \* \*

(6) [Reserved]

(7) Election to apply high-tax exception of section 954(b)(4)--(i) In general. For purposes of section 951A(c)(2)(A)(i)(III) and paragraph (c)(1)(iii) of this section, a tentative gross tested income item of a controlled foreign corporation for a CFC inclusion year qualifies for the exception described in section 954(b)(4) only if--

(A) An election made under paragraph (c)(7)(viii) of this section is effective with respect to the controlled foreign corporation for the CFC inclusion year; and

(B) The tentative tested income item with respect to the tentative gross tested income item was subject to an effective rate of foreign tax, as determined under paragraph (c)(7)(vi) of this section, that is greater than 90 percent of the maximum rate of tax specified in section 11.

(ii) Calculation of tentative gross tested income item--(A) In general. A tentative gross tested income item with respect to a controlled foreign corporation for a CFC inclusion year is the aggregate of all items of gross income of the controlled foreign corporation attributable to a tested unit (as defined in paragraph (c)(7)(iv) of this section) of the controlled foreign corporation in the CFC inclusion year that would be gross tested income without regard to this paragraph (c)(7) and would be in a single tested

income group (as defined in §1.960-1(d)(2)(ii)(C)). A controlled foreign corporation may have multiple tentative gross tested income items. See paragraphs (c)(8)(iii)(A)(2)(i) (Example 1) and (c)(8)(iii)(B)(2)(i) (Example 2) of this section for illustrations of the application of the rule set forth in this paragraph (c)(7)(ii)(A).

(B) Gross income attributable to a tested unit--(1) Items properly reflected on separate set of books and records. Items of gross income of a controlled foreign corporation are attributable to a tested unit of the controlled foreign corporation to the extent they are properly reflected on the separate set of books and records of the tested unit, as modified under paragraph (c)(7)(ii)(B)(2) of this section. Each item of gross income of a controlled foreign corporation is attributable to a tested unit (and not to more than one tested unit) of the controlled foreign corporation. See paragraphs (c)(8)(iii)(D)(2) and (c)(8)(iii)(D)(5) (Example 4) of this section for illustrations of the application of the rule set forth in this paragraph (c)(7)(ii)(B).

(2) Gross income determined under federal income tax principles, as adjusted for disregarded payments. For purposes of paragraph (c)(7)(ii)(B)(1) of this section, gross income must be determined under federal income tax principles, except that the principles of §1.904-4(f)(2)(vi) apply to adjust gross income of the tested unit, to the extent thereof, to reflect disregarded payments. For purposes of this paragraph (c)(7)(ii)(B)(2), the principles of §1.904-4(f)(2)(vi) are applied taking into account the rules in paragraphs (c)(7)(ii)(B)(2)(i) through (v) of this section.

(i) The controlled foreign corporation is treated as the foreign branch owner and any other tested units of the controlled foreign corporation are treated as foreign branches.

(ii) The principles of the rules in §1.904-4(f)(2)(vi)(A) apply in the case of disregarded payments between a foreign branch and another foreign branch without regard to whether either foreign branch makes a disregarded payment to, or receives a disregarded payment from, the foreign branch owner.

(iii) The exclusion for interest and interest equivalents described in §1.904-4(f)(2)(vi)(C)(1) does not apply to the extent of the amount of a disregarded payment that is deductible in the country of tax residence (or location, in the case of a branch) of the tested unit that is the payor.

(iv) In the case of an amount described in paragraph (c)(7)(ii)(B)(2)(iii) of this section, the rules for determining how a disregarded payment is allocated to gross income of a foreign branch or foreign branch owner in §1.904-4(f)(2)(vi)(B) are applied by treating the disregarded payment as allocated and apportioned ratably to all of the gross income attributable to the tested unit that is making the disregarded payment. If a tested unit is both a payor and payee of an amount described in paragraph (c)(7)(ii)(B)(2)(iii) of this section, gross income to which the disregarded payments are allocable include gross income allocated to the payor tested unit as a result of the receipt of amounts described in paragraph (c)(7)(ii)(B)(2)(iii) of this section, to the extent thereof. If a tested unit makes and receives payments described in paragraph (c)(7)(ii)(B)(2)(iii) of this section to and from the same tested unit, the payments are netted so that paragraph (c)(7)(ii)(B)(2)(iii) of this section and the principles of §1.904-4(f)(2)(vi) apply only to the net amount of such payments between the two tested units.

(v) In the case of multiple disregarded payments, in lieu of §1.904-4(f)(2)(vi)(F), disregarded payments are taken into account under paragraph (c)(7)(ii)(B)(2) of this

section and the principles of §1.904-4(f)(2)(vi) under the rules provided in this paragraph (c)(7)(ii)(B)(2)(v). Adjustments are made with respect to a disregarded payment received by a tested unit before payments made by that tested unit. Except as provided in paragraph (c)(7)(ii)(B)(2)(iv) of this section, if a tested unit both makes and receives disregarded payments, adjustments are first made with respect to disregarded payments that would be definitely related to a single class of gross income under the principles of §1.861-8; second, adjustments are made with respect to disregarded payments that would be definitely related to multiple classes of gross income under the principles of §1.861-8, but that are not definitely related to all gross income of the tested unit; third, adjustments are made with respect to disregarded payments (other than interest described in paragraph (c)(7)(ii)(B)(2)(iii) of this section) that would be definitely related to all gross income under the principles of §1.861-8; and fourth, adjustments are made with respect to interest described in paragraph (c)(7)(ii)(B)(2)(iii) and disregarded payments that would not be definitely related to any gross income under the principles of §1.861-8.

(iii) Calculation of tentative tested income item--(A) In general. A tentative tested income item with respect to the tentative gross tested income item described in paragraph (c)(7)(ii)(A) of this section is determined by allocating and apportioning deductions for the CFC inclusion year (including expense for current year taxes (as defined in §1.960-1(b)(4)), and not including any items described in §1.951A-2(c)(5) or (c)(6)) to the tentative gross tested income item under the principles of §1.960-1(d)(3). For purposes of this paragraph (c)(7)(iii), each tentative gross tested income item (if any) is treated as assigned to a separate tested income group, as that term is described

in §1.960-1(d)(2)(ii)(C), and all other income is treated as assigned to a residual income group. For purposes of applying §§1.861-9 and 1.861-9T under the principles of §1.960-1(d)(3), the amount of interest deductions that are allocated and apportioned to the assets (or gross income, in the case of a taxpayer that has elected the modified gross income method) of a lower-tier corporation, such as a corporation the stock of which is owned by the controlled foreign corporation indirectly through the tested unit, are allocated and apportioned to the residual income category and not to any tentative gross tested income item of the controlled foreign corporation. See paragraphs (c)(8)(iii)(A)(2)(iii) (Example 1), (c)(8)(iii)(B)(2)(iv) (Example 2), and (c)(8)(iii)(C)(2)(iv) (Example 3) of this section for illustrations of the application of the rules set forth in this paragraph (c)(7)(iii)(A).

(B) Allocation and apportionment of current year taxes imposed by reason of disregarded payments. The principles of §1.904-6(a)(2) apply to allocate and apportion the expense for current year taxes imposed by reason of disregarded payments to a tentative gross tested income item. For purposes of this paragraph (c)(7)(iii)(B), the principles of §1.904-6(a)(2) apply by--

(1) Treating the CFC as the foreign branch owner and any other tested unit as a foreign branch;

(2) In the case of payments to a tested unit that is treated as a foreign branch under paragraph (c)(7)(vi)(B)(1) of this section, applying the principles of §1.904-6(a)(2)(ii) and (iii) as if the tested unit receiving the payment were a foreign branch owner; and

(3) Treating any portion of a disregarded payment between individual tested units that does not result in a reallocation of gross income under paragraph (c)(7)(ii)(B)(2) of this section (because the amount of the payment exceeds the gross income of the individual tested unit making the payment) as a payment that is described in §1.904-4(f)(2)(vi)(C)(4) (to which §1.904-6(a)(2)(iii) applies). See paragraph (c)(8)(iii)(B)(2)(iii) (Example 2) of this section for illustrations of the application of the rules set forth in this paragraph (c)(7)(iii)(B).

(C) Effect of potential and actual changes in taxes paid or accrued. Except as otherwise provided in this paragraph (c)(7)(iii)(C), the amount of current year taxes paid or accrued by a controlled foreign corporation for purposes of this paragraph (c)(7) does not take into account any potential reduction in foreign income taxes that may occur by reason of a future distribution to shareholders of all or part of such income. However, to the extent the foreign income taxes paid or accrued by the controlled foreign corporation are reasonably certain to be returned to a shareholder by the foreign country imposing such taxes, directly or indirectly, through any means (including, but not limited to, a refund, credit, payment, discharge of an obligation, or any other method) on a subsequent distribution to such shareholder, the foreign income taxes are not treated as paid or accrued for purposes of this paragraph (c)(7). In addition, foreign income taxes that have not been paid or accrued because they are contingent on a future distribution of earnings (or other similar transaction, such as a loan to a shareholder) are not taken into account for purposes of this paragraph (c)(7). If, pursuant to section 905(c) and §1.905-3, a redetermination of U.S. tax liability is required to account for the effect of a foreign tax redetermination (as defined in §1.905-3(a)), this paragraph (c)(7) is applied

in the adjusted year taking into account the adjusted amount of the redetermined foreign tax.

(iv) Tested unit rules--(A) In general. Subject to the combination rule in paragraph (c)(7)(iv)(C) of this section, the term tested unit means any corporation, interest, or branch described in paragraphs (c)(7)(iv)(A)(1) through (3) of this section. See paragraph (c)(8)(iii)(D) (Example 4) of this section for an example that illustrates the application of the tested unit rules set forth in this paragraph (c)(7)(iv).

(1) A controlled foreign corporation (as defined in section 957(a)).

(2) An interest held directly or indirectly by a controlled foreign corporation in a pass-through entity that is--

(i) A tax resident (as described in §1.267A-5(a)(23)(i)) of any foreign country; or

(ii) Not treated as fiscally transparent (as determined under the principles of §1.267A-5(a)(8)) for purposes of the tax law of the foreign country of which the controlled foreign corporation is a tax resident or, in the case of an interest in a pass-through entity held by a controlled foreign corporation indirectly through one or more other tested units, for purposes of the tax law of the foreign country of which the tested unit that directly (or indirectly through the fewest number of transparent interests) owns the interest is a tax resident.

(3) A branch (as described in §1.267A-5(a)(2)) the activities of which are carried on directly or indirectly (through one or more pass-through entities) by a controlled foreign corporation. However, in the case of a branch that does not give rise to a taxable presence under the tax law of the foreign country where the branch is located, the branch is a tested unit only if, under the tax law of the foreign country of which the

controlled foreign corporation is a tax resident (or, if applicable, under the tax law of a foreign country of which the tested unit that directly (or indirectly, through the fewest number of transparent interests) carries on the activities of the branch is a tax resident), an exclusion, exemption, or other similar relief (such as a preferential rate) applies with respect to income attributable to the branch. For purposes of this paragraph (c)(7)(iv)(A)(3), similar relief does not include a credit (for example, a foreign tax credit) against the tax imposed under such tax law. If a controlled foreign corporation carries on directly or indirectly (through one or more pass-through entities) less than all of the activities of a branch (for example, if the activities are carried on indirectly through an interest in a partnership), then the rules in this paragraph apply separately with respect to the portion (or portions, if carried on indirectly through more than one chain of pass-through entities) of the activities carried on by the controlled foreign corporation. See paragraphs (c)(8)(iii)(D)(3) and (c)(8)(iii)(D)(4) (Example 4) of this section for illustrations of the application of the rules set forth in this paragraph (c)(7)(iv)(A)(3).

(B) Items attributable to only one tested unit. For purposes of paragraph (c)(7) of this section, if an item is attributable to more than one tested unit in a tier of tested units, the item is considered attributable only to the lowest-tier tested unit. Thus, for example, if a controlled foreign corporation directly owns a branch tested unit described in paragraph (c)(7)(iv)(A)(3) of this section, and an item of gross income is (under the rules of paragraph (c)(7)(ii)(B) of this section) attributable to both the branch tested unit and the controlled foreign corporation tested unit, then the item is considered attributable only to the branch tested unit.

(C) Combination rule--(1) In general. Except as provided in paragraph (c)(7)(iv)(C)(2) of this section, tested units of a controlled foreign corporation (including the controlled foreign corporation tested unit) are treated as a single tested unit if the tested units are tax residents of, or located in (in the case of a tested unit that is a branch, or a portion of the activities of a branch, that gives rise to a taxable presence under the tax law of a foreign country), the same foreign country. For purposes of this paragraph (c)(7)(iv)(C)(1), in the case of a tested unit that is an interest in a pass-through entity or a portion of the activities of a branch, a reference to the tax residency or location of the tested unit means the tax residency of the entity the interest in which is the tested unit or the location of the branch, as applicable. See paragraphs (c)(8)(iii)(D)(2) and (c)(8)(iii)(D)(5) (Example 4) of this section for illustrations of the application of the rule set forth in this paragraph (c)(7)(iv)(C)(1).

(2) Exception for nontaxed branches. The rule in paragraph (c)(7)(iv)(C)(1) of this section does not apply to a tested unit that is described in paragraph (c)(7)(iv)(A)(3) of this section if the branch described in paragraph (c)(7)(iv)(A)(3) of this section does not give rise to a taxable presence under the tax law of the foreign country where the branch is located. See paragraph (c)(8)(iii)(D)(4) (Example 4) of this section for an illustration of the application of the rule set forth in this paragraph (c)(7)(iv)(C)(2).

(3) Effect of combination rule. If, pursuant to paragraph (c)(7)(iv)(C)(1) of this section, tested units are treated as a single tested unit, then, solely for purposes of paragraph (c)(7) of this section, items of gross income attributable to such tested units, and items of deduction and foreign taxes allocated and apportioned to such gross income, are aggregated for purposes of determining the combined tested unit's tentative

gross tested income item, tentative tested income item, and foreign income taxes paid or accrued with respect to such tentative tested income item.

(v) Separate set of books and records--(A) In general. For purposes of this paragraph (c)(7), the term separate set of books and records has the meaning set forth in §1.989(a)-1(d). In addition, for purposes of this paragraph (c)(7), in the case of a tested unit or a transparent interest that is an interest in a pass-through entity or a portion of the activities of a branch, a reference to the separate set of books and records of the tested unit or the transparent interest means the separate set of books and records of the entity or the branch, as applicable.

(B) Failure to maintain separate set of books and records. If a separate set of books and records is not maintained for a tested unit or transparent interest, the items of gross income, disregarded payments, and any other items required to apply paragraph (c)(7) of this section that would be reflected on a separate set of books and records of the tested unit or transparent interest must be determined. Such items are treated as properly reflected on the separate set of books and records of the tested unit or transparent interest for purposes of applying paragraph (c)(7) of this section.

(C) Transparent interests. If a tested unit of a controlled foreign corporation or an entity an interest in which is a tested unit of a controlled foreign corporation holds a transparent interest, either directly or indirectly through one or more other transparent interests, then, for purposes of paragraph (c)(7) of this section (and subject to the rule of paragraph (c)(7)(iv)(C) of this section), items of the controlled foreign corporation properly reflected on the separate set of books and records of the transparent interest are treated as being properly reflected on the separate set of books and records of the

tested unit, as modified under paragraph (c)(7)(ii)(B)(2) of this section. See paragraph (c)(8)(iii)(D)(6) (Example 4) of this section for an illustration of the application of the rule set forth in this paragraph (c)(7)(v)(C).

(D) Items not taken into account for financial accounting purposes. For purposes of this paragraph (c)(7), an item of gross income in a CFC inclusion year that is not taken into account in such year for financial accounting purposes, and therefore not properly reflected on a separate set of books and records of a tested unit or a transparent interest, or an entity an interest in which is a tested unit or a transparent interest, is treated as properly reflected on a separate set of books and records to the extent it would have been so reflected if the item were taken into account for financial accounting purposes in such CFC inclusion year.

(vi) Effective rate at which foreign taxes are imposed. For a CFC inclusion year of a controlled foreign corporation, the effective rate of foreign tax with respect to the tentative tested income items of the controlled foreign corporation is determined separately for each such item. See paragraphs (c)(8)(iii)(A)(2)(v) (Example 1), (c)(8)(iii)(B)(2)(vi) (Example 2), and (c)(8)(iii)(C)(2)(vi) (Example 3) of this section for illustrations of the application of the rules set forth in this paragraph (c)(7)(vi). The effective rate at which foreign income taxes are imposed on a tentative tested income item is--

(A) The U.S. dollar amount of foreign income taxes paid or accrued with respect to the tentative tested income item, determined by applying paragraph (c)(7)(vii) of this section; divided by

(B) The U.S. dollar amount of the tentative tested income item, increased by the amount of foreign income taxes referred to in paragraph (c)(7)(vi)(A) of this section.

(vii) Foreign income taxes paid or accrued with respect to a tentative tested income item. For a CFC inclusion year, the amount of foreign income taxes paid or accrued by a controlled foreign corporation with respect to a tentative tested income item of the controlled foreign corporation for purposes of this paragraph (c)(7) is the U.S. dollar amount of the controlled foreign corporation's current year taxes (as defined in §1.960-1(b)(4)) that are allocated and apportioned to the related tentative gross tested income item under the rules of paragraph (c)(7)(iii) of this section. See paragraphs (c)(8)(iii)(A)(2)(iv) (Example 1), (c)(8)(iii)(B)(2)(v) (Example 2), and (c)(8)(iii)(C)(2)(v) (Example 3) of this section for illustrations of the application of the rule set forth in this paragraph (c)(7)(vii).

(viii) Rules regarding the high-tax election--(A) Manner--(1) An election is made under this paragraph (c)(7)(viii) by the controlling domestic shareholders (as defined in §1.964-1(c)(5)) with respect to a controlled foreign corporation for a CFC inclusion year (a high-tax election) in accordance with the rules provided in forms or instructions and by--

(i) Filing the statement required under §1.964-1(c)(3)(ii) with a timely filed original federal income tax return, or with an amended federal income tax return in accordance with paragraph (c)(7)(viii)(A)(2) of this section, for the U.S. shareholder inclusion year of each controlling domestic shareholder in which or with which such CFC inclusion year ends;

(ii) Providing any notices required under §1.964-1(c)(3)(iii); and

(iii) Providing any additional information required by applicable administrative pronouncements.

(2) In the case of an election (or revocation) made with an amended federal income tax return--

(i) The election (or revocation) must be made on an amended federal income tax return duly filed within 24 months of the unextended due date of the original federal income tax return for the U.S. shareholder inclusion year with or within which the CFC inclusion year ends;

(ii) Each United States shareholder in the controlled foreign corporation as of the end of the CFC's taxable year to which the election relates must file amended federal income tax returns (or timely original federal income tax returns if a return has not yet been filed) reflecting the effect of such election (or revocation) for the U.S. shareholder inclusion year with or within which the CFC inclusion year ends as well as for any other taxable year in which the U.S. tax liability of the United States shareholder would be increased by reason of the election (or revocation) (or in the case of a partnership if any item reported by the partnership or any partnership-related item would change as a result of the election (or revocation)) within a single period no greater than six months within the 24-month period described in paragraph (c)(7)(viii)(A)(2)(i) of this section; and

(iii) Each United States shareholder in the controlled foreign corporation as of the end of the controlled foreign corporation's taxable year to which the election relates must pay any tax due as a result of such adjustments within a single period no greater than six months within the 24-month period described in paragraph (c)(7)(viii)(A)(2)(i) of this section.

(3) In the case of a United States shareholder that is a partnership, paragraphs (c)(7)(viii)(A)(1) and (2) and (c)(7)(viii)(C) of this section are applied by substituting “Form 1065 (or successor form)” for “federal income tax return” and by substituting “amended Form 1065 (or successor form) or administrative adjustment request (as described in §301.6227-1), as applicable,” for “amended federal income tax return”, each place that it appears.

(4) A United States shareholder that is a partner in a partnership that is also a United States shareholder in the controlled foreign corporation must generally file an amended return, as required under paragraph (c)(7)(viii)(B)(2) of this section, and must generally pay any additional tax owed as required under paragraph (c)(7)(viii)(B)(3). However, in the case of a United States shareholder that is a partner in a partnership that duly files an administrative adjustment request under paragraph (c)(7)(viii)(A)(2) of this section, the partner is treated as having satisfied the requirements of paragraphs (c)(7)(viii)(A)(2)(ii) and (iii) of this section with respect to the interest held through that partnership if:

(i) The partnership timely files an administrative adjustment request described in paragraph (c)(7)(viii)(A)(1)(i) or (ii) of this section, as applicable; and,

(ii) Both the partnership and its partners timely comply with the requirements of section 6227 with respect to the administrative adjustment request. See §§301.6227-1 through -3 for rules relating to administrative adjustment requests.

(B) Scope. A high-tax election applies with respect to each tentative gross tested income item of the controlled foreign corporation for the CFC inclusion year and is binding on all United States shareholders of the controlled foreign corporation.

(C) Revocation. A high-tax election may be revoked by the controlling domestic shareholders of the controlled foreign corporation in the same manner as prescribed for an election made on an amended return as described in paragraph (c)(7)(viii)(A) of this section.

(D) Failure to satisfy election requirements. A high-tax election (or revocation) is valid only if all of the requirements in paragraph (c)(7)(viii)(A) of this section, including the requirement to provide notice under paragraph (c)(7)(viii)(A)(1)(ii) of this section, are satisfied.

(E) Rules applicable to CFC groups--(1) In general. In the case of a controlled foreign corporation that is a member of a CFC group, a high-tax election is made under paragraph (c)(7)(viii)(A) of this section, or revoked under paragraph (c)(7)(viii)(C) of this section, with respect to all controlled foreign corporations that are members of the CFC group and the rules in paragraphs (c)(7)(viii)(A) through (D) of this section apply by reference to the CFC group.

(2) Determination of the CFC group--(i) Definition. Subject to the rules in paragraphs (c)(7)(viii)(E)(2)(ii) and (iii) of this section, the term CFC group means an affiliated group as defined in section 1504(a) without regard to section 1504(b)(1) through (6), except that section 1504(a) is applied by substituting “more than 50 percent” for “at least 80 percent” each place it appears, and section 1504(a)(2)(A) is applied by substituting “or” for “and.” For purposes of this paragraph (c)(7)(viii)(E)(2)(i), stock ownership is determined by applying the constructive ownership rules of section 318(a), other than section 318(a)(3)(A) and (B), by applying section 318(a)(4) only to options (as defined in §1.1504-4(d)) that are reasonably certain to be exercised as

described in §1.1504-4(g), and by substituting in section 318(a)(2)(C) “5 percent” for “50 percent.

(ii) Member of a CFC group. The determination of whether a controlled foreign corporation is included in a CFC group is made as of the close of the CFC inclusion year of the controlled foreign corporation that ends with or within the taxable years of the controlling domestic shareholders. One or more controlled foreign corporations are members of a CFC group if the requirements of paragraph (c)(7)(viii)(E)(2) of this section are satisfied as of the end of the CFC inclusion year of at least one of the controlled foreign corporations, even if the requirements are not satisfied as of the end of the CFC inclusion year of all controlled foreign corporations. If the controlling domestic shareholders do not have the same taxable year, the determination of whether a controlled foreign corporation is a member of a CFC group is made with respect to the CFC inclusion year that ends with or within the taxable year of the majority of the controlling domestic shareholders (determined based on voting power) or, if no such majority taxable year exists, the calendar year. See paragraph (c)(8)(iii)(E) (Example 5) of this section for an example that illustrates the application of the rule set forth in this paragraph (c)(7)(viii)(E)(2)(ii).

(iii) Controlled foreign corporations included in only one CFC group. A controlled foreign corporation cannot be a member of more than one CFC group. If a controlled foreign corporation would be a member of more than one CFC group under paragraph (c)(7)(viii)(E)(2) of this section, then ownership of stock of the controlled foreign corporation is determined by applying paragraph (c)(7)(viii)(E)(2) of this section without regard to section 1504(a)(2)(B) or, if applicable, by reference to the ownership existing

as of the end of the first CFC inclusion year of a controlled foreign corporations that would cause a CFC group to exist.

(ix) Definitions. The following definitions apply for purposes of this paragraph (c)(7).

(A) Indirectly. The term indirectly, when used in reference to ownership, means ownership through one or more pass-through entities.

(B) Pass-through entity. The term pass-through entity means a partnership, a disregarded entity, or any other person (whether domestic or foreign) other than a corporation to the extent that income, gain, deduction or loss of the person is taken into account in determining the income or loss of a controlled foreign corporation that owns, directly or indirectly, interests in the person.

(C) Transparent interest. The term transparent interest means an interest in a pass-through entity (or the activities of a branch) that is not a tested unit.

(8) Examples--(i) Scope. This paragraph (c)(8) provides examples illustrating the application of the rules in paragraph (c)(7) of this section.

(ii) Presumed facts. For purposes of the examples in paragraph (c)(8)(iii) of this section, except as otherwise stated, the following facts are presumed:

(A) USP is a domestic corporation.

(B) CFC1X and CFC2X are controlled foreign corporations organized in, and tax residents of, Country X.

(C) CFC3Z is a controlled foreign corporation organized in, and tax resident of, Country Z.

(D) FDEX is a disregarded entity that is a tax resident of Country X.

(E) FDE1Y and FDE2Y are disregarded entities that are tax residents of Country Y.

(F) FPSY is an entity that is organized in, and a tax resident of, Country Y but is classified as a partnership for federal income tax purposes.

(G) CFC1X, CFC2X, CFC3Z, and the interests in FDEX, FDE1Y, FDE2Y, and FPSY are tested units (the CFC1X tested unit, CFC2X tested unit, CFC3Z tested unit, FDEX tested unit, FDE1Y tested unit, FDE2Y tested unit, and FPSY tested unit, respectively).

(H) CFC1X, CFC2X, CFC3Z, FDEX, FDE1Y, and FDE2Y conduct activities in the foreign country in which they are tax resident, and properly reflect items of income, gain, deduction, and loss on separate sets of books and records.

(I) All entities have calendar taxable years (for both federal income tax purposes and for purposes of the relevant foreign country) and use the Euro (€) as their functional currency. At all relevant times €1 = \$1.

(J) The maximum rate of tax specified in section 11 for the CFC inclusion year is 21 percent.

(K) Neither CFC1X, CFC2X, nor CFC3Z directly or indirectly earns income described in section 952(b), has any items of income, gain, deduction, or loss, or makes or receives disregarded payments. In addition, no tested unit of CFC1X, CFC2X, or CFC3Z makes or receives disregarded payments.

(L) An election made under section 954(b)(4) and paragraph (c)(7)(viii) of this section is effective with respect to CFC1X and CFC2X, as applicable, for the CFC inclusion year.

(iii) Examples--(A) Example 1: Effect of disregarded interest--(1) Facts--(i) Ownership. USP owns all of the stock of CFC1X, and CFC1X owns all of the interests of FDE1Y.

(ii) Gross income and deductions (other than for foreign income taxes). In Year 1, CFC1X generates €100x of gross income from services to unrelated parties that would be gross tested income without regard to paragraph (c)(7) of this section and that is properly reflected on the books and records of FDE1Y. The €100x of services income is general category income under §1.904-4(d). In Year 1, FDE1Y accrues and pays €20x of interest to CFC1X that is deductible for Country Y tax purposes but is disregarded for federal income tax purposes. The €20x of disregarded interest income received by CFC1X from FDE1Y is properly reflected on CFC1X's books and records, and the €20x of disregarded interest expense paid from FDE1Y to CFC1X is properly reflected on FDE1Y's books and records.

(iii) Foreign income taxes. Country X imposes no tax on net income, and Country Y imposes a 25% tax on net income. For Country Y tax purposes, FDE1Y (which is not disregarded under Country Y tax law) has €80x of taxable income (€100x of services income from the unrelated parties, less a €20x deduction for the interest paid to CFC1X). Accordingly, FDE1Y incurs a Country Y income tax liability with respect to Year 1 of €20x (€80x x 25%), the U.S. dollar amount of which is \$20x.

(2) Analysis--(i) Tentative gross tested income items. Under paragraph (c)(7)(ii)(A) of this section, the tentative gross tested income item with respect to each of the CFC1X tested unit and the FDE1Y tested unit is the aggregate of the gross income of CFC1X that is attributable to the tested unit, that would be gross tested income (without regard to this paragraph (c)(7)), and that would be in a single tested income group. Under paragraphs (c)(7)(ii)(B)(1) and (2) of this section, items of gross income of CFC1X are attributable to the CFC1X tested unit, or the FDE1Y tested unit, to the extent properly reflected on its separate set of books and records, as determined under federal income tax principles and adjusted to take into account disregarded payments. Without regard to the €20x disregarded interest payment from FDE1Y to CFC1X, gross income attributable to the CFC1X tested unit would be €0 (that is, the €20x of interest income reflected on the books and records of CFC1X would be reduced by €20x, the amount attributable to the payment that is disregarded for federal income tax purposes). Similarly, without regard to the €20x disregarded interest payment from FDE1Y to CFC1X, gross income attributable to the FDE1Y tested unit would be €100x (that is, €100x of services income reflected on the books and records of FDE1Y, unreduced by the €20x disregarded interest payment from FDE1Y to CFC1X). However, under paragraph (c)(7)(ii)(B)(2) of this section, the gross income attributable to each of the CFC1X tested unit and the FDE1Y tested unit is adjusted by €20x, the amount of the disregarded interest payment from FDE1Y to CFC1X that is deductible for Country Y tax purposes. Accordingly, the tentative gross tested income item attributable to the CFC1X tested unit (the "CFC1X tentative gross tested income item") is €20x (€0 + €20x), and the tentative gross tested income item attributable to the FDE1Y tested unit (the "FDE1Y tentative gross tested income item") is €80x (€100x - €20x).

(ii) Foreign income tax deduction. Under paragraph (c)(7)(iii)(A) of this section, CFC1X's tentative tested income items are computed by treating the CFC1X tentative gross tested income item and the FDE1Y tentative gross tested income item each as income in a separate tested income group (the "CFC1X income group" and the "FDE1Y income group") and by allocating and apportioning CFC1X's deductions for current year taxes under the principles of §1.960-1(d)(3)(ii) (CFC1X has no other deductions to allocate and apportion). Under paragraph (c)(7)(iii)(A) of this section, the €20x deduction for Country Y income taxes is allocated and apportioned solely to the FDE1Y income group (the "FDE1Y group tax"). None of the Country Y taxes are allocated and apportioned to the CFC1X income group under paragraph (c)(7)(iii)(B) of this section and the principles of §1.904-6(a)(2)(ii)(A), because none of the Country Y tax is imposed solely by reason of the disregarded interest payment.

(iii) Tentative tested income items. Under paragraph (c)(7)(iii) of this section, the tentative tested income item with respect to the CFC1X income group (the "CFC1X tentative tested item"), is €20x. The tentative tested income item with respect to the FDE1Y income group (the "FDE1Y tentative tested item") is €60x (the FDE1Y tentative gross tested income item of €80x, less the €20x deduction for the FDE1Y group tax).

(iv) Foreign income tax paid or accrued with respect to a tentative tested income item. Under paragraph (c)(7)(vii) of this section, the foreign income taxes paid or accrued with respect to a tentative tested income item is the U.S. dollar amount of the current year taxes that are allocated and apportioned to the related tentative gross tested income item under the rules of paragraph (c)(7)(iii) of this section. Therefore, the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item is \$20x, the U.S. dollar amount of the FDE1Y group tax. The foreign income tax paid or accrued with respect to the CFC1X tentative tested income item is \$0, the U.S. dollar amount of the foreign tax allocated and apportioned to the CFC1X tentative gross tested income item under paragraph (c)(7)(iii) of this section.

(v) Effective foreign tax rate. The effective foreign tax rate is determined under paragraph (c)(7)(vi) of this section by dividing the U.S. dollar amount of foreign income taxes paid or accrued with respect to each respective tentative tested income item by the U.S. dollar amount of the tentative tested income item increased by the U.S. dollar amount of the relevant foreign income taxes. Therefore, the effective foreign tax rate with respect to the FDE1Y tentative tested income item is 25%, computed by dividing \$20x (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item under paragraph (c)(7)(vii) of this section) by \$80x (the sum of \$60x, the U.S. dollar amount of the FDE1Y tentative tested income item, and \$20x, the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item). The CFC1X tentative tested income item is not subject to any foreign income tax, so is subject to an effective foreign tax rate of 0%, calculated as \$0 (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the CFC1X tentative tested income item) divided by \$20x (the U.S. dollar amount of the CFC1X tentative tested income item).

(vi) Gross income items excluded under sections 954(b)(4) and 951A(c)(2)(A)(i)(III). The FDE1Y tentative tested income item is subject to an effective foreign tax rate (25%) that is greater than 18.9% (90% of the maximum rate of tax specified in section 11). Therefore, the requirement of paragraph (c)(7)(i)(B) of this section is satisfied, and the FDE1Y tentative gross tested income item qualifies under paragraph (c)(7)(i) of this section for the high-tax exception of section 954(b)(4) and is excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii) of this section. The CFC1X tentative tested income item is subject to an effective foreign tax rate of 0%. Therefore, the CFC1X tentative tested income item does not satisfy the requirement of paragraph (c)(7)(i)(B) of this section, and the CFC1X tentative gross tested income item does not qualify under paragraph (c)(7)(i) of this section for the high-tax exception of section 954(b)(4) and is not excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii) of this section.

(B) Example 2: Disregarded payment for services--(1) Facts--(i) Ownership. USP owns all of the stock of CFC1X. CFC1X owns all of the interests of FDE1Y. FDE1Y is a tax resident of Country Y, but is treated as fiscally transparent for Country X tax purposes, so that FDE1Y is subject to tax in Country Y and CFC1X is subject to tax in Country X with respect to FDE1Y's activities.

(ii) Gross income, deductions (other than for foreign income taxes), and disregarded payments. In Year 1, CFC1X generates €1,000x of gross income from services to unrelated parties that would be gross tested income without regard to paragraph (c)(7) of this section and that is properly reflected on the books and records of CFC1X. In Year 1, CFC1X accrues and pays €480x of deductible expenses to unrelated parties, €280x of which is properly reflected on CFC1X's books and records and is definitely related solely to CFC1X's gross income reflected on its books and records, and €200x of which is properly reflected on FDE1Y's books and records and is definitely related solely to FDE1Y's gross income reflected on its books and records. Country X law does not provide rules for the allocation or apportionment of these deductions to particular items of gross income. In Year 1, CFC1X also accrues and pays €325x to FDE1Y for support services performed by FDE1Y in Country Y; the payment is disregarded for federal income tax purposes. The €325x of disregarded support services income received by FDE1Y from CFC1X is properly reflected on FDE1Y's books and records, and the €325x of disregarded support services expense paid from CFC1X to FDE1Y is properly reflected on CFC1X's books and records.

(iii) Foreign income taxes. Country X imposes a 10% tax on net income, and Country Y imposes a 16% tax on net income. Country X allows a deduction, but not a credit, for foreign income taxes paid or accrued to another country (such as Country Y). For Country Y tax purposes, FDE1Y (which is not disregarded under Country Y tax law) has €125x of taxable income (€325x of support services income received from CFC1X, less a €200x deduction for expenses paid to unrelated parties). Accordingly, FDE1Y incurs a Country Y income tax liability with respect to Year 1 of €20x (€125x x 16%), the

U.S. dollar amount of which is \$20x. For Country X tax purposes, CFC1X has €500x of taxable income (€1,000x of gross income for services, less a €480x deduction for expenses paid to unrelated parties by CFC1X and FDE1Y and a €20x deduction for Country Y taxes; Country X does not allow CFC1X a deduction for the €325x paid to FDE1Y for support services because the €325x payment is disregarded for Country X tax purposes). Accordingly, CFC1X incurs a Country X income tax liability with respect to Year 1 of €50x (€500x x 10%), the U.S. dollar amount of which is \$50x.

(2) Analysis--(i) Tentative gross tested income item. Under paragraph (c)(7)(ii) of this section, CFC1X has two tentative gross tested income items, one item with respect to CFC1X (the “CFC1X tentative gross tested income item”) and one item with respect to CFC1X’s interest in FDE1Y (the “FDE1Y tentative gross tested income item”). The gross income attributable to each tested unit comprises the gross income properly reflected on the books and records of each tested unit under paragraph (c)(7)(ii)(B)(1) of this section, as adjusted under paragraph (c)(7)(ii)(B)(2) of this section. Without regard to the €325x payment for support services from CFC1X to FDE1Y, the gross income attributable to the FDE1Y tested unit would be €0 (that is, the €325x of services income properly reflected on the books and records of FDE1Y, reduced by the €325x payment from CFC1X to FDE1Y that is disregarded for federal income tax purposes). Similarly, without regard to the €325x payment for support services from CFC1X to FDE1Y, the gross income attributable to the CFC1X tested unit would be €1,000x (that is, €1,000x of services income reflected on the books and records of CFC1X, unreduced by the €325x disregarded payment). However, under paragraph (c)(7)(ii)(B)(2) of this section, the gross income attributable to each of the CFC1X tested unit and the FDE1Y tested unit is adjusted by €325x, the amount of the disregarded services payment from CFC1X to FDE1Y. Accordingly, the FDE1Y tentative gross tested income item is €325x (€0 + €325x), and the CFC1X tentative gross tested income item is €675x (€1,000x - €325x).

(ii) Deductions (other than for foreign income taxes). Under paragraph (c)(7)(iii) of this section, CFC1X’s tentative tested income items are computed by applying the principles of §1.960-1(d)(3), treating the CFC1X tentative gross tested income item and the FDE1Y tentative gross tested income item each as income in a separate tested income group (the “CFC1X income group” and the “FDE1Y income group”) and by allocating and apportioning CFC1X’s deductions among the income groups under federal income tax principles. For Year 1, CFC1X has deductible expense (other than foreign income tax) of €480x. This amount includes €280x of deductible expense that is definitely related solely the services activity of the CFC1X tested unit, and another €200x of deductible expense (other than foreign income tax) that is definitely related solely to the services provided by the FDE1Y tested unit. Therefore, €280x of deductible expense (other than foreign income tax) is allocated and apportioned to the CFC1X income group, and €200x of deductible expense (other than foreign income tax) is allocated and apportioned to the FDE1Y income group.

(iii) Foreign income tax deduction. CFC1X accrues foreign income tax in Year 1 of €70x (€50x imposed by Country X and €20x imposed by Country Y). Under paragraph (c)(7)(iii) of this section, the deductions for foreign income taxes are allocated

and apportioned under the principles of §1.960-1(d)(3)(ii) to the FDE1Y income group and the CFC1X income group. Under paragraph (c)(7)(iii)(A) of this section and §1.960-1(d)(3)(ii), the principles of §1.904-6(a)(1) generally apply to determine the amount of the foreign income tax paid or accrued with respect to each income group. However, under paragraph (c)(7)(iii)(B) of this section, foreign income taxes imposed by reason of the receipt of a disregarded payment are allocated and apportioned under the principles of §1.904-6(a)(2). The Country Y tax of €20x is imposed solely by reason of FDE1Y's receipt of a €325x disregarded payment. As a result, the entire €20x of Country Y tax is allocated and apportioned to the FDE1Y income group under the principles of §1.904-6(a)(2)(ii)(A). If Country X had allowed a deduction for the disregarded payment from CFC1X to FDE1Y and not otherwise imposed tax on CFC1X with respect to income of FDE1Y, the foreign tax imposed by Country X would relate only to the CFC1X tested income group, and no portion of it would be allocated and apportioned to the FDE1Y income group because the FDE1Y income would not be included in the Country X tax base. However, because gross income subject to tax in Country X includes gross income that for federal income tax purposes is attributable to both the FDE1Y tested unit and the CFC1X tested unit, the €50x of foreign income tax imposed by Country X is related to both the FDE1Y income group and to the CFC1X income group and must be allocated and apportioned under the principles of §1.904-6(a)(1)(i). Because Country X does not provide specific rules for the allocation or apportionment of the €500x of deductible expenses, §1.904-6(a)(1)(ii) applies the principles of §§1.861-8 through 1.861-14T to determine the foreign law net income subject to Country X tax for purposes of apportioning the €50x of Country X tax between the income groups. CFC1X has €1,000x of gross income and €500x of deductible expenses under the tax laws of Country X, resulting in €500x of net foreign law income. Of the €1,000x of foreign law gross income, €325x corresponds to the gross income in the FDE1Y income group, and €675x corresponds to the gross income in the CFC1X income group. Applying federal income tax principles to allocate and apportion the foreign law deductions to foreign law gross income, €220x of the €500x foreign law deductions is allocated and apportioned to the FDE1Y income group and €280x is allocated and apportioned to the CFC1X income group. Of the total €500x of net foreign law income, €105x (€325x Country X gross income corresponding to the FDE1Y income group, less €220x allocable Country X expenses) corresponds to the FDE1Y income group and €395x (€675x Country X gross income corresponding to the CFC1X income group, less €280x allocable Country X expenses) corresponds to the CFC1X income group. Therefore, €10.5x ( $€50x \times €105x/€500x$ ) of Country X tax is allocated and apportioned to the FDE1Y income group, and €39.5x ( $€50x \times €395x/€500x$ ) is allocated and apportioned to the CFC1X income group. In total, €30.5x of foreign tax (€10.5x of Country X tax and €20x of Country Y tax) is allocated and apportioned to the FDE1Y income group (the "FDE1Y group tax"), and €39.5x of foreign tax (all of which is Country X tax) is allocated and apportioned to the CFC1X tested income group (the "CFC1X group tax").

(iv) Tentative tested income items. Under paragraph (c)(7)(iii) of this section, the tentative tested income item attributable to FDE1Y (the "FDE1Y tentative tested income item") is €94.5x (the FDE1Y gross tested income item of €325x, less the allocated and

apportioned deductions of €230.5x (the sum of deductions (other than for foreign income tax) of €200x, Country Y tax of €20x, and Country X tax of €10.5x)). The tentative tested income item attributable to CFC1X (the “CFC1X tentative tested income item”) is €355.5x (the CFC1X gross tentative tested income item of €675x, less the allocated and apportioned deductions of €319.5x (the sum of deductions (other than for foreign income tax) of €280x and Country X tax of €39.5x)).

(v) Foreign income taxes paid or accrued with respect to a tentative tested income item. Under paragraph (c)(7)(vii) of this section, the foreign income taxes paid or accrued with respect to a tentative tested income item is the U.S. dollar amount of the current year taxes that are allocated and apportioned to the related tentative gross tested income item under the rules of paragraph (c)(7)(iii) of this section. Therefore, the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item is \$30.5x, the U.S. dollar amount of the FDE1Y group tax, and the foreign income taxes paid or accrued with respect to the CFC1X tentative tested income item is \$39.5x, the U.S. dollar amount of the CFC1X group tax.

(vi) Effective foreign tax rate. The effective foreign tax rate is determined under paragraph (c)(7)(vi) of this section by dividing the U.S. dollar amount of foreign income taxes paid or accrued with respect to each respective tentative tested income item by the U.S. dollar amount of the tentative tested income item increased by the U.S. dollar amount of the relevant foreign income taxes. Therefore, the effective foreign tax rate for the FDE1Y tentative tested income item is 24.4%, computed by dividing \$30.5x (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item), by \$125x (the sum of \$94.5x, the U.S. dollar amount of the FDE1Y tentative tested income item, and \$30.5x, the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item). Similarly, the effective foreign tax rate for the CFC1X tentative tested income item is 10%, computed by dividing \$39.5x (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the CFC1X tentative tested income item) by \$395x (the sum of \$355.5x, the U.S. dollar amount of the CFC1X tentative tested income item, and \$39.5x, the U.S. dollar amount of the foreign taxes paid or accrued with respect to the CFC1X tentative tested income item).

(vii) Gross income items excluded under sections 954(b)(4) and 951A(c)(2)(A)(i)(III). The FDE1Y tentative tested income item has an effective foreign tax rate (24.4%) that is greater than 18.9% (90% of the maximum rate of tax specified in section 11). Therefore, the requirement of paragraph (c)(7)(i)(B) of this section is satisfied, and the FDE1Y tentative gross tested income item qualifies under paragraph (c)(7)(i) of this section for the high-tax exception of section 954(b)(4) and is excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii) of this section. The CFC1X tentative tested income item has an effective foreign tax rate (10%) that is not greater than 90% of the maximum rate of tax specified in section 11. Therefore, the CFC1X tentative gross tested income item does not qualify under paragraph (c)(7)(i) of this section for the high-tax exception of section

954(b)(4) and is not excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii) of this section.

(C) Example 3: Interest expense allocated and apportioned with respect to the income of a lower-tier CFC--(1) Facts--(i) Ownership. USP owns all of the stock of CFC1X. CFC1X directly owns all the interests of FDE1Y. FDE1Y owns all of the stock of CFC3Z. Pursuant to §1.861-9(j) and §1.861-9T(j), CFC1X uses the modified gross income method to allocate and apportion its interest expense.

(ii) Gross income and deductions (including for foreign income taxes). During Year 1, CFC1X generates €4,000x of gross income from services that would be gross tested income without regard to paragraph (c)(7) of this section, €3,000x of which is properly reflected on the books and records of the CFC1X tested unit and €1,000x of which is properly reflected on the books and records of the FDE1Y tested unit. CFC1X also accrues €1,000x of interest expense to an unrelated person. Country X imposes €200x of income taxes with respect to the €3,000x of gross income properly reflected on the books and records of the CFC1X tested unit, and Country Y imposes €200x of income taxes with respect to the €1,000x of gross income properly reflected on the books and records of the FDE1Y tested unit. CFC3Z generates €1,000x of gross income from services that would be gross tested income without regard to paragraph (c)(7) of this section, and such gross income is properly reflected on the books and records of the CFC3Z tested unit. CFC3Z accrues no expenses, and Country Z imposes €100x of income taxes with respect to the €1,000x of gross income generated by CFC3Z.

(2) Analysis--(i) Tentative gross tested income items. Under paragraph (c)(7)(ii) of this section, the €3,000x of gross income that is reflected on the books and records of the CFC1X tested unit, and the €1,000x of gross income that is reflected on the books and records of the FDE1Y tested unit, are attributable to the CFC1X tested unit and the FDE1Y tested unit, respectively. Under paragraph (c)(7)(ii) of this section, each of these amounts is a separate tentative gross tested income item of CFC1X (the “CFC1X tentative gross tested income item” and the “FDE1Y tentative gross tested income item,” respectively). Under paragraph (c)(7)(ii) of this section, the €1,000x item of tentative gross tested income that is properly reflected on the books and records of the CFC3Z tested unit is attributable to the CFC3Z tested unit. Under paragraph (c)(7)(ii) of this section, the amount attributable to the CFC3Z tested unit is a tentative gross tested income item of CFC3Z (the “CFC3Z tentative gross tested income item”).

(ii) Allocation and apportionment of interest expense. To compute CFC1X’s tentative tested income items, the principles of §1.960-1(d)(3) apply by treating each of CFC1X’s tentative gross tested income items as income in a separate tested income group (the “CFC1X income group” and the “FDE1Y income group”) and allocate and apportion its deductions among those income groups under federal income tax principles. Because CFC1X uses the modified gross income method under §1.861-9(j) and §1.861-9T(j) to allocate and apportion interest expense, it must allocate and apportion its interest expense between the CFC1X income group and the FDE1Y

income group based on a combined gross income amount that includes both the gross income of CFC1X (including the gross income attributable to both the CFC1X tested unit and the FDE1Y tested unit) and the gross income of CFC3Z, adjusted as provided under §1.861-9(j) and §1.861-9T(j). Under §1.861-9(j) and §1.861-9T(j), the adjusted combined gross income of CFC1X comprises the CFC1X tentative gross tested income item (€3,000x), or 60% of the combined adjusted gross income amount, the FDE1Y tentative gross tested income item (€1,000x), or 20% of the combined adjusted gross income amount, and the CFC3Z gross tentative tested income item (€1,000x), or 20% of the combined adjusted gross income amount. Under paragraph (c)(7)(iii) of this section, interest expense of CFC1X that is allocated and apportioned to the gross income of CFC3Z under §1.861-9(j) and §1.861-9T(j) is not allocated and apportioned to either the CFC1X income group or the FDE1Y income group. Therefore, €600x of interest expense (60% of the €1,000x of interest expense) is allocated and apportioned to the CFC1X income group, and €200x of interest expense (20% of the €1,000x of interest expense) is allocated and apportioned to the FDE1Y income group. The €200x of interest expense that is allocated and apportioned to the €1,000x of gross tentative tested income of CFC3Z is allocated and apportioned to the residual income group for purposes of paragraph (c)(7) of this section, but can still be allocated and apportioned to a statutory grouping of tested income of CFC1X for purposes of paragraph (c)(3) of this section. See paragraph (c)(7)(iii) of this section.

(iii) Foreign income tax deduction. Under paragraph (c)(7)(iii) of this section, deductions for foreign income taxes paid or accrued by CFC1X are allocated and apportioned under the principles of §§1.960-1(d)(3)(ii) and §1.904-6(a)(1) to the CFC1X income group and the FDE1Y income group. Similarly, foreign income taxes paid or accrued by CFC3Z are allocated and apportioned under the principles of §§1.960-1(d)(3)(ii) and 1.904-6(a)(1) to the tentative gross tested income item of CFC3Z (the “CFC3Z income group”). Under these principles, the €200x of Country X income taxes are allocated and apportioned to the CFC1X income group (the “CFC1X group tax”), the €200x of Country Y income taxes are allocated and apportioned to the FDE1Y income group (the “FDE1Y group tax”), and the €100x of Country Z income taxes are allocated and apportioned to the CFC3Z income group (the “CFC3Z group tax”).

(iv) Tentative tested income items. After the allocation and apportionment of deductions to reduce the tentative gross tested income in each income group, under paragraph (c)(7)(iii) of this section, CFC1X has a tentative tested income item with respect to the CFC1X tested unit of €2,200x (€3,000x, less €600x of interest expense and €200x of foreign income tax expense, the “CFC1X tentative tested income item”) and a tentative tested income item with respect to the FDE1Y tested unit of €600x (€1,000x, less €200x of interest expense and €200x of foreign income tax expense, the “FDE1Y tentative tested income item”). CFC3Z has a tentative tested income item of €900x (€1,000x, less €100x of foreign income tax expense, the “CFC3Z tentative tested income item”).

(v) Foreign income taxes paid or accrued with respect to a tentative tested income item. Under paragraph (c)(7)(vii) of this section, the foreign income taxes paid

or accrued with respect to a tentative tested income item is the U.S. dollar amount of the current year taxes that are allocated and apportioned to the related tentative gross tested income item under the rules of paragraph (c)(7)(iii) of this section. Therefore, the foreign income tax paid or accrued with respect to the CFC1X tentative tested income item is \$200x, the U.S. dollar amount of the CFC1X group tax. Similarly, the foreign income tax paid or accrued with respect to the FDE1Y tentative tested income item is \$200x, the U.S. dollar amount of the FDE1Y group tax, and the foreign income tax paid or accrued with respect to the CFC3Z tentative tested income item is \$100x, the U.S. dollar amount of the CFC3Z group tax.

(vi) Effective foreign tax rate. The effective foreign tax rate is determined under paragraph (c)(7)(vi) of this section by dividing the U.S. dollar amount of foreign income taxes paid or accrued with respect to each respective tentative tested income item by the U.S. dollar amount of the tentative tested income item increased by the U.S. dollar amount of the relevant foreign income taxes. Therefore, the effective foreign tax rate for the CFC1X tentative tested income item is 8.3%, computed by dividing \$200x (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the CFC1X tentative tested income item), by \$2,400x (the sum of \$2,200x, the U.S. dollar amount of the CFC1X tentative tested income item and \$200x, the U.S. dollar amount of the foreign taxes paid or accrued with respect to the CFC1X tentative tested income item). The effective foreign tax rate for the FDE1Y tentative tested income item is 25%, computed by dividing \$200x (the U.S. dollar amount of the foreign taxes paid or accrued with respect to the FDE1Y tentative tested income item) by \$800x (the sum of \$600x, the U.S. dollar amount of the FDE1Y tentative tested income item, and \$200x, the U.S. dollar amount of the foreign taxes paid or accrued with respect to the FDE1Y tentative tested income item). The effective foreign tax rate for the CFC3Z tentative tested income item is 10%, computed by dividing \$100x (the U.S. dollar amount of the foreign taxes paid or accrued with respect to the CFC3Z tentative tested income item) by \$1,000x (the sum of \$900x, the U.S. dollar amount of the CFC3Z tentative tested income item, and \$100x, the U.S. dollar amount of the foreign taxes paid or accrued with respect to the CFC3Z tentative tested income item).

(vii) Gross income items excluded under sections 954(b)(4) and 951A(c)(2)(A)(i)(III). The FDE1Y tentative tested income item is subject to tax at an effective foreign tax rate (25%) that is greater than 18.9% (90% of the maximum rate of tax specified in section 11). Therefore, the requirement of paragraph (c)(7)(i)(B) of this section is satisfied, and the FDE1Y tentative gross tested income item qualifies under paragraph (c)(7)(i) of this section for the high-tax exception of section 954(b)(4) and is excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii) of this section. In computing the tested income of CFC1X under paragraph (c)(3) of this section, the deductions of CFC1X that were allocated and apportioned to the FDE1Y tentative gross tested income item (that is, the €200x of interest expense and the €200x of FDE1Y group taxes) are allocated and apportioned to this item of tentative gross tested income. As a result, the €1,000x of tentative gross tested income excluded from tested income under section 954(b)(4), as well as the €200x of interest expense and €200x of foreign tax expense allocable to that gross

income, are allocated and apportioned to the residual category under paragraph (c)(3) of this section for purposes of determining the tested income of CFC1X. Under §1.960-1(d)(3), the \$200x of foreign income taxes allocated and apportioned to the excluded gross income would also be assigned to the residual income group for purposes of determining CFC1X's tested taxes for purposes of section 960(d). The CFC1X tentative tested income item and CFC3Z tentative tested income item each have effective foreign tax rates (8.3% and 10%, respectively) that are not greater than 90% of the maximum rate of tax specified in section 11. Therefore, the CFC1X tentative gross tested income item and the CFC3Z tentative gross tested income item do not qualify under paragraph (c)(7)(i) of this section for the high-tax exception of section 954(b)(4), and are not excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(i) of this section. Under paragraph (c)(3) of this section, the corresponding deductions are allocated and apportioned to that gross tested income in a manner that achieves a result that is consistent the result of the allocation and apportionment of those deductions under paragraph (c)(7) of this section. Accordingly, because CFC3Z's tentative gross tested income is not excluded from gross tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(i) of this section, under paragraph (c)(3) of this section the €200x of CFC1X's interest expense that was apportioned to tentative gross tested income of CFC3Z under the modified gross income method in §1.861-9 is allocated and apportioned to gross tested income of CFC1X and therefore reduces CFC1X's tested income. In contrast, if the CFC3Z tentative gross tested item had been excluded from gross tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(i) of this section, then the €200x of CFC1X's interest expense that was allocated and apportioned to that income would be assigned to the residual category.

(D) Example 4: Application of tested unit rules--(1) Facts--(i) Ownership. USP owns all of the stock of CFC1X. CFC1X directly owns all the interests of FDEX and FDE1Y. In addition, CFC1X directly carries on activities in Country Y that constitute a branch (as described in §1.267A-5(a)(2)) and that give rise to a taxable presence under Country Y tax law and Country X tax law (such branch, "FBY").

(ii) Items reflected on books and records. For the CFC inclusion year, CFC1X had a €20x item of gross income (Item A), which is properly reflected on the books and records of FBY, and a €30x item of gross income (Item B), which is properly reflected on the books and records of FDEX.

(2) Analysis--(i) Identifying the tested units of CFC1X. Without regard to the combination rule of paragraph (c)(7)(iv)(C) of this section, CFC1X, CFC1X's interest in FDEX, CFC1X's interest in FDE1Y, and FBY would each be a tested unit of CFC1X. See paragraph (c)(7)(iv)(A) of this section. Pursuant to the combination rule, however, the FDE1Y tested unit is combined with the FBY tested unit and treated as a single tested unit because FDE1Y is a tax resident of Country Y, the same country in which FBY is located (the "Country Y tested unit"). See paragraph (c)(7)(iv)(C)(1) of this section. The CFC1X tested unit (without regard to any items attributable to the FDEX, FDE1Y, or FBY tested units) is also combined with the FDEX tested unit and treated as

a single tested unit because CFC1X and FDEX are both tax residents of Country X (the “Country X tested unit”). See paragraph (c)(7)(iv)(C)(1) of this section.

(ii) Computing the items of CFC1X. Under paragraph (c)(7)(ii)(A) of this section, a tentative gross tested income item is determined with respect to each of the Country Y tested unit and the Country X tested unit. To determine the tentative gross tested income item of each tested unit, the item of gross income that is attributable to the tested unit is determined under paragraph (c)(7)(ii)(B) of this section. Under paragraph (c)(7)(ii)(B) of this section, only Item A is attributable to the Country Y tested unit. Item A is not attributable to the Country X tested unit because it is not reflected on the separate set of books and records of the CFC1X tested unit or the FDEX tested unit, and an item of gross income is only attributable to one tested unit. See paragraph (c)(7)(ii)(B)(1) of this section. Under paragraph (c)(7)(ii)(B) of this section, only Item B is attributable to the Country X tested unit.

(3) Alternative facts – branch does not give rise to a taxable presence in country where located--(i) Facts. The facts are the same as in paragraph (c)(8)(iii)(D)(1) of this section (the original facts in this Example 4), except that FBY does not give rise to a taxable presence under Country Y tax law; moreover, Country X tax law does not provide an exclusion, exemption, or other similar relief with respect to income attributable to FBY.

(ii) Analysis. FBY is not a tested unit but is a transparent interest. See paragraphs (c)(7)(iv)(A)(3) and (c)(7)(ix)(C) of this section. CFC1X has a tested unit in Country X that includes the CFC1X tested unit (without regard to any items related to the interest in FDEX or FDE1Y, but that includes FBY since it is a transparent interest and not a tested unit) and the interest in FDEX. See paragraph (c)(7)(iv)(C) of this section. CFC1X has another tested unit in Country Y, the interest in FDE1Y.

(4) Alternative facts -- branch is a tested unit but is not combined--(i) Facts. The facts are the same as in paragraph (c)(8)(iii)(D)(1) of this section (the original facts in this Example 4), except that FBY does not give rise to a taxable presence under Country Y tax law but Country X tax law provides an exclusion, exemption, or other similar relief (such as a preferential rate) with respect to income attributable to FBY.

(ii) Analysis. FBY is a tested unit. See paragraph (c)(7)(iv)(A)(3) of this section. CFC1X has two tested units in Country Y, the interest in FDE1Y and FBY. The interest in FDE1Y and FBY tested units are not combined because FBY does not give rise to a taxable presence under the tax law of Country Y. See paragraph (c)(7)(iv)(C)(2) of this section. CFC1X also has a tested unit in Country X that includes the activities of CFC1X (without regard to any items related to the interest in FDEX, the interest in FDE1Y, or FBY) and the interest in FDEX.

(5) Alternative facts – split ownership of tested unit--(i) Facts. The facts are the same as in paragraph (c)(8)(iii)(D)(1) of this section (the original facts in this Example

4), except that USP also owns CFC2X, CFC1X does not own FDE1Y, and CFC1X and CFC2X own 60% and 40%, respectively, of the interests of FPSY.

(ii) Analysis for CFC1X. Under paragraph (c)(7)(iv)(C)(1) of this section, FBY and CFC1X's 60% interest in FPSY are combined and treated as a single tested unit of CFC1X ("CFC1X's Country Y tested unit"), and CFC1X's interest in FDEX and CFC1X's other activities are combined and treated as a single tested unit of CFC1X ("CFC1X's Country X tested unit"). CFC1X's Country Y tested unit is attributed any item of CFC1X that is derived through its interest in FPSY to the extent the item is properly reflected on the books and records of FPSY. See paragraph (c)(7)(ii)(B)(1) of this section.

(iii) Analysis for CFC2X. Under paragraphs (c)(7)(iv)(A)(1) and (c)(7)(iv)(A)(2)(i) of this section, CFC2X and CFC2X's 40% interest in FPSY are tested units of CFC2X. CFC2X's interest in FPSY is attributed any item of CFC2X that is derived through FPSY to the extent that it is properly reflected on the books and records of FPSY. See paragraph (c)(7)(ii)(B)(1) of this section.

(iv) Analysis for not combining CFC1X and CFC2X tested units. None of the tested units of CFC1X are combined with the tested units of CFC2X under paragraph (c)(7)(iv)(C)(1) of this section because they are tested units of different controlled foreign corporations, and the combination rule only combines tested units of the same controlled foreign corporation.

(6) Alternative facts – split ownership of transparent interest--(i) Facts. The facts are the same as in paragraph (c)(8)(iii)(D)(1) of this section (the original facts in this Example 4), except that USP also owns CFC2X, CFC1X does not own DE1Y, and CFC1X and CFC2X own 60% and 40%, respectively, of the interests in FPSY, but FPSY is not a tax resident of any foreign country and is fiscally transparent for Country X tax law purposes.

(ii) Analysis for CFC1X. CFC1X's interest in FPSY is not a tested unit but is a transparent interest. See paragraphs (c)(7)(iv)(A)(2) and (c)(7)(ix)(C) of this section. Under paragraph (c)(7)(v)(C) of this section, any item of CFC1X that is derived through its interest in FPSY and is properly reflected on the books and records of FPSY is treated as properly reflected on the books and records of CFC1X.

(iii) Analysis for CFC2X. CFC2X's interest in FPSY is not a tested unit but is a transparent interest. See paragraphs (c)(7)(iv)(A)(2) and (c)(7)(ix)(C) of this section. Under paragraph (c)(7)(v)(C) of this section, any item of CFC2X that is derived through its interest in FPSY and is properly reflected on the books and records of FPSY is treated as properly reflected on the books and records of CFC1X.

(E) Example 5: CFC group -- Controlled foreign corporations with different taxable years--(1) Facts. USP owns all the stock of CFC1X and CFC2X. CFC2X has a taxable year ending November 30. On December 15, Year 1, USP sells all the stock of CFC2X to an unrelated party for cash.

(2) Analysis. The determination of whether CFC1X and CFC2X are in a CFC group is made as of the close of their CFC inclusion years that end with or within the taxable year ending December 31, Year 1, the taxable year of USP, the controlling domestic shareholder. See paragraph (c)(7)(viii)(E)(2)(ii) of this section. Under paragraph (c)(7)(viii)(E)(2)(i) of this section, USP directly owns more than 50% of the stock of CFC1X as of December 31, Year 1, the end of CFC1X's CFC inclusion year. USP also directly owns more than 50% of the stock of CFC2X as of November 30, Year 1, the end of CFC2X's CFC inclusion year. Therefore, CFC1X and CFC2X are members of a CFC group, and USP must consistently make high-tax elections, or revocations, under paragraph (c)(7)(viii) of this section with respect to CFC1X's taxable year ending December 31, Year 1, and CFC2X's taxable year ending November 30, Year 1. This is the case notwithstanding that USP does not directly own more than 50% of the stock of CFC2X as of December 31, Year 1, the end of CFC1X's CFC inclusion year. See paragraph (c)(7)(viii)(E)(2)(ii) of this section.

Par. 4. Section 1.951A-7 is amended by:

1. Designating the undesignated text as paragraph (a);
2. Adding a subject heading to newly designated paragraph (a);
3. Removing the word "Sections" and adding in its place "Except as otherwise provided in this section, sections" in newly designated paragraph (a); and
4. Adding paragraph (b).

The additions read as follows:

§1.951A-7 Applicability dates.

(a) In general. \* \* \*

(b) High-tax exception. Section 1.951A-2(c)(1)(iii), (c)(3)(ii), and (c)(7) and (8) apply to taxable years of foreign corporations beginning on or after July 23, 2020, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end. In addition, taxpayers may choose to apply the rules in §1.951A-2(c)(1)(iii), (c)(3)(ii), and (c)(7) and (8) to taxable years of foreign corporations that begin after December 31, 2017, and before July 23, 2020, and to taxable years of U.S. shareholders in which or with which such taxable years of the foreign corporations

end, provided that they consistently apply those rules and the rules in §1.954-1(c)(1)(iii)(A)(3), §1.954-1(c)(1)(iv), and the first sentence of §1.954-1(d)(3)(i) to such taxable years.

§ 1.954-0 [Amended]

Par. 5. Section 1.954-0 is amended by removing and reserving paragraph (b).

Par. 6. Section 1.954-1 is amended by:

1. Adding “or” to the end of paragraph (c)(1)(iii)(A)(2)(ii);
2. Removing and reserving paragraphs (c)(1)(iii)(A)(2)(iii) and (iv);
3. Adding paragraphs (c)(1)(iii)(A)(3) and (c)(1)(iv);
4. In paragraph (d)(1) introductory text, removing the language “foreign base company oil related income, as defined in section 954(g), or” in the second sentence and adding a sentence after the fourth sentence;
  5. Removing the language “imposed by a foreign country or countries” in paragraph (d)(1)(ii);
  6. Removing the language “in a chain of corporations through which a distribution is made” in the first sentence in paragraph (d)(2) introductory text;
  7. Removing the language “(or deemed paid or accrued)” in paragraph (d)(2)(i);
  8. Revising paragraph (d)(3)(i);
  9. Removing and reserving paragraph (d)(3)(ii);
  10. Removing paragraph (d)(7);
  11. Revising paragraph (h)(1); and
  12. Adding paragraph (h)(3).

The additions and revisions read as follows:

§1.954-1 Foreign base company income.

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(A) \* \* \*

(3) For purposes of paragraph (c)(1)(iii)(A) of this section, the aggregate amount from all transactions that falls within a single separate category (as defined in §1.904-5(a)(4)(v)) and is described in paragraph (c)(1)(iii)(A)(1)(i) of this section is a single item of income. Similarly, the aggregate amount from all transactions that falls within a single separate category (as defined in §1.904-5(a)(4)(v)) and is described in each one of paragraphs (c)(1)(iii)(A)(1)(ii) through (c)(1)(iii)(A)(1)(v) of this section is in each case a separate single item of income. The same principles apply for transactions described in each one of paragraphs (c)(1)(iii)(A)(2)(i) through (v) of this section.

\* \* \* \* \*

(iv) Treatment of deductions or loss attributable to disqualified basis. For purposes of paragraph (c)(1)(i) of this section (and in the case of insurance income, paragraph (a)(6) of this section), in determining the amount of a net item of foreign base company income or insurance income, deductions or loss described in §1.951A-2(c)(5) or (c)(6) are not allocated and apportioned to gross foreign base company income or gross insurance income.

(d) \* \* \*

(1) \* \* \* For rules concerning the application of the high-tax exception of sections 954(b)(4) and 951A(c)(2)(A)(i)(III) to tentative gross tested income items, see §1.951A-2(c)(1)(iii), (c)(3)(ii), and (c)(7) and (8). \* \* \*

\* \* \* \* \*

(3) \* \* \*

(i) In general. The amount of foreign income taxes paid or accrued by a controlled foreign corporation with respect to a net item of income for purposes of section 954(b)(4) and this paragraph (d) is the U.S. dollar amount of the controlled foreign corporation's current year taxes (as defined in §1.960-1(b)(4)) that are allocated and apportioned under §1.960-1(d)(3)(ii) to the subpart F income group (as defined in §1.960-1(d)(2)(ii)(B)) that corresponds with the net item of income.

\* \* \* \* \*

(h) \* \* \*

(1) Paragraph (d)(3) of this section for taxable years ending on or after December 4, 2018, and before July 23, 2020. For the application of paragraph (d)(3) of this section to taxable years of controlled foreign corporations ending on or after December 4, 2018, and before July 23, 2020, and to taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end, see §1.954-1, as contained in 26 CFR part 1 revised as of April 1, 2020.

\* \* \* \* \*

(3) Paragraphs (c)(1)(iii)(A)(3), (c)(1)(iv), and (d)(3)(i) of this section for taxable years beginning on or after July 23, 2020. Paragraphs (c)(1)(iii)(A)(3), (c)(1)(iv), and (d)(3)(i) of this section apply to taxable years of a controlled foreign corporation

beginning on or after July 23, 2020, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end. In addition, taxpayers may choose to apply the rules in paragraphs (c)(1)(iii)(A)(3), (c)(1)(iv), and (d)(3)(i) of this section to taxable years of controlled foreign corporations that begin after December 31, 2017, and before July 23, 2020, and to taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end, provided that they consistently apply those rules and the rules in §1.951A-2(c)(1)(iii), (c)(3)(ii), and (c)(7) and (8) to such taxable years.

§ 1.1502 [Amended]

Par. 7. Section 1.1502-51 is amended in paragraph (g)(1) by removing the language “§ 1.951A-7” and adding in its place “§ 1.951A-7(a)” wherever it appears.

Sunita Lough

Deputy Commissioner for Services and Enforcement.

Approved: July 1, 2020.

David Kautter

Assistant Secretary of the Treasury (Tax Policy).

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