

**Department of the Treasury****Internal Revenue Service****26 CFR Part 1**

[REG 129128–14]

RIN 1545–BM36

**Covered Asset Acquisitions**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking by cross-reference in part to temporary regulations.

**SUMMARY:** This document contains proposed Income Tax Regulations under section 901(m) of the Internal Revenue Code (Code) with respect to transactions that generally are treated as asset acquisitions for U.S. income tax purposes and either are treated as stock acquisitions or are disregarded for foreign income tax purposes. In the Rules and Regulations section of this issue of the **Federal Register**, temporary regulations are being issued under section 901(m) (the temporary regulations), the text of which serves as the text of a portion of these proposed regulations. These regulations are necessary to provide guidance on applying section 901(m). These regulations affect taxpayers claiming foreign tax credits.

**DATES:** Comments and requests for a public hearing must be received by March 7, 2017.

**ADDRESSES:** Send submissions to CC:PA:LPD:PR (REG–129128–14), Room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–129128–14), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20044, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG–129128–14).

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, Jeffrey L. Parry, (202) 317–6936; concerning submissions of comments, Regina Johnson, (202) 317–6901 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:****Background****I. Section 901(m)**

Section 212 of the Education Jobs and Medicaid Assistance Act (EJMAA), enacted on August 10, 2010 (Pub. L.

111–226), added section 901(m) to the Code. Section 901(m)(1) provides that, in the case of a covered asset acquisition (CAA), the disqualified portion of any foreign income tax determined with respect to the income or gain attributable to relevant foreign assets (RFAs) will not be taken into account in determining the foreign tax credit allowed under section 901(a), and, in the case of foreign income tax paid by a section 902 corporation (as defined in section 909(d)(5)), will not be taken into account for purposes of section 902 or 960. Instead, the disqualified portion of any foreign income tax (the disqualified tax amount) is permitted as a deduction. See section 901(m)(6).

Under section 901(m)(2), a CAA is (i) a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies; (ii) any transaction that is treated as an acquisition of assets for U.S. income tax purposes and as the acquisition of stock of a corporation (or is disregarded) for purposes of a foreign income tax; (iii) any acquisition of an interest in a partnership that has an election in effect under section 754; and (iv) to the extent provided by the Secretary, any other similar transaction. The Joint Committee on Taxation's technical explanation of EJMAA states that it is anticipated that the Secretary will issue regulations identifying other similar transactions that result in an increase to the basis of assets for U.S. income tax purposes without a corresponding increase for foreign income tax purposes. Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 1586, Scheduled for Consideration by the House of Representatives on August 10, 2010, at 14 (Aug. 10, 2010) (JCT Explanation).

Section 901(m)(3)(A) provides that the term “disqualified portion” means, with respect to any CAA, for any taxable year, the ratio (expressed as a percentage) of (i) the aggregate basis differences (but not below zero) allocable to such taxable year with respect to all RFAs; divided by (ii) the income on which the foreign income tax referenced in section 901(m)(1) is determined. If the taxpayer fails to substantiate the income on which the foreign income tax is determined to the satisfaction of the Secretary, such income will be determined by dividing the amount of such foreign income tax by the highest marginal tax rate applicable to the taxpayer's income in the relevant jurisdiction. The JCT Explanation states that for this purpose the income on which the foreign income

tax is determined is the income as determined under the law of the relevant jurisdiction. See JCT Explanation at 14.

Section 901(m)(3)(B)(i) provides the general rule that the basis difference with respect to any RFA will be allocated to taxable years using the applicable cost recovery method for U.S. income tax purposes. Section 901(m)(3)(B)(ii) provides that, except as otherwise provided by the Secretary, if there is a disposition of an RFA, the basis difference allocated to the taxable year of the disposition will be the excess of the basis difference of such asset over the aggregate basis difference of such asset that has been allocated to all prior taxable years. The statute further provides that no basis difference with respect to such asset will be allocated to any taxable year thereafter.

Section 901(m)(3)(C)(i) provides that basis difference means, with respect to any RFA, the excess of: (i) The adjusted basis of such asset immediately after the CAA, over (ii) the adjusted basis of such asset immediately before the CAA. If the adjusted basis of an RFA immediately before the CAA exceeds the adjusted basis of the RFA immediately after the CAA (that is, where the adjusted basis of an asset with a built-in loss is reduced in a CAA), such excess is taken into account as a basis difference of a negative amount. See section 901(m)(3)(C)(ii).

The JCT Explanation states that, for purposes of determining basis difference, it is the tax basis for U.S. income tax purposes that is relevant and not the tax basis as determined under the law of the relevant jurisdiction. See JCT Explanation at 14. However, the JCT Explanation further states that it is anticipated that the Secretary will issue regulations identifying those circumstances in which, for purposes of determining the adjusted basis of such assets immediately before the CAA, it may be acceptable to use foreign basis or another reasonable method. Id.

Section 901(m)(4) provides that an RFA means, with respect to a CAA, any asset (including goodwill, going concern value, or other intangible) with respect to such acquisition if income, deduction, gain, or loss attributable to such asset is taken into account in determining the foreign income tax referenced in section 901(m)(1).

Section 901(m)(7) provides that the Secretary may issue regulations or other guidance as is necessary or appropriate to carry out the purposes of section 901(m), including to exempt from its application certain CAAs and RFAs with respect to which the basis difference is de minimis. The JCT

Explanation states that regulations may also exclude from the application of section 901(m) CAAs that are not taxable for U.S. income tax purposes, or in which the basis of the RFAs is also increased for purposes of the law of the relevant foreign jurisdiction. See JCT Explanation at 16.

Section 901(m) generally applies to CAAs occurring after December 31, 2010. Section 901(m), however, does not apply to any CAA with respect to which the transferor and transferee are not related if the acquisition is made pursuant to a written agreement that was binding on January 1, 2011, and at all times thereafter; described in a ruling request submitted to the IRS on or before July 29, 2010; or described on or before January 1, 2011, in a public announcement or in a filing with the Securities and Exchange Commission. See EJMAA, section 212(b).

## II. Notices 2014–44 and 2014–45

The Department of the Treasury (Treasury Department) and the IRS issued Notice 2014–44 (2014–32 I.R.B. 270 (July 21, 2014)) and Notice 2014–45 (2014–34 I.R.B. 388 (July 29, 2014)), announcing the intent to issue regulations addressing the application of section 901(m) to dispositions of RFAs following CAAs and to CAAs described in section 901(m)(2)(C) (regarding section 754 elections). In addition, the notices announced the intent to issue regulations providing successor rules for the continued application of section 901(m) after subsequent transfers of RFAs with remaining basis difference. The temporary regulations issued in the Rules and Regulations section of this issue of the **Federal Register** provide the rules described in those Notices.

## Explanation of Provisions

### I. Overview

These proposed regulations provide rules for computing the disqualified portion of foreign income taxes under section 901(m). Proposed § 1.901(m)–1 provides definitions that apply for purposes of the proposed regulations. Proposed § 1.901(m)–2 identifies the transactions that are CAAs, including additional categories of transactions that are identified as CAAs pursuant to the authority granted in section 901(m)(2)(D), and provides rules for identifying assets that are RFAs with respect to a CAA. Proposed § 1.901(m)–3 provides rules for computing the disqualified portion of foreign income taxes, describes the treatment under section 901(m)(1) of the disqualified portion, and provides rules for

determining whether and to what extent basis difference that is assigned to a given taxable year is carried over to subsequent taxable years. Proposed § 1.901(m)–4 provides rules for determining the basis difference with respect to an RFA, including an election to use foreign basis for purposes of this determination. Proposed § 1.901(m)–5 provides rules for taking into account basis difference under an applicable cost recovery method or as a result of a disposition of an RFA, rules for allocating that basis difference, when necessary, to one or more persons subject to section 901(m), and rules for assigning that basis difference to a U.S. taxable year. Proposed § 1.901(m)–6 provides successor rules for applying section 901(m) to subsequent transfers of RFAs that have basis difference that has not yet been fully taken into account, as well as for transferring an aggregate basis difference carryover of a person subject to section 901(m) either to another aggregate basis difference carryover account of such person or to another person subject to section 901(m). Proposed § 1.901(m)–7 provides de minimis rules under which certain basis differences are not taken into account under section 901(m). Proposed § 1.901(m)–8 provides guidance on the application of section 901(m) to pre-1987 foreign income taxes and anti-abuse rules relating to built-in loss assets.

### II. Relevance of the Terms Section 901(m) Payor, Foreign Payor, RFA Owner (U.S.), and RFA Owner (Foreign)

As provided under proposed § 1.901(m)–1, a section 901(m) payor is a person that is eligible to claim the foreign tax credit allowed under section 901(a), regardless of whether the person chooses to claim the foreign tax credit, as well as a section 902 corporation. Therefore, a section 901(m) payor is the person required to compute a disqualified tax amount when section 901(m) applies. The foreign payor is the individual or entity (including a disregarded entity) subject to a foreign income tax. The RFA owner (U.S.) is the person that owns one or more RFAs for U.S. income tax purposes and therefore is required to report, or otherwise track, items of income, deduction, gain, or loss attributable to the RFAs for purposes of computing the U.S. taxable income of the RFA owner (U.S.). Similarly, the RFA owner (foreign) is the individual or entity (including a disregarded entity) that owns one or more RFAs for purposes of a foreign income tax and that therefore generally would report, or otherwise track, items of income,

deduction, gain, or loss attributable to the RFAs for purposes of determining income reported on a foreign income tax return.

The section 901(m) payor may also be the foreign payor, the RFA owner (U.S.), or the RFA owner (foreign), or any combination thereof; alternatively, the section 901(m) payor may not be any of them depending upon the application of the entity classification rules for U.S. income tax purposes. Further, the foreign payor and the RFA owner (foreign) may or may not be the same person for purposes of a foreign income tax depending upon whether the RFA owner (foreign) is a fiscally transparent entity for purposes of the foreign income tax. For example, if a foreign corporation, which is a section 902 corporation, owns RFAs and is the entity that is subject to a foreign income tax under the relevant foreign law, the foreign corporation is the section 901(m) payor, foreign payor, RFA owner (U.S.), and RFA owner (foreign). As another example, if two U.S. corporations each own a 50 percent interest in a partnership and the partnership owns a disregarded entity that is subject to a foreign income tax and that, for purposes of the foreign income tax, owns one or more RFAs, the corporate partners are each a section 901(m) payor, the disregarded entity is the foreign payor and the RFA owner (foreign), and the partnership is the RFA owner (U.S.).

Finally, because the computation of a section 901(m) payor's disqualified tax amount is based on items determined at the level of the foreign payor, the RFA owner (U.S.), and the RFA owner (foreign), the regulations provide rules for allocating those items when the section 901(m) payor is not the foreign payor, the RFA owner (U.S.), or the RFA owner (foreign), or any combination thereof.

### III. CAAs and RFAs

#### A. CAAs

Proposed § 1.901(m)–2(b) identifies six categories of transactions that constitute CAAs, three of which are specified in the statute (incorporated by cross reference to the temporary regulations) and three of which are additional categories of transactions that are identified as CAAs pursuant to the authority granted under section 901(m)(2)(D). In addition, for transactions that occurred on or after January 1, 2011, and before the general applicability date of the temporary regulations (referred to as the “transition period” in the preamble to the temporary regulations and in this

preamble), proposed § 1.901(m)–2(d) (incorporated by cross reference to the temporary regulations) defines CAAs by reference to the statutory definition under section 901(m)(2). Transactions are CAAs regardless of whether any gain, income, loss, or deduction realized in connection with the transaction is taken into account for U.S. income tax purposes. However, basis difference resulting from a CAA may not be taken into account under section 901(m) pursuant to de minimis rules in proposed § 1.901(m)–7.

Proposed § 1.901(m)–2(b)(1) through (4) describes four specific types of transactions that are generally expected to result in an increase in the basis of assets for U.S. income tax purposes without a corresponding increase in basis for foreign income tax purposes. This is because these transactions generally are treated as an acquisition of assets for U.S. income tax purposes and either are treated as an acquisition of stock or of a partnership interest or are disregarded for foreign income tax purposes. The other two categories of transactions described in proposed § 1.901(m)–2(b)(5) and (6), which involve an acquisition of assets for both U.S. and foreign income tax purposes, are CAAs only if the transaction results in an increase in the basis of an asset for U.S. income tax purposes but not for foreign income tax purposes. Such transactions may include, for example, an acquisition of assets that is structured to avoid the application of the Code's corporate nonrecognition provisions, such as section 332, 351, or 361, while still qualifying for nonrecognition treatment for foreign income tax purposes.

#### B. RFAs

Proposed § 1.901(m)–2(c)(1) incorporates by cross reference to the temporary regulations the general definition of an RFA, which provides that an RFA means, with respect to a foreign income tax and a CAA, any asset (including goodwill, going concern value, or other intangible) subject to the CAA that is relevant in determining foreign income for purposes of the foreign income tax. In addition, for CAAs that occurred during the transition period, proposed § 1.901(m)–2(d) (incorporated by cross reference to the temporary regulations) defines RFAs by reference to the statutory definition under section 901(m)(4).

Proposed § 1.901(m)–2(c)(2) generally provides that an asset is relevant in determining foreign income if income, deduction, gain, or loss attributable to such asset is or would be taken into account in determining foreign income

immediately after the CAA. Proposed § 1.901(m)–2(c)(3) provides, however, that, after a CAA, an asset will become an RFA with respect to another foreign income tax if, pursuant to a plan or series of related transactions that have a principal purpose of avoiding the application of section 901(m), an asset that is not relevant in determining foreign income for purposes of that foreign income tax immediately after the CAA later becomes relevant in determining such foreign income. A principal purpose of avoiding section 901(m) will be deemed to exist if income, deduction, gain, or loss attributable to the asset is taken into account in determining such foreign income within the one-year period following the CAA.

#### IV. Disqualified Tax Amount and Aggregate Basis Difference Carryover

##### A. Disqualified Tax Amount

Proposed § 1.901(m)–3 sets forth the rules for computing the disqualified portion of foreign income taxes (referred to in the regulations as the “disqualified tax amount”). Proposed § 1.901(m)–3 also sets forth the treatment under section 901(m)(1) of the disqualified tax amount and provides rules for determining whether and to what extent basis difference that is assigned to a given U.S. taxable year is carried over to subsequent U.S. taxable years (referred to in the regulations as “aggregate basis difference carryover”).

In general, a disqualified tax amount is computed separately for each foreign tax return that takes into account income, gain, deduction, or loss from one or more RFAs in computing the foreign taxable income and for each section 901(m) payor that pays or accrues, or that is considered to pay or accrue, a portion of the foreign income taxes reflected on the foreign tax return. Furthermore, if the foreign income taxes relate to more than one separate category described in § 1.904–4(m) (including section 904(d) categories), a separate disqualified tax amount computation is done for each such separate category. Members of a U.S. affiliated group of corporations (as defined in section 1504) that file a consolidated return are each treated as a separate section 901(m) payor; therefore, disqualified tax amounts are computed at the member-level.

The proposed regulations refer to the total taxable income (or loss) that is computed under foreign law for a foreign taxable year and reflected on a foreign tax return as “foreign income” and the total amount of tax reflected on a foreign tax return as a “foreign income

tax amount.” Thus, foreign income does not include income that is exempt from the foreign income tax. The proposed regulations use the term “foreign country creditable taxes” (or “FCCTs”) to refer to any foreign income taxes imposed by another foreign country or possession of the United States that were allowed under the relevant foreign law as a credit to reduce the foreign income tax amount and for which a credit is allowed under section 901 or 903. In addition, the proposed regulations define “foreign income tax” (by cross reference to the temporary regulations) to mean any income, war profits, or excess profits tax for which a credit is allowable under section 901 or 903, other than any withholding tax determined on a gross basis as described in section 901(k)(1)(B).

The foreign income, foreign income tax amount, and any FCCTs are determined at the foreign-payor level. If the foreign payor is not a section 901(m) payor, current law provides rules for determining the person that is considered to pay or accrue a foreign income tax amount for purposes of the foreign tax credit (see, for example, §§ 1.702–1(a)(6) and 1.901–2(f)). Those rules are not changed by these proposed regulations and therefore apply for purposes of determining the extent to which a foreign income tax amount is paid or accrued by, or considered paid or accrued by, a section 901(m) payor for purposes of section 901(m).

Proposed § 1.901(m)–3(b) sets forth the treatment of the disqualified tax amount and the computation of the disqualified tax amount. Pursuant to section 901(m)(1) and proposed § 1.901(m)–3(b)(1), the disqualified tax amount is not taken into account for purposes of determining foreign tax credits under section 901, 902, or 960. A section 901(m) payor must compute a disqualified tax amount for any U.S. taxable year for which it is assigned a portion of the basis difference with respect to one or more RFAs.

The disqualified tax amount is the lesser of the tentative disqualified tax amount and the foreign income tax amount paid or accrued by, or considered paid or accrued by, a section 901(m) payor. The tentative disqualified tax amount is determined using a modified version of the formula provided in section 901(m)(3). To determine the tentative disqualified tax amount, the foreign income tax amount paid or accrued by, or considered paid or accrued by, the section 901(m) payor for its U.S. taxable year (multiplied) is multiplied by a ratio (disqualified ratio), the numerator of which is the sum of the portion of the basis

difference for all RFAs that is taken into account and assigned to the U.S. taxable year of the section 901(m) payor, and the denominator of which is the portion of the foreign income reflected on the foreign tax return that relates to the foreign income tax amount included in the multiplicand. The numerator and the denominator of the disqualified ratio are referred to in the proposed regulations as the “aggregate basis difference” and “allocable foreign income,” respectively.

Allocable foreign income (the denominator of the disqualified ratio) and the foreign income tax amount (the multiplicand) are determined using the total amount of foreign income and foreign income tax amount reflected on the foreign income tax return that are allocable to the section 901(m) payor, instead of by reference only to the amounts determined with respect to the RFAs. The Treasury Department and the IRS have determined that this approach appropriately carries out the purposes of section 901(m) while avoiding the administrative and compliance burdens that would result from a requirement to trace amounts of income to RFAs and identify the portion of foreign income taxes imposed on that income.

If a foreign income tax amount is computed taking into account an FCCT, the multiplicand of the tentative disqualified tax amount computation is the sum of the foreign income tax amount and any FCCTs paid or accrued by, or considered paid or accrued by, the section 901(m) payor. The Treasury Department and the IRS have determined that it is appropriate to include any FCCTs in the multiplicand to better reflect the effective tax rate imposed on the aggregate basis difference. However, the tentative disqualified tax amount is reduced (but not below zero) to the extent any portion of the FCCTs is itself treated as a disqualified tax amount of the section 901(m) payor with respect to a different foreign income tax.

The aggregate basis difference in the numerator includes cost recovery amounts and disposition amounts taken into account with respect to RFAs and assigned to the U.S. taxable year of the section 901(m) payor under proposed § 1.901(m)-5, as discussed in section VI. of this the Explanation of Provisions of this preamble. When the numerator and denominator are both positive amounts, the amount of aggregate basis difference included in the numerator is limited to the amount of foreign income in the denominator of the disqualified ratio (in other words, the allocable foreign income). This limitation ensures that multiplying the foreign income tax

amount included in the multiplicand by the disqualified ratio would not produce a disqualified tax amount greater than 100 percent of the foreign income tax amount. See section IV.B. of the Explanation of Provisions section of this preamble for the treatment of any excess of the aggregate basis difference over the allocable foreign income as an aggregate basis difference carryover.

The denominator of the disqualified ratio is the allocable foreign income. When the entire foreign income tax amount reflected on a foreign tax return is paid or accrued by, or considered paid or accrued by, a single section 901(m) payor for U.S. income tax purposes, the allocable foreign income is simply the total foreign income reflected on the foreign tax return. In general, this will be the case when the section 901(m) payor is the foreign payor or owns a disregarded entity that is the foreign payor, unless there is a change in ownership or a change in entity classification in the foreign payor requiring an allocation of the foreign income tax amount of the foreign payor (a mid-year transaction).

If, however, the foreign income tax amount reflected on a foreign tax return is allocated to more than one person for U.S. income tax purposes, the allocable foreign income in the denominator of the disqualified ratio for a particular section 901(m) payor is equal to the portion of the foreign income reflected on the foreign tax return that relates to the foreign income tax amount allocated to, and considered paid or accrued by, that section 901(m) payor (and therefore that is included in the multiplicand of the tentative disqualified tax amount computation). Proposed § 1.901(m)-3(b)(2)(iii)(C) provides guidance on how to determine the allocable foreign income in three types of cases: (i) The foreign income tax amount is allocated to a section 901(m) payor because the foreign payor is involved in a mid-year transaction, such as the transfer of a disregarded entity during the disregarded entity's foreign taxable year or acquisitions involving elections under section 338 or 336(e); (ii) the foreign income tax amount is allocated to a section 901(m) payor that is a partner because the foreign payor is a partnership for U.S. income tax purposes that is legally liable for the foreign income tax amount under § 1.901-2(f)(4)(i) (or the foreign payor is a disregarded entity and its assets are owned for U.S. income tax purposes by an entity that is treated as a partnership for U.S. income tax purposes and that is legally liable for the foreign income tax amount under § 1.901-2(f)(4)(ii)); and (iii) the foreign income tax amount is

allocated to a section 901(m) payor under § 1.901-2(f)(3)(i) because the section 901(m) payor is a member of a group whose income is taxed on a combined basis for foreign income tax purposes.

Notwithstanding the rules described in the two preceding paragraphs for determining allocable foreign income, if a section 901(m) payor fails to substantiate its allocable foreign income to the satisfaction of the Secretary, then proposed § 1.901(m)-3(b)(2)(iii)(D) provides that allocable foreign income will equal the amount determined by dividing the sum of the foreign income tax amount and the FCCTs that are paid or accrued by, or considered paid or accrued by, the section 901(m) payor, by the highest marginal tax rate applicable to income of the foreign payor under the relevant foreign income tax. See section 901(m)(3)(A).

If the numerator is less than zero, the denominator is less than or equal to zero, or the multiplicand is zero, the tentative disqualified tax amount (and therefore the disqualified tax amount) is zero. If the disqualified tax amount for a year either is zero or is limited by the foreign income tax amount paid or accrued by, or considered paid or accrued by, a section 901(m) payor, there will be an aggregate basis difference carryover as described in the next section.

#### *B. Aggregate Basis Difference Carryover*

Proposed § 1.901(m)-3(c) provides rules for determining the amount of aggregate basis difference carryover for a given U.S. taxable year of a section 901(m) payor that will be included in the section 901(m) payor's aggregate basis difference for the next U.S. taxable year (and therefore included in the numerator of the disqualified ratio for purposes of the next year's disqualified tax amount computation). The carryover reflects the extent to which the aggregate basis difference for a U.S. taxable year has not yet given rise to a disqualified tax amount.

If the disqualified tax amount is zero, none of the aggregate basis difference gives rise to a disqualified tax amount and therefore the full amount of the section 901(m) payor's aggregate basis difference for that year will be reflected in an aggregate basis difference carryover (positive or negative).

If the disqualified tax amount is not zero, an aggregate basis difference carryover may still arise in two situations. First, if the aggregate basis difference exceeds the section 901(m) payor's allocable foreign income (the denominator of the disqualified ratio) and therefore the amount of the

aggregate basis difference included in the numerator is limited, the excess is reflected in an aggregate basis difference carryover. Second, if the tentative disqualified tax amount (which takes into account FCCTs) exceeds the foreign income tax amount paid or accrued by the section 901(m) payor (which does not include FCCTs), that excess tax amount is converted into an equivalent amount of aggregate basis difference that is reflected in an aggregate basis difference carryover. See Prop. § 1.901(m)-3(c)(2)(ii)(B).

#### V. Determination of Basis Difference

Proposed § 1.901(m)-4 incorporates by cross reference the general rules in the temporary regulations for determining basis difference. Under these rules, basis difference is determined separately with respect to each foreign income tax for which an asset is an RFA.

Proposed § 1.901(m)-4(c)(1) provides for a foreign basis election, pursuant to which basis difference is equal to the U.S. basis in the RFA immediately after the CAA less the foreign basis in the RFA immediately after the CAA (including any adjustments to the foreign basis resulting from the CAA). Proposed § 1.901(m)-4(c)(2) through (4) provide rules for making a foreign basis election. A foreign basis election generally is made by the RFA owner (U.S.). For example, in a section 338 CAA, the foreign basis election is made by the corporation that is the subject of the qualified stock purchase (new target as defined in § 1.338-2(c)(17)). If the RFA owner (U.S.) is a partnership, however, each partner in the partnership (and not the partnership) may independently make a foreign basis election. A foreign basis election is made separately for each CAA and with respect to each foreign income tax and each foreign payor. For this purpose, a series of CAAs occurring as part of a plan (referred to in the regulations as an “aggregated CAA transaction”) are treated as a single CAA. The proposed regulations contain examples illustrating the scope of the foreign basis election.

The election is made by using foreign basis to determine the basis differences for purposes of computing a disqualified tax amount and an aggregate basis difference carryover. The election generally must be reflected on a timely filed original federal income tax return for the first U.S. taxable year that the foreign basis election is relevant. Proposed § 1.901(m)-4(c)(5) provides an exception for certain cases in which the RFA owner (U.S.) is a partnership. This exception generally provides relief

when one or more partners and the partnership have agreed that the partnership would determine whether to provide the partners with information to apply section 901(m) based on foreign basis and, in fact, the partnership provided the information to the partner using foreign basis, but when the partner timely filed its tax return it failed to report the application of section 901(m). The purpose of the relief is to address situations in which a partner must file an amended return in order to properly reflect the application of section 901(m) but does not have access to the necessary information to apply section 901(m) using U.S. basis. The criteria for qualifying for this relief should prevent partners from using hindsight in determining whether to make the foreign basis election.

Proposed § 1.901(m)-4(c)(6) provides another exception to the requirement to make the election in a timely filed original federal income tax return that applies if a taxpayer chooses to consistently apply these proposed regulations retroactively to all CAAs occurring before the regulations are issued in final form, including CAAs for which the taxpayer chooses not to make a foreign basis election. In this case, a foreign basis election may be reflected on a timely filed amended federal income tax return (or tax returns, as appropriate), provided that all amended returns are filed no later than one year following the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

#### VI. Basis Difference Taken Into Account

Section 1.901(m)-5 provides rules for determining the amount of basis difference with respect to an RFA that is taken into account in a given U.S. taxable year (referred to in the regulations as “allocated basis difference”). This allocated basis difference is used to compute a disqualified tax amount for a U.S. taxable year. Basis difference is taken into account in two ways: under an applicable cost recovery method or as a result of a disposition of the RFA.

For purposes of the discussion under this section VI of the Explanation of Provisions section of the preamble, unless otherwise indicated, a reference to direct ownership of an interest in an entity refers to direct ownership for U.S. income tax purposes, which includes ownership through one or more disregarded entities. A reference to indirect ownership of an interest in an entity refers to ownership through one or more entities that are treated as

fiscally transparent for U.S. income tax purposes, at least one of which is not a disregarded entity. Finally, a reference to indirect ownership of an interest in an entity for foreign income tax purposes means ownership through one or more entities that are treated as fiscally transparent for foreign income tax purposes.

#### A. Cost Recovery Rules

##### 1. Determining a Cost Recovery Amount

Proposed § 1.901(m)-5(b)(2)(i) incorporates by cross reference the general rule in the temporary regulations that a cost recovery amount for an RFA is determined by applying an applicable cost recovery method to the basis difference rather than to the U.S. basis of the RFA.

Proposed § 1.901(m)-5(b)(2)(ii) provides that if the entire U.S. basis of the RFA is not subject to the same cost recovery method, the applicable cost recovery method for determining the cost recovery amount is the cost recovery method that applies to the portion of the U.S. basis that corresponds to the basis difference.

Proposed § 1.901(m)-5(b)(3) provides that, for purposes of section 901(m), an applicable cost recovery method includes any method for recovering the cost of property over time for U.S. income tax purposes (each application of a method giving rise to a “U.S. basis deduction”). Such methods include depreciation, amortization, or depletion, as well as a method that allows the cost (or a portion of the cost) of property to be expensed in the year of acquisition or in the placed-in-service year, such as under section 179. Applicable cost recovery methods do not include any provision allowing for the recovery of U.S. basis upon a disposition of an RFA.

##### 2. Attributing or Allocating a Cost Recovery Amount to a Section 901(m) Payor

Under proposed § 1.901(m)-5(b)(1), when an RFA owner (U.S.) is a section 901(m) payor, all of the cost recovery amount is attributed to the section 901(m) payor and assigned to the U.S. taxable year of the section 901(m) payor in which the corresponding U.S. basis deduction with respect to the RFA is taken into account under the applicable cost recovery method. This is the case regardless of whether the deduction is deferred or disallowed under other Code provisions (for example, see section 263A, which requires the capitalization of certain costs and expenses).

If instead the RFA owner (U.S.) is not a section 901(m) payor but a fiscally transparent entity for U.S. income tax

purposes in which a section 901(m) payor directly or indirectly owns an interest, proposed § 1.901(m)-5(d)(2) allocates all or a portion of the cost recovery amount to the section 901(m) payor. Under those rules, a cost recovery amount is allocated to the section 901(m) payor to the extent the U.S. basis deduction that corresponds to the cost recovery amount (both of which are determined at the level of the RFA owner (U.S.)) is (or will be) included in the section 901(m) payor's distributive share of the income of the RFA owner (U.S.) for U.S. income tax purposes. Proposed § 1.901(m)-5(d)(6) assigns an allocated cost recovery amount to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the RFA owner (U.S.) in which the RFA owner (U.S.) takes into account the corresponding U.S. basis deduction (without regard to whether the deduction is deferred or disallowed under other Code provisions).

Special rules under proposed § 1.901(m)-5(e), discussed in section VI.D of the Explanation of Provisions section of this preamble, allocate a cost recovery amount that arises from an RFA with respect to certain section 743(b) CAAs. In addition, special rules under proposed § 1.901(m)-5(g), discussed in section VI.F of the Explanation of Provisions section of this preamble, allocate a cost recovery amount to a section 901(m) payor in certain cases in which the RFA owner (U.S.) either is a reverse hybrid or is a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid. A reverse hybrid is an entity that is treated as a corporation for U.S. income tax purposes but as a fiscally transparent entity for foreign income tax purposes.

#### B. General Disposition Rules

##### 1. Definition of Disposition and Determining a Disposition Amount

Proposed § 1.901(m)-1(a)(10) defines (by cross reference to the temporary regulations) a disposition for purposes of section 901(m) as an event that results in gain or loss being recognized with respect to an RFA for purposes of U.S. income tax, a foreign income tax, or both. Proposed § 1.901(m)-5(c)(2) incorporates by cross reference the rules provided in the temporary regulations for determining the amount of basis difference taken into account upon a disposition of an RFA (the disposition amount). Section 1.901(m)-5T(c)(2) provides that, if a disposition of an RFA is fully taxable for U.S. and foreign

income tax purposes, the disposition amount will be any remaining unallocated basis difference (positive or negative). Section 1.901(m)-5T(c)(2) further provides that, if a disposition of an RFA is not fully taxable for both U.S. and foreign income tax purposes and the RFA has a *positive* basis difference, the disposition amount is based solely on the amount, if any, of foreign disposition gain and U.S. disposition loss. If, on the other hand, a disposition of an RFA is not fully taxable for both U.S. and foreign income tax purposes and the RFA has a *negative* basis difference, the temporary regulations provide that the disposition amount is based solely on the amount, if any, of foreign disposition loss and U.S. disposition gain. See section V.B of the preamble to the temporary regulations for a further discussion of these provisions.

##### 2. Attributing or Allocating a Disposition Amount to a Section 901(m) Payor

Under proposed § 1.901(m)-5(c)(1), when the RFA owner (U.S.) is a section 901(m) payor, all of the disposition amount is attributed to the section 901(m) payor and assigned to the U.S. taxable year of the section 901(m) payor in which the disposition occurs.

If instead the RFA owner (U.S.) is not a section 901(m) payor but a fiscally transparent entity for U.S. income tax purposes in which a section 901(m) payor directly or indirectly owns an interest, proposed § 1.901(m)-5(d), discussed in section VI.C of the Explanation of Provisions section of this preamble, allocates all or a portion of a disposition amount to the section 901(m) payor and assigns it to a U.S. taxable year of the section 901(m) payor.

Special rules under proposed § 1.901(m)-5(e), discussed in section VI.D of the Explanation of Provisions section of this preamble, allocate a disposition amount to a section 901(m) payor and assign it to a U.S. taxable year of the section 901(m) payor when the disposition amount arises from an RFA with respect to certain section 743(b) CAAs. Special rules under proposed § 1.901(m)-5(f), discussed in section VI.E of the Explanation of Provisions section of this preamble, allocate a disposition amount attributable to foreign disposition gain or foreign disposition loss to a section 901(m) payor and assign it to a U.S. taxable year of the section 901(m) payor when there is a mid-year transaction. Special rules under proposed § 1.901(m)-5(g), discussed in section VI.F of the Explanation of Provisions section of this preamble, allocate a disposition amount

to a section 901(m) payor and assign it to a U.S. taxable year of the section 901(m) payor in certain cases in which the RFA owner (U.S.) either is a reverse hybrid or is a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid.

##### C. Rules for Allocating and Assigning a Disposition Amount When the RFA Owner (U.S.) Is a Fiscally Transparent Entity

This section describes the rules for allocating a disposition amount to a section 901(m) payor when the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes in which a section 901(m) payor directly or indirectly owns an interest, as well as rules for assigning the allocated amount to a U.S. taxable year of the section 901(m) payor.

The allocation rules (discussed in sections VI.C.1 and 2 of the Explanation of Provisions section of this preamble) vary depending on whether the disposition amount is attributable to foreign disposition gain or loss or U.S. disposition gain or loss. The rules for determining the extent to which a disposition amount is attributable to foreign or U.S. disposition gain or loss are discussed in section VI.C.3 of the Explanation of Provisions section of this preamble. The rules for assigning allocated disposition amounts to a U.S. taxable year of a section 901(m) payor are discussed in section VI.C.4 of the Explanation of Provisions section of this preamble.

##### 1. Allocation of a Disposition Amount Attributable to Foreign Disposition Gain or Foreign Disposition Loss

Proposed § 1.901(m)-5(d)(3) addresses the allocation of a disposition amount attributable to foreign disposition gain or foreign disposition loss of an RFA. These rules should be interpreted and applied in a manner consistent with the principle that a disposition amount attributable to foreign disposition gain or foreign disposition loss should be allocated to a section 901(m) payor in the same proportion that the gain or loss is taken into account in computing a foreign income tax amount that is paid or accrued by, or considered paid or accrued by, the section 901(m) payor. This is because, for example, if an RFA has a positive basis difference, a disposition amount attributable to foreign disposition gain represents an amount of gain in years following the CAA that is included in foreign income but never included in U.S. taxable income or earnings and profits because of the step-up in the U.S. basis of the

RFA that occurred as a result of the CAA. Accordingly, to the extent a foreign disposition gain is taken into account in computing a foreign income tax amount, a portion of that foreign income tax amount should be disallowed as a foreign tax credit under section 901(m). Similarly, if an RFA has a negative basis difference and a foreign disposition loss is taken into account in computing a foreign income tax amount, this should result in an offset to the amount of the foreign income tax that otherwise would be disallowed as a foreign tax credit under section 901(m) as a result of a positive basis difference with respect to one or more other RFAs.

There are two separate rules for identifying the extent to which a foreign disposition gain or foreign disposition loss is taken into account in computing a foreign income tax amount that is paid or accrued by, or considered paid or accrued by, a section 901(m) payor that directly or indirectly owns an interest in an RFA owner (U.S.) that is a fiscally transparent entity for U.S. income tax purposes. The first rule, which is described in proposed § 1.901(m)-5(d)(3)(ii), applies when the foreign income tax amount is not allocated, for example, when the foreign payor is the section 901(m) payor. The second rule, which is described in proposed § 1.901(m)-5(d)(3)(iii), applies when the foreign income tax amount is allocated, for example, under § 1.704-1(b)(4)(viii) when the foreign payor is a partnership for U.S. income tax purposes in which the section 901(m) payor is a partner.

#### a. First Allocation Rule

The first allocation rule applies when a section 901(m) payor, or a disregarded entity directly owned by a section 901(m) payor, is a foreign payor whose foreign income includes a distributive share of the foreign income (that includes the foreign disposition gain or foreign disposition loss) of the RFA owner (foreign). In this structure, the entire foreign income tax amount reflected on the foreign income tax return of the foreign payor is paid or accrued by, or considered paid or accrued by, the section 901(m) payor. This will be the case when the RFA owner (U.S.) is treated as a fiscally transparent entity not just for U.S. income tax purposes, but also for foreign income tax purposes, and the section 901(m) payor directly or indirectly owns an interest in the RFA owner (U.S.), provided that, in the case of indirect ownership, any entities in the ownership chain between the section 901(m) payor and the RFA owner (U.S.), or, when one or more disregarded entities are directly owned

by the section 901(m) payor, between the lowest-tier disregarded entity and the RFA owner (U.S.), are fiscally transparent for both U.S. and foreign income tax purposes. In these cases, the RFA owner (U.S.) and the RFA owner (foreign) are the same entity, except in the unusual case where the RFA owner (U.S.) is an entity that is disregarded as separate from its owner for foreign income tax purposes.

The first allocation rule allocates a portion of a disposition amount attributable to foreign disposition gain or foreign disposition loss, as applicable, to the section 901(m) payor proportionally to the amount of the foreign disposition gain or foreign disposition loss that is included in the foreign payor's (in other words, the section 901(m) payor or the disregarded entity, as the case may be) distributive share of the foreign income of the RFA owner (foreign) for foreign income tax purposes.

The following example illustrates the first allocation rule. A domestic entity that is a corporation for both U.S. and foreign income tax purposes (corporate partner) directly owns, for both U.S. and foreign income tax purposes, an interest in a foreign entity that is a partnership for both U.S. and foreign income tax purposes and that is the RFA owner (U.S.) and the RFA owner (foreign). In this case, when the partnership recognizes foreign disposition gain with respect to an RFA, the foreign income tax amount with respect to such gain is paid by the partners on their distributive shares of the foreign income of the partnership that includes the foreign disposition gain. The corporate partner, and not the partnership, is therefore a foreign payor and a section 901(m) payor. Accordingly, under the first allocation rule, a disposition amount attributable to foreign disposition gain is allocated to the corporate partner proportionally to the amount of the foreign disposition gain that is included in the corporate partner's distributive share of the foreign income of the partnership. Thus, for example, if the partnership recognizes \$100 of foreign disposition gain and 50 percent of that gain is included in the corporate partner's distributive share of the foreign income of the partnership, and the disposition amount attributable to the foreign disposition gain is \$40, the corporate partner would be allocated \$20 of that amount (50 percent of \$40). The same result would apply if the corporate partner directly owned the partnership interest through a disregarded entity that is the foreign payor.

#### b. Second Allocation Rule

The second allocation rule applies when, instead of a section 901(m) payor or a disregarded entity directly owned by a section 901(m) being a foreign payor, a section 901(m) payor directly or indirectly owns an interest in a fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by the section 901(m) payor) that is a foreign payor whose foreign income includes all or a portion of the foreign income (that includes the foreign disposition gain or foreign disposition loss) of the RFA owner (foreign). Therefore, the section 901(m) payor is considered to pay or accrue only an allocated portion of the foreign income tax amount reflected on the foreign income tax return of the foreign payor. This will be the case when a section 901(m) payor directly or indirectly owns an interest in the foreign payor, and the foreign payor is (i) the RFA owner (U.S.), (ii) another fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by a section 901(m) payor) that directly or indirectly owns an interest in the RFA owner (U.S.) for both U.S. and foreign income tax purposes, or (iii) a disregarded entity directly owned by the RFA owner (U.S.). In each of these cases, the entity subject to tax for purposes of the foreign income tax (that is, the foreign payor) is treated as a fiscally transparent entity for U.S. income tax purposes.

The mechanics of the second allocation rule are different than those of the first allocation rule. This is because the second allocation rule applies when neither the section 901(m) payor, nor a disregarded entity directly owned by a section 901(m) payor, is a foreign payor that takes into account a foreign disposition gain or foreign disposition loss for purposes of calculating a foreign income tax amount, but instead, for U.S. income tax purposes, a foreign income tax amount of the foreign payor is allocated to, and considered paid or accrued by, the section 901(m) payor. Accordingly, the second allocation rule allocates a portion of a disposition amount attributable to foreign disposition gain or foreign disposition loss, as applicable, to the section 901(m) payor proportionally to the amount of the foreign disposition gain or foreign disposition loss that is included in the allocable foreign income of the section 901(m) payor. As described in section IV.A of the Explanation of Provisions section of this preamble, allocable foreign income is generally the portion

of foreign income of a foreign payor that relates to the portion of the foreign income tax amount of that foreign payor that is allocated to and considered paid or accrued by a section 901(m) payor.

The following example illustrates the second allocation rule. A domestic entity that is a corporation for both U.S. and foreign income tax purposes (corporate partner) directly owns an interest in a foreign entity, the RFA owner (U.S.) and RFA owner (foreign), that is a partnership for U.S. income tax purposes but a corporation for purposes of a foreign income tax (a hybrid partnership). In this case, when the hybrid partnership recognizes foreign disposition gain with respect to an RFA, it is the hybrid partnership, rather than the partners, that takes the gain into account for purposes of calculating a foreign income tax amount. The hybrid partnership is therefore the foreign payor. For U.S. income tax purposes, a foreign income tax amount of the hybrid partnership is allocated to, and considered paid or accrued by, its partners, including the corporate partner that is a section 901(m) payor (see §§ 1.702-1(a)(6), 1.704-1(b)(4)(viii), and 1.901-2(f)(4)(i)). Under the second allocation rule, a disposition amount attributable to foreign disposition gain is allocated to the corporate partner proportionally to the amount of the foreign disposition gain that is included in the corporate partner's allocable foreign income. Thus, for example, if the hybrid partnership pays a foreign income tax amount of \$30 on \$200 of foreign income that includes \$100 of foreign disposition gain and \$15 of the foreign income tax amount (50 percent of \$30) is allocated to and considered paid by the corporate partner, the corporate partner's allocable foreign income would be \$100 (50 percent of the \$200 foreign income to which the foreign income tax amount relates), which would include \$50 of foreign disposition gain (50 percent of \$100). If the disposition amount attributable to the foreign disposition gain is \$60, the corporate partner would be allocated \$30 of that amount (\$60 multiplied by 50 percent, the portion of the total foreign disposition gain that is included in the corporate partner's allocable foreign income).

In this example, the analysis would be similar if the corporate partner instead indirectly owned the partnership interest (for example through an upper-tier partnership), because the corporate partner would continue to be the section 901(m) payor and the hybrid partnership would continue to be the RFA owner (U.S.), the RFA owner (foreign), and the foreign payor.

## 2. Allocation of a Disposition Amount Attributable to U.S. Disposition Gain or U.S. Disposition Loss

Proposed § 1.901(m)-5(d)(4) addresses the allocation of a disposition amount attributable to U.S. disposition gain or U.S. disposition loss. Such disposition amounts are allocated to a section 901(m) payor based on the portion of the U.S. disposition gain or U.S. disposition loss (which are determined at the level of the RFA owner (U.S.)) that is (or will be) included in the section 901(m) payor's distributive share of the income of the RFA owner (U.S.) for U.S. income tax purposes.

### 3. Determining the Extent to Which a Disposition Amount Is Attributable to Foreign or U.S. Disposition Gain or Loss

#### a. Positive Basis Difference

When an RFA has a positive basis difference, a disposition amount arises from a disposition of the RFA only if the disposition results in a foreign disposition gain or a U.S. disposition loss (or both). To allocate such a disposition amount to a section 901(m) payor, it is necessary to determine the extent to which the disposition amount is attributable to foreign disposition gain or U.S. disposition loss.

Proposed § 1.901(m)-5(d)(5)(i) provides that if the disposition results in either a foreign disposition gain or a U.S. disposition loss, but not both, the entire disposition amount is attributable to foreign disposition gain or U.S. disposition loss, as applicable, even if the disposition amount exceeds the foreign disposition gain or the absolute value of the U.S. disposition loss. If the disposition results in both a foreign disposition gain and a U.S. disposition loss, the disposition amount is attributable first to foreign disposition gain to the extent thereof, and the excess disposition amount, if any, is attributable to the U.S. disposition loss, even if the excess disposition amount exceeds the absolute value of the U.S. disposition loss. In the case of a disposition that is fully taxable for both U.S. and foreign income tax purposes, a disposition amount may exceed the sum of the foreign disposition gain and the absolute value of the U.S. disposition loss if, immediately before the CAA, the foreign basis in the RFA was greater than the U.S. basis, and a foreign basis election was not made.

#### b. Negative Basis Difference

When an RFA has a negative basis difference, a disposition amount arises from a disposition of the RFA only if the disposition results in a foreign disposition loss or a U.S. disposition

gain (or both). To allocate such a disposition amount to a section 901(m) payor, it is necessary to determine the extent to which the disposition amount is attributable to foreign disposition loss or U.S. disposition gain.

Proposed § 1.901(m)-5(d)(5)(ii) provides rules for making this determination when there is a negative basis difference that are similar to those provided in proposed § 1.901(m)-5(d)(5)(i) for a positive basis difference.

## 4. Assigning a Disposition Amount to a U.S. Taxable Year of a Section 901(m) Payor

When a disposition amount is allocated to a section 901(m) payor under proposed § 1.901(m)-5(d), proposed § 1.901(m)-5(d)(6) provides that the disposition amount is assigned to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the RFA owner (U.S.) in which the disposition occurs.

### D. Special Allocation Rules for Certain Section 743(b) CAAs

Proposed § 1.901(m)-5(e) provides that when a section 901(m) payor acquires a partnership interest in a section 743(b) CAA, including a section 743(b) CAA with respect to a lower-tier partnership that results from a direct acquisition by the section 901(m) payor of an interest in an upper-tier partnership, a cost recovery amount or a disposition amount that arises from an RFA with respect to that CAA is allocated to the acquiring section 901(m) payor. These amounts are assigned to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the partnership in which, in the case of a cost recovery amount, the partnership takes into account the corresponding U.S. basis deduction, or, in the case of a disposition amount, the disposition occurs.

This special rule does not apply if it is another partnership, and not a section 901(m) payor, that acquires a partnership interest in a section 743(b) CAA. In that case, the general rules for allocating a cost recovery amount or disposition amount when the RFA owner (U.S.) is a fiscally transparent entity apply.

### E. Special Allocation Rules for Certain Mid-Year Transactions

Proposed § 1.901(m)-5(f) provides rules for allocating a disposition amount when there is a disposition of an RFA during a foreign taxable year in which the foreign payor is involved in a mid-year transaction, and the disposition

results in foreign disposition gain or foreign disposition loss that is allocated under the principles of § 1.1502-76(b) to the persons involved in the mid-year transaction for purposes of allocating the foreign income tax amount of the foreign payor. A typical example is when a section 901(m) payor owns a disregarded entity that is both an RFA owner (foreign) and the foreign payor, and the disregarded entity sells the RFA in the same year that the section 901(m) payor sells the disregarded entity to another section 901(m) payor. If the RFA has positive unallocated basis difference and there is foreign disposition gain on the sale of the RFA, the sale will give rise to a disposition amount that will be used by the section 901(m) payors to calculate a disqualified portion of the foreign income tax amount reflected on the foreign income tax return of the disregarded entity. Pursuant to § 1.901-2(f)(4)(ii), that foreign income tax amount must be allocated between the buyer and seller of the disregarded entity based on the respective portions of foreign income that are attributable under the principles of § 1.1502-76(b) to the buyer's and seller's respective periods of ownership of the disregarded entity during its foreign taxable year. Under proposed § 1.901(m)-5(f)(2), the disposition amount attributable to foreign disposition gain is similarly allocated between the buyer and the seller based on the principles in proposed § 1.901(m)-5(d), discussed in section VI.C of the Explanation of Provisions section of this preamble, that apply to allocate a disposition amount when the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes.

#### *F. Special Allocation Rules for Certain Reverse Hybrids*

Proposed § 1.901(m)-5(g) addresses the allocation of cost recovery amounts and disposition amounts when the RFA owner (U.S.) is either a reverse hybrid or a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid for U.S. and foreign income tax purposes, and in either case, a foreign payor directly or indirectly owns an interest in the reverse hybrid for foreign income tax purposes and therefore includes in its foreign income a distributive share of the foreign income (that includes the foreign disposition gain or foreign disposition loss) of the RFA owner (foreign). These allocation rules are similar to the allocation rules discussed in section VI.C.1 of the Explanation of Provisions section of this preamble that apply to

allocate a disposition amount attributable to foreign disposition gain or foreign disposition loss when the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes. These rules are broader in scope, however, because they apply to allocate not just foreign disposition gain or foreign disposition loss, but rather, both cost recovery amounts and entire disposition amounts (which may be attributable, in whole or in part, to U.S. disposition gain or U.S. disposition loss). This is because the basis difference giving rise to such amounts may not be taken into account in computing U.S. taxable income or earnings and profits of the owners of the reverse hybrid until one or more subsequent U.S. taxable years (for example, upon the receipt of a distribution of property from the reverse hybrid).

These rules should be interpreted and applied in a manner consistent with the principle that a cost recovery amount or a disposition amount (or both) should be allocated to a section 901(m) payor proportionally to the amount of the foreign income of the RFA owner (foreign) that is taken into account in computing a foreign income tax amount of a foreign payor that is paid or accrued by, or considered paid or accrued by, the section 901(m) payor.

There are two separate rules for allocating a cost recovery amount or disposition amount to a section 901(m) payor when the RFA owner (U.S.) either is a reverse hybrid or a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid for U.S. and foreign income tax purposes. The first rule, which is described in § 1.901(m)-5(g)(2), applies when the foreign income tax amount is not allocated, for example, when the foreign payor is the section 901(m) payor. The second rule, which is described in § 1.901(m)-5(g)(3), applies when the foreign income tax amount is allocated, for example, under § 1.704-1(b)(4)(viii) when the foreign payor is a partnership for U.S. income tax purposes in which the section 901(m) payor is a partner.

##### 1. First Allocation Rule

The first allocation rule applies when a section 901(m) payor, or a disregarded entity directly owned by a section 901(m) payor, is the foreign payor whose foreign income includes a distributive share of the foreign income of the RFA owner (foreign). In this structure, the entire foreign income tax amount reflected on the foreign income tax return of the foreign payor is paid or

accrued by, or considered paid or accrued by, the section 901(m) payor. This will be the case when a section 901(m) payor directly or indirectly owns an interest in the reverse hybrid, provided that in the case of indirect ownership, any entities in the ownership chain between the section 901(m) payor and the reverse hybrid, or, when one or more disregarded entities are directly owned by the section 901(m) payor, between the lowest-tier disregarded entity and the reverse hybrid, are fiscally transparent for both U.S. and foreign income tax purposes. In these cases, the RFA owner (U.S.) and the RFA owner (foreign) are the same entity, except in the unusual case where the RFA owner (U.S.) is an entity that is disregarded as separate from its owner for foreign income tax purposes.

The first allocation rule allocates a portion of a cost recovery amount or a disposition amount to the section 901(m) payor proportionally to the amount of the foreign income of the RFA owner (foreign) that is included in the foreign income of the foreign payor (in other words, the section 901(m) payor or the disregarded entity, as the case may be).

The following example illustrates the first allocation rule. A domestic entity that is a corporation for both U.S. and foreign income tax purposes (corporate owner) owns an interest in a reverse hybrid that is the RFA owner (U.S.) and the RFA owner (foreign). A foreign income tax amount with respect to the foreign income of the reverse hybrid is paid by the owners of the reverse hybrid on their distributive shares of such foreign income. The corporate owner, and not the reverse hybrid, is therefore a foreign payor and a section 901(m) payor. Under the first allocation rule, a cost recovery amount or a disposition amount is allocated to the corporate owner proportionally to the amount of the foreign income of the reverse hybrid that is included in the foreign income of the corporate owner. Thus, for example, if 50 percent of the foreign income of the reverse hybrid is included in the foreign income of the corporate owner, the corporate owner would be allocated 50 percent of a cost recovery amount or a disposition amount with respect to an RFA owned by the reverse hybrid. The same result would apply if the corporate owner directly owned the interest in the reverse hybrid through a disregarded entity that is the foreign payor.

Alternatively, if the reverse hybrid was not the RFA owner (foreign) but instead the reverse hybrid owned an interest in the RFA owner (U.S.) and RFA owner (foreign), which is a partnership for both U.S. and foreign

income tax purposes, and 60 percent of the foreign income of the partnership is included in the foreign income of the reverse hybrid (and therefore 30 percent (50 percent of 60 percent) of the foreign income of the partnership is included in the foreign income of the corporate owner), the corporate owner would be allocated 30 percent of a cost recovery amount or a disposition amount with respect to an RFA owned by the partnership.

## 2. Second Allocation Rule

The second allocation rule applies when instead of a section 901(m) payor, or a disregarded entity directly owned by a section 901(m) payor, being a foreign payor, a section 901(m) payor directly or indirectly owns an interest in the foreign payor whose foreign income includes a distributive share of the foreign income of the RFA owner (foreign). Therefore, the section 901(m) payor is considered to pay or accrue only an allocated portion of the foreign income tax amount reflected on the foreign income tax return of the foreign payor. This will be the case when the foreign payor is a fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by the section 901(m) payor) that either directly or indirectly owns an interest in the RFA owner (foreign) for foreign income tax purposes. In these cases, the RFA owner (U.S.) and the RFA owner (foreign) are the same entity, except in the unusual case where the RFA owner (U.S.) is an entity that is disregarded as separate from its owner for foreign income tax purposes.

The mechanics of the second allocation rule are different than those of the first allocation rule. This is because the second allocation rule applies when neither a section 901(m) payor, nor a disregarded entity directly owned by a section 901(m) payor, is a foreign payor that takes into account the foreign income of the RFA owner (foreign) for purposes of calculating a foreign income tax amount, but instead, for U.S. income tax purposes, a foreign income tax amount of the entity that is the foreign payor is allocated to, and considered paid or accrued by, the section 901(m) payor. Accordingly, the second allocation rule allocates a portion of cost recovery amounts and disposition amounts proportionally to the amount of the foreign income of the RFA owner (foreign) that is included in the foreign income of the foreign payor that is then included in the allocable foreign income of the section 901(m) payor. As described in section IV.A of the Explanation of Provisions section of this preamble, allocable foreign income

is generally the portion of foreign income of a foreign payor that relates to the portion of the foreign income tax amount of that foreign payor that is allocated to and considered paid or accrued by a section 901(m) payor.

The following example illustrates the second allocation rule. A domestic entity that is a corporation for both U.S. and foreign income tax purposes (corporate partner) owns an interest in an entity that is a partnership for U.S. income tax purposes but a corporation for foreign income tax purposes (hybrid partnership), which, in turn, owns an interest in a reverse hybrid that is the RFA owner (U.S.) and the RFA owner (foreign). A foreign income tax amount with respect to the foreign income of the reverse hybrid is paid by the owners of the reverse hybrid on their distributive shares of such foreign income. Therefore, the hybrid partnership, rather than its partners, is the foreign payor. For U.S. income tax purposes, the foreign income tax amount paid or accrued by the hybrid partnership is allocated to, and considered paid or accrued by, the corporate partner that is the section 901(m) payor (see §§ 1.702-1(a)(6), 1.704-1(b)(4)(viii), and 1.901-2(f)(4)(i)). Under the second allocation rule, a cost recovery amount or a disposition amount with respect to an RFA owned by the reverse hybrid is allocated to the corporate partner proportionally to the amount of foreign income of the reverse hybrid that is taken into account in determining the foreign income of the hybrid partnership and then the allocable foreign income of the corporate partner. Thus, for example, if the reverse hybrid has \$500 of foreign income and the hybrid partnership pays a foreign income tax amount of \$30 on \$200 of foreign income that includes a \$100 distributive share of the foreign income of the reverse hybrid (20 percent of \$500) and \$15 of the foreign income tax amount (50 percent of \$30) is allocated to and considered paid by the corporate partner, then the corporate partner's allocable foreign income would be \$100 (50 percent of the \$200 foreign income to which the foreign income tax amount relates). A cost recovery amount or disposition amount with respect to the RFAs owned by the reverse hybrid would be allocated 10 percent to the corporate partner (the corporate partner's 50 percent share of the hybrid partnership's 20 percent share of the reverse hybrid's foreign income).

## VII. Successor Rules

Proposed § 1.901(m)-6 provides successor rules for applying section 901(m) following a transfer of RFAs that

have basis difference that has not yet been fully taken into account (referred to in the regulations as "unallocated basis difference") as well as for determining when an aggregate basis difference carryover of a section 901(m) payor either becomes an aggregate basis difference carryover of the section 901(m) payor with respect to another foreign payor or is transferred to another section 901(m) payor.

### A. Unallocated Basis Difference

Proposed § 1.901(m)-6(b)(1) and (2) incorporate by cross reference the successor rules set forth in the temporary regulations, which provide generally that section 901(m) continues to apply to an RFA after it has been transferred for U.S. income tax purposes if the RFA continues to have unallocated basis difference following the transfer (a successor transaction).

Proposed § 1.901(m)-6(b)(3) sets forth two clarifications for applying the successor rules. First, if an asset is an RFA with respect to more than one foreign income tax, the successor rules apply separately with respect to each foreign income tax. Second, any subsequent cost recovery amount for an RFA transferred in a successor transaction will be determined based on the applicable cost recovery method that applies to the U.S. basis (or portion thereof) that corresponds to the unallocated basis difference. Thus, if a successor transaction restarts the depreciation schedule for an RFA, the transaction may result in unallocated basis difference being taken into account at a different recovery rate than otherwise would have applied.

Proposed § 1.901(m)-6(b)(4)(iii) also incorporates by cross reference the rule set forth in the temporary regulations that provides an exception to the general rule when an RFA is subject to multiple section 743(b) CAAs. See section VI.B. of the Explanation of Provisions section of the preamble to the temporary regulations for a discussion of those provisions.

Proposed § 1.901(m)-6(b)(4)(ii), which is not included in the temporary regulations, provides an exception to the general successor rule if a foreign basis election is made under proposed § 1.901(m)-4(c) with respect to a subsequent CAA that otherwise would trigger the rules for successor transactions. If a foreign basis election is made with respect to a foreign income tax, the only basis difference that will be taken into account after the subsequent CAA with respect to that foreign income tax is the basis difference determined for the subsequent CAA.

### B. Aggregate Basis Difference Carryover

Proposed § 1.901(m)–6 provides successor rules for aggregate basis difference carryovers, the computation of which is described in section IV.B of the Explanation of Provisions section of this preamble. An aggregate basis difference carryover is treated as a tax attribute of the section 901(m) payor that retains its character as an aggregate basis difference carryover with respect to a foreign income tax and a foreign payor and with respect to a separate category, as described in § 1.904–4(m) (including the section 904(d) categories). When a section 901(m) payor transfers its assets in a transaction to which section 381 applies, proposed § 1.901(m)–6(c)(1) provides that any aggregate basis difference carryovers of the section 901(m) payor are transferred to the corporation that succeeds to the earnings and profits, if any. When substantially all of the assets of one foreign payor are transferred to another foreign payor, both of which are directly or indirectly owned by the same section 901(m) payor, proposed § 1.901(m)–6(c)(2) provides that an aggregate basis difference carryover of the section 901(m) payor with respect to the transferor foreign payor becomes an aggregate basis difference carryover of the section 901(m) payor with respect to the transferee foreign payor.

Proposed § 1.901(m)–6(c)(3) provides an anti-abuse rule that would transfer an aggregate basis difference carryover when, with a principal purpose of avoiding the application of section 901(m), there is a transfer of assets or a change in either the allocation of foreign income for foreign income tax purposes or the allocation of foreign income tax amounts for U.S. income tax purposes that is intended to separate foreign income tax amounts from the related aggregate basis difference carryover. This anti-abuse rule would apply, for example, if, with the principal purpose of avoiding the application of section 901(m), a partnership agreement is amended in order to reduce the allocation of foreign income to a partner that is a section 901(m) payor with an aggregate basis difference carryover.

### VIII. De Minimis Rules

Proposed § 1.901(m)–7 describes de minimis rules under which certain basis differences are not taken into account for purposes of section 901(m). This determination is made when an asset subject to a CAA first becomes an RFA. If that same asset is also an RFA by reason of being subject to a subsequent CAA, the de minimis tests are applied only to the additional basis difference,

if any, that results from the subsequent CAA. Accordingly, any unallocated basis difference that arose from the prior CAA that did not qualify for the de minimis exemption at the time of the prior CAA will not be retested at the time of the subsequent CAA.

In general, a basis difference with respect to an RFA is not taken into account for purposes of section 901(m) if either (i) the sum of the basis differences for all RFAs with respect to the CAA is less than the greater of \$10 million or 10 percent of the total U.S. basis of all RFAs immediately after the CAA; or (ii) the RFA is part of a class of RFAs for which the sum of the basis differences of all RFAs in the class is less than the greater of \$2 million or 10 percent of the total U.S. basis of all RFAs in the class. For this purpose, the classes of RFAs are the seven asset classes defined in § 1.338–6(b).

The Treasury Department and the IRS decided that transactions between related parties should be more tightly regulated, and therefore, the threshold dollar amounts and percentages to meet the de minimis exemptions for related party CAAs are lower than those for unrelated party CAAs, replacing the terms “\$10 million,” “10 percent,” and “\$2 million” wherever they occur with the terms “\$5 million,” “5 percent,” and “\$1 million,” respectively. In addition, an anti-abuse provision at proposed § 1.901(m)–7(e) denies application of the de minimis exemptions to CAAs between related parties that are entered into or structured with a principal purpose of avoiding the application of section 901(m).

### IX. Miscellaneous

Proposed § 1.901(m)–8(b) provides that, when a foreign corporation becomes a section 902 corporation for the first time, as part of the required reconstruction of the U.S. tax history of the pre-1987 foreign income taxes of the foreign corporation, section 901(m) and these regulations must be applied to determine any disqualified tax amounts or aggregate basis difference carryovers that apply to the foreign corporation.

Proposed § 1.901(m)–8(c) provides an anti-abuse rule that applies to disregard an RFA with a built-in loss to the extent it relates to any asset acquisition structured with a principal purpose to use that RFA to avoid the application of section 901(m). This rule may apply, for example, if, with a principal purpose of avoiding the application of section 901(m), an asset is acquired in a transaction that preserves a built-in loss in the asset for U.S. income tax purposes but not for foreign income tax purposes.

### X. Modifications to the Section 704(b) Regulations Related to Section 901(m)

Section 1.704–1(b)(4)(viii) provides a safe harbor under which allocations of creditable foreign tax expenditures (CFTEs) (as defined in § 1.704–1(b)(4)(viii)(b)) by a partnership to its partners are deemed to be in accordance with the partners’ interests in the partnership. In general, the purpose of the safe harbor is to match allocations of CFTEs with the income to which the CFTEs relate. In order to apply the safe harbor, a partnership must (1) determine the partnership’s “CFTE categories,” (2) determine the partnership’s net income in each CFTE category, and (3) allocate the partnership’s CFTEs to each category. In order to satisfy the safe harbor, partnership allocations of CFTEs in a CFTE category must be proportionate to the allocations of the partnership’s net income in the CFTE category.

A CFTE may be subject to section 901(m) because it is a foreign income tax amount that is paid or accrued by a partnership. Specifically, if a partnership owns an RFA with respect to a foreign income tax and that RFA has a basis difference subject to section 901(m), a portion of a foreign income tax amount paid or accrued by the partnership that relates to that foreign income tax may be disallowed as a foreign tax credit under section 901(m) in the hands of section 901(m) payors to whom the foreign income tax amount is allocated. The disqualified tax amount is determined by taking into account cost recovery amounts and disposition amounts with respect to the RFA that are allocated to those section 901(m) payors pursuant to the rules provided in proposed § 1.901(m)–5. In order to ensure that the proper portion of a foreign income tax amount paid or accrued by a partnership is disallowed under section 901(m), adjustments to the net income (and the allocations of that income) in a CFTE category that includes items attributable to the RFA are necessary in certain cases.

To illustrate such a case, assume a domestic entity that is a partnership for U.S. income tax purposes but a corporation for purposes of a foreign income tax (a hybrid partnership) is owned by partner A and partner B, each of which is a domestic entity that is a corporation for both U.S. and foreign income tax purposes. In this case, the hybrid partnership is the foreign payor and partners A and B are section 901(m) payors. The hybrid partnership is the RFA owner (U.S.) and the RFA owner (foreign) with respect to a single asset that is an RFA. Assume that in a given

year the hybrid partnership has 110u of gross income for both U.S. and foreign tax purposes and a 10u depreciation deduction solely for U.S. income tax purposes, which gives rise to a cost recovery amount with respect to the RFA (as determined under proposed § 1.901(m)-5(b)(2)). All partnership items are allocated equally to partners A and B, except that the entire 10u U.S. depreciation deduction is allocated to partner A. Thus, partner A's distributive share of income is 45u (110u × 50%, less 10u) and partner B's distributive share of income is 55u (110u × 50%). Because the entire U.S. depreciation deduction is (or will be included) in partner A's distributive share of income for U.S. income tax purposes, the entire cost recovery amount that corresponds to the U.S. depreciation deduction of 10u is allocated to partner A. See proposed § 1.901(m)-5(d)(2). As a result, Partner A will take into account the 10u cost recovery amount in calculating a disqualified tax amount with respect to the portion of the relevant foreign income tax amount paid or accrued by the hybrid partnership and allocated to partner A under the CFTE allocation rules. In order to ensure that the portion of the foreign income tax amount paid or accrued by the hybrid partnership that is attributable to the 10u basis difference is properly subject to section 901(m), the U.S. depreciation deduction should not be taken into account under the CFTE allocation rules so that the portion of the foreign income tax amount attributable to the 10u basis difference is allocated to partner A. Accordingly, the net income of the CFTE category that includes the U.S. basis deduction should be increased by 10u (from 100u to 110u) to back out the portion of the U.S. depreciation deduction that corresponds to the cost recovery amount, and partner A's share of that net income should be increased by 10u (from 45u to 55u). In this example, as a result of the adjustment, the foreign income tax amount paid or accrued by the hybrid partnership will be allocated equally between partner A and partner B, because they each will have a 50-percent share of the net income in the CFTE category, as adjusted. Absent the adjustment, a portion of the foreign income tax amount attributable to the 10u basis difference would be allocated to partner B, a person that is not subject to section 901(m) (because no cost recovery amount is allocated to partner B).

No modification to the safe harbor is necessary to address cost recovery amounts and disposition amounts attributable to section 743(b)

adjustments that are allocated to partners under proposed § 1.901(m)-5(e) (which applies when a section 901(m) payor acquires a partnership interest in a section 743(b) CAA), because, in these cases, § 1.704-1T(b)(4)(viii)(c)(3)(i) already provides that the partnership determines net income in a CFTE category without regard to section 743(b) adjustments that its partners may have to the basis of property of the partnership. However, as discussed in section VI.D of the Explanation of Provisions section of this preamble, proposed § 1.901(m)-5(e) does not apply when another partnership (which by definition cannot be a section 901(m) payor) acquires a partnership interest in a section 743(b) CAA. Thus, modification to the safe harbor is necessary for all CAAs other than those section 743(b) CAAs described in proposed § 1.901(m)-5(e).

Accordingly, these proposed regulations add special rules under proposed § 1.704-1(b)(4)(viii)(c)(4)(v), (vi), and (vii) to address partnership items that give rise to cost recovery amounts and disposition amounts attributable to CAAs (other than section 743(b) CAAs described in proposed § 1.901(m)-5(e)). Specifically, these rules provide that, if an RFA has a positive basis difference, net income in a CFTE category that takes into account partnership items of income, deduction, gain, or loss attributable to the RFA (applicable CFTE category) is increased by the sum of the cost recovery amounts and disposition amounts attributable to U.S. disposition loss that correspond to those partnership items. Furthermore, to the extent a partner is allocated those cost recovery amounts or disposition amounts attributable to U.S. disposition loss, that partner's share of the net income in the CFTE category is increased by the same amount. Alternatively, if an RFA has a negative basis difference, the net income in the applicable CFTE category is decreased by the sum of the cost recovery amounts and disposition amounts attributable to U.S. disposition gain that correspond to partnership items in that CFTE category. Furthermore, to the extent a partner is allocated those cost recovery amounts or disposition amounts attributable to U.S. disposition gain, that partner's share of the net income in the CFTE category is decreased by the same amount.

#### XI. Effective/Applicability Dates

These proposed regulations will apply to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers may, however, rely on the proposed

regulations prior to the date the regulations are applicable provided that they both consistently apply proposed § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016 and consistently apply proposed § 1.901(m)-1 and §§ 1.901(m)-3 through 1.901(m)-8 (excluding § 1.901(m)-4(e)) to all CAAs occurring on or after January 1, 2011. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

#### Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Pursuant to section 7805(f), these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under **ADDRESSES**. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

#### Drafting Information

The principal author of these regulations is Jeffrey L. Parry 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.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

Sections 1.901(m)–1 through –8 also issued under 26 U.S.C. 901(m)(7). \* \* \*

Section 1.901(m)–5 also issued under 26 U.S.C. 901(m)(3)(B)(ii). \* \* \*

■ **Par. 2.** Section 1.704–1, as proposed to be amended at 81 FR 5967, February 4, 2016, is further amended by adding two sentences at the end of paragraph (b)(1)(ii)(b)(1) and by adding paragraphs (b)(4)(viii)(c)(4)(v) through (b)(4)(viii)(c)(4)(vii) to read as follows:

#### § 1.704–1 Partner's distributive share.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(ii) \* \* \*

(b) \* \* \*

(1) \* \* \* Paragraphs

(b)(4)(viii)(c)(4)(v) through (vii) of this section apply to covered asset acquisitions (CAAs) (as defined in § 1.901(m)–1(a)(8)) occurring on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers may, however, rely on paragraphs (b)(4)(viii)(c)(4)(v) through (vii) of this section prior to the date paragraphs (b)(4)(viii)(c)(4)(v) through (vii) of this section are applicable provided that they consistently apply paragraphs (b)(4)(viii)(c)(4)(v) through (vii) of this section, § 1.901(m)–1, and §§ 1.901(m)–3 through 1.901(m)–8 (excluding § 1.901(m)–4(e)) to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)–2 (excluding § 1.901(m)–2(d)) to all CAAs occurring on or after *December 7, 2016*.

\* \* \* \* \*

(4) \* \* \*

(viii) \* \* \*

(c) \* \* \*

(4) \* \* \*

(v) *Adjustments related to section 901(m).* If one or more assets owned by a partnership are relevant foreign assets (or RFAs) with respect to a foreign income tax, then, solely for purposes of applying the safe harbor provisions of paragraph (b)(4)(viii)(a)(1) of this section to allocations of CFTEs with respect to that foreign income tax, the net income in a CFTE category that includes partnership items of income, deduction, gain, or loss attributable to

the RFA shall be increased by the amount described in paragraph (b)(4)(viii)(c)(4)(vi) of this section and reduced by the amount described in paragraph (b)(4)(viii)(c)(4)(vii) of this section. Similarly, a partner's CFTE category share of income shall be increased by the portion of the amount described in paragraph (b)(4)(viii)(c)(4)(vi) of this section that is allocated to the partner under § 1.901(m)–5(d) and reduced by the portion of the amount described in paragraph (b)(4)(viii)(c)(4)(vii) of this section that is allocated to the partner under § 1.901(m)–5(d). The principles of this paragraph (b)(4)(viii)(c)(4)(v) apply similarly when a partnership owns an RFA indirectly through one or more other partnerships. For purposes of paragraphs (b)(4)(viii)(c)(4)(v), (b)(4)(viii)(c)(4)(vi), and (b)(4)(viii)(c)(4)(vii) of this section, basis difference is defined in § 1.901(m)–4, cost recovery amount is defined in § 1.901(m)–5(b)(2), disposition amount is defined in § 1.901(m)–5(c)(2), foreign income tax is defined in § 1.901(m)–1(a)(21), RFA is defined in § 1.901(m)–2(c), U.S. disposition gain is defined in § 1.901(m)–1(a)(43), and U.S. disposition loss is defined in § 1.901(m)–1(a)(44).

(vi) *Adjustment amounts for RFAs with a positive basis difference.* With respect to RFAs with a positive basis difference, the amount referenced in (b)(4)(viii)(c)(4)(v) is the sum of any cost recovery amounts and disposition amounts attributable to U.S. disposition loss that correspond to partnership items that are included in the net income in the CFTE category and that are taken into account for the U.S. taxable year of the partnership under § 1.901(m)–5(d).

(vii) *Adjustment amounts for RFAs with a negative basis difference.* With respect to RFAs with a negative basis difference, the amount referenced in (b)(4)(viii)(c)(4)(v) is the sum of any cost recovery amounts and disposition amounts attributable to U.S. disposition gain that correspond to partnership items that are included in the net income in the CFTE category and that are taken into account for the U.S. taxable year of the partnership under § 1.901(m)–5(d).

\* \* \* \* \*

■ **Par. 3.** Section 1.901(m)–1 is added to read as follows:

#### § 1.901(m)–1 Definitions.

(a) *Definitions.* [The text of proposed § 1.901(m)–1(a) is the same as the text of § 1.901(m)–1T(a) published elsewhere in this issue of the **Federal Register**.]

(1) The term *aggregate basis difference* means, with respect to a foreign income tax and a foreign payor, the sum of the allocated basis differences for a U.S. taxable year of a section 901(m) payor, plus any aggregate basis difference carryover from the immediately preceding U.S. taxable year of the section 901(m) payor with respect to the foreign income tax and foreign payor, as adjusted under § 1.901(m)–6(c). For purposes of this definition, if foreign law imposes tax on the combined income (within the meaning of § 1.901–2(f)(3)(ii)) of two or more foreign payors, all foreign payors whose items of income, deduction, gain, or loss are included in the U.S. taxable income or earnings and profits of the section 901(m) payor are treated as a single foreign payor. Aggregate basis difference is determined with respect to each separate category described in § 1.904–4(m).

(2) The term *aggregate basis difference carryover* has the meaning provided in § 1.901(m)–3(c).

(3) The term *aggregated CAA transaction* means a series of related CAAs occurring as part of a plan.

(4) The term *allocable foreign income* means the portion of foreign income of a foreign payor that relates to the foreign income tax amount of the foreign payor that is paid or accrued by, or considered paid or accrued by, a section 901(m) payor.

(5) The term *allocated basis difference* means, with respect to an RFA and a foreign income tax, the sum of the cost recovery amounts and disposition amounts assigned to a U.S. taxable year of the section 901(m) payor under § 1.901(m)–5.

(6) through (8) [The text of proposed §§ 1.901(m)–1(a)(6) through (8) is the same as the text of §§ 1.901(m)–1T(a)(6) through (8) published elsewhere in this issue of the **Federal Register**.]

(9) The term *cumulative basis difference exemption* has the meaning provided in § 1.901(m)–7(b)(2).

(10) through (11) [The text of proposed §§ 1.901(m)–1(a)(10) through (11) is the same as the text of §§ 1.901(m)–1T(a)(10) through (11) published elsewhere in this issue of the **Federal Register**.]

(12) The term *disqualified tax amount* has the meaning provided in § 1.901(m)–3(b).

(13) through (14) [The text of proposed §§ 1.901(m)–1(a)(13) through (14) is the same as the text of §§ 1.901(m)–1T(a)(13) through (14) published elsewhere in this issue of the **Federal Register**.]

(15) The term *foreign basis* means the adjusted basis of an asset determined for purposes of a foreign income tax.

(16) The term *foreign basis election* has the meaning provided in § 1.901(m)-4(c).

(17) The term *foreign country creditable tax* (or *FCCT*) means, with respect to a foreign income tax amount, the amount of income, war profits, or excess profits tax paid or accrued to a foreign country or possession of the United States and claimed as a foreign tax credit for purposes of determining the foreign income tax amount. To qualify as a FCCT, the tax imposed by the foreign country or possession must be a foreign income tax or a withholding tax determined on a gross basis as described in section 901(k)(1)(B).

(18) through (21) [The text of proposed §§ 1.901(m)-1(a)(18) through (21) is the same as the text of §§ 1.901(m)-1T(a)(18) through (21) published elsewhere in this issue of the **Federal Register**.]

(22) The term *foreign income tax amount* means, with respect to a foreign income tax, the amount of tax (including an amount of tax that is zero) reflected on a foreign tax return (as properly amended or adjusted). If foreign law imposes tax on the combined income (within the meaning of § 1.901-2(f)(3)(ii)) of two or more foreign payors, however, a foreign income tax amount means the amount of tax imposed on the combined income, regardless of whether the tax is reflected on a single foreign tax return.

(23) The term *foreign payor* means an individual or entity (including a disregarded entity) subject to a foreign income tax. If a foreign income tax imposes tax on the combined income (within the meaning of § 1.901-2(f)(3)(ii)) of two or more individuals or entities, each such individual or entity is a foreign payor. An individual or entity may be a foreign payor with respect to more than one foreign income tax for purposes of applying section 901(m).

(24) The term *foreign taxable year* means a taxable year for purposes of a foreign income tax.

(25) The term *mid-year transaction* means a transaction in which a foreign payor that is a corporation or a disregarded entity has a change in ownership or makes an election pursuant to § 301.7701-3 to change its entity classification, or a transaction in which a foreign payor that is a partnership terminates under section 708(b)(1), provided in each case that the foreign payor's foreign taxable year does not close as a result of the transaction, and, if the foreign payor is a corporation

or a partnership, the foreign payor's U.S. taxable year closes.

(26) through (28) [The text of proposed §§ 1.901(m)-1(a)(26) through (28) is the same as the text of §§ 1.901(m)-1T(a)(26) through (28) published elsewhere in this issue of the **Federal Register**.]

(29) The term *reverse hybrid* has the meaning provided in § 1.909-2(b)(1)(iv).

(30) The term *RFA class exemption* has the meaning provided in § 1.901(m)-7 (b)(3).

(31) The term *RFA owner (U.S.)* means a person that owns an RFA for U.S. income tax purposes.

(32) The term *RFA owner (foreign)* means an individual or entity (including a disregarded entity) that owns an RFA for purposes of a foreign income tax.

(33) through (34) [The text of proposed §§ 1.901(m)-1(a)(33) through (34) is the same as the text of §§ 1.901(m)-1T(a)(33) through (34) published elsewhere in this issue of the **Federal Register**.]

(35) The term *section 901(m) payor* means a person eligible to claim the foreign tax credit allowed under section 901(a), regardless of whether the person chooses to claim the foreign tax credit, as well as a section 902 corporation (as defined in section 909(d)(5)). If members of a U.S. affiliated group of corporations (as defined in section 1504) file a consolidated return, each member is a separate section 901(m) payor. If individuals file a joint return, those individuals are treated as a single section 901(m) payor.

(36) through (38) [The text of proposed §§ 1.901(m)-1(a)(36) through (38) is the same as the text of §§ 1.901(m)-1T(a)(36) through (38) published elsewhere in this issue of the **Federal Register**.]

(39) The term *tentative disqualified tax amount* has the meaning provided in § 1.901(m)-3(b)(2).

(40) through (41) [The text of proposed §§ 1.901(m)-1(a)(40) through (41) is the same as the text of §§ 1.901(m)-1T(a)(40) through (41) published elsewhere in this issue of the **Federal Register**.]

(42) The term *U.S. basis deduction* has the meaning provided in § 1.901(m)-5(b)(3).

(43) through (45) [The text of proposed §§ 1.901(m)-1(a)(43) through (45) is the same as the text of §§ 1.901(m)-1T(a)(43) through (45) published elsewhere in this issue of the **Federal Register**.]

(b) *Effective/applicability date.* (1) Paragraphs (a)(1), (2), (3), (4), (5), (9), (12), (15), (16), (17), (22), (23), (24), (25), (29), (30), (31), (32), (35), (39), and (42) of this section apply to CAAs occurring

on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(2) [The text of proposed § 1.901(m)-1(b)(2) is the same as the text of § 1.901(m)-1T(b)(2) published elsewhere in this issue of the **Federal Register**.]

(3) Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), and §§ 1.901(m)-3 through 1.901(m)-8 (excluding § 1.901(m)-4(e)) to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 4.** Section 1.901(m)-2 is added to read as follows:

**§ 1.901(m)-2 Covered asset acquisitions and relevant foreign assets.**

(a) through (b)(3) [The text of proposed §§ 1.901(m)-2(a) through (b)(3) is the same as the text of §§ 1.901(m)-2T(a) through (b)(3) published elsewhere in this issue of the **Federal Register**.]

(4) Any transaction (or series of transactions occurring pursuant to a plan) to the extent it is treated as an acquisition of assets for purposes of U.S. income tax and as the acquisition of an interest in a fiscally transparent entity for purposes of a foreign income tax;

(5) Any transaction (or series of transactions occurring pursuant to a plan) to the extent it is treated as a partnership distribution of one or more assets the U.S. basis of which is determined by section 732(b) or 732(d) or which causes the U.S. basis of the partnership's remaining assets to be adjusted under section 734(b), provided the transaction results in an increase in the U.S. basis of one or more of the assets distributed by the partnership or retained by the partnership without a corresponding increase in the foreign basis of such assets; and

(6) Any transaction (or series of transactions occurring pursuant to a plan) to the extent it is treated as an acquisition of assets for purposes of both U.S. income tax and a foreign income tax, provided the transaction results in an increase in the U.S. basis without a corresponding increase in the foreign basis of one or more assets.

(c) *Relevant foreign asset*—(1) [The text of proposed § 1.901(m)-2(c)(1) is the same as the text of § 1.901(m)-

2T(c)(1) published elsewhere in this issue of the **Federal Register**.]

(2) *RFA status with respect to a foreign income tax.* An asset is relevant in determining foreign income if income, deduction, gain, or loss attributable to the asset is taken into account in determining foreign income immediately after the CAA, or would be taken into account in determining foreign income immediately after the CAA if the asset were to give rise to income, deduction, gain, or loss at such time.

(3) *Subsequent RFA status with respect to another foreign income tax.* After a CAA, an asset will become an RFA with respect to another foreign income tax if, pursuant to a plan or series of related transactions that have a principal purpose of avoiding the application of section 901(m), an asset that was not relevant in determining foreign income for purposes of that foreign income tax immediately after the CAA becomes relevant in determining such foreign income. A principal purpose of avoiding section 901(m) will be deemed to exist if income, deduction, gain, or loss attributable to the asset is taken into account in determining such foreign income within the one-year period following the CAA, or would be taken into account in determining such foreign income during such time if the asset were to give rise to income, deduction, gain, or loss within the one-year period.

(d) [The text of proposed § 1.901(m)-2(d) is the same as the text of § 1.901(m)-2T(d) published elsewhere in this issue of the **Federal Register**.]

(e) *Examples.* The following examples illustrate the rules of this section:

*Example 1. CAA involving an acquisition of a partnership interest for foreign income tax purposes—(i) Facts.* (A) FPS is an entity organized in Country F that is treated as a partnership for both U.S. and Country F income tax purposes. FPS is owned 50/50 by FC1 and FC2, each of which is a corporation organized in Country F and treated as a corporation for both U.S. and Country F income tax purposes. FPS has a single asset, Asset A. USP, a domestic corporation, owns all the interests in DE, a disregarded entity.

(B) Pursuant to the same transaction, USP acquires FC1's interest in FPS, and DE acquires FC2's interest in FPS. For U.S. income tax purposes, with respect to USP, the acquisition of the interests in FPS is treated as the acquisition of Asset A by USP. See Rev. Rul. 99-6, 1999-1 C.B. 432. For Country F tax purposes, the acquisitions of the interests of FPS by USP and DE are treated as acquisitions of partnership interests.

(ii) *Result.* The transaction is a CAA under paragraph (b)(4) of this section because it is treated as the acquisition of Asset A for U.S. income tax purposes and the acquisition of

interests in a partnership for Country F tax purposes.

*Example 2. CAA involving an asset acquisition for purposes of both U.S. income tax and a foreign income tax—(i) Facts.* (A) USP, a domestic corporation, wholly owns CFC1, a foreign corporation, and CFC1 wholly owns CFC2, also a foreign corporation. CFC1 and CFC2 are organized in Country F. CFC1 owns Asset A.

(B) In an exchange described in section 351, CFC1 transfers Asset A to CFC2 in exchange for CFC2 common stock and cash. CFC1 recognizes gain on the exchange under section 351(b). Under section 362(a), CFC2's U.S. basis in Asset A is increased by the gain recognized by CFC1. For Country F tax purposes, gain or loss is not recognized on the transfer of Asset A to CFC2, and therefore there is no increase in the foreign basis in Asset A.

(ii) *Result.* The transaction is a CAA under paragraph (b)(6) of this section because it is treated as an acquisition of Asset A by CFC2 for both U.S. and Country F income tax purposes, and it results in an increase in the U.S. Basis of Asset A without a corresponding increase in the foreign basis of Asset A.

*Example 3. RFA status determined immediately after CAA; application of principal purpose rule—(i) Facts.* (A) USP1 and USP2 are unrelated domestic corporations. USP1 wholly owns USSub, also a domestic corporation. On January 1 of Year 1, USP2 acquires all of the stock of USSub from USP1 in a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies. Immediately after the acquisition, none of the income, deduction, gain, or loss attributable to any of the assets of USSub is taken into account in determining foreign income for purposes of a foreign income tax nor would such items be taken into account in determining foreign income for purposes of a foreign income tax immediately after the acquisition if such assets were to give rise to income, deduction, gain, or loss immediately after the acquisition.

(B) On December 1 of Year 1, USSub contributes all its assets to FSub, its wholly owned subsidiary, which is a corporation for both U.S. and Country X income tax purposes, in a transfer described in section 351 (subsequent transfer). USSub recognizes no gain or loss for U.S. or Country X income tax purposes as a result of the subsequent transfer. As a result of the subsequent transfer, income, deduction, gain, or loss attributable to the assets of USSub that were transferred to FSub is taken into account in determining foreign income of FSub for Country X tax purposes.

(ii) *Result.* (A) Under paragraph (b)(1) of this section, the acquisition by USP2 of the stock of USSub is a section 338 CAA. Under paragraph (c)(1) of this section, none of the assets of USSub are RFAs immediately after the CAA, because none of the income, deduction, gain, or loss attributable to such assets is taken into account for purposes of determining foreign income with respect to any foreign income tax immediately after the CAA (nor would such items be taken into account for purposes of determining foreign

income immediately after the CAA if such assets were to give rise to income, deduction, gain, or loss at such time).

(B) Although the subsequent transfer is not a CAA under paragraph (b) of this section, the subsequent transfer causes the assets of USSub to become relevant in the hands of FSub in determining foreign income for Country X tax purposes. Because the subsequent transfer occurred within the one-year period following the CAA, it is presumed to have a principal purpose of avoiding section 901(m). Accordingly, under paragraph (c)(2) of this section, the assets of USSub with respect to the CAA occurring on January 1 of Year 1 become RFAs with respect to Country X tax as a result of the subsequent transfer. Thus, a basis difference with respect to Country X tax must be computed for the RFAs and taken into account under section 901(m).

(f) *Effective/applicability date.* (1) [The text of proposed § 1.901(m)-2(f)(1) is the same as the text of § 1.901(m)-2T(f)(1) published elsewhere in this issue of the **Federal Register**.]

(2) Paragraphs (b)(4) through (b)(6), (c)(2), (c)(3), and (e) of this section apply to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(3) Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section (excluding paragraph (d) of this section) to all CAAs occurring on or after December 7, 2016 and consistently apply § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, and §§ 1.901(m)-3 through 1.901(m)-8 (excluding § 1.901(m)-4(e)) to all CAAs occurring on or after January 1, 2011. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 5.** Section 1.901(m)-3 is added to read as follows:

**§ 1.901(m)-3 Disqualified tax amount and aggregate basis difference carryover.**

(a) *In general.* If a section 901(m) payor has an aggregate basis difference, with respect to a foreign income tax and a foreign payor, for a U.S. taxable year, the section 901(m) payor must determine the portion of a foreign income tax amount that is disqualified under section 901(m) (disqualified tax amount). Paragraph (b) of this section provides rules for determining the disqualified tax amount. Paragraph (c) of this section provides rules for determining what portion, if any, of aggregate basis difference will be carried forward to the next U.S. taxable year (aggregated basis difference carryover). Paragraph (d) of this section provides the effective/applicability date.

(b) *Disqualified tax amount*—(1) *In general.* A section 901(m) payor's disqualified tax amount is not taken into account in determining the credit allowed under section 901(a). If the section 901(m) payor is a section 902 corporation, the disqualified tax amount is not taken into account for purposes of section 902 or 960. Sections 78 and 275 do not apply to the disqualified tax amount. The disqualified tax amount is allowed as a deduction to the extent otherwise deductible (see sections 164, 212, and 964 and the regulations under those sections).

(2) *Determination of disqualified tax amount*—(i) *In general.* Except as provided in paragraph (b)(2)(iv) of this section, the disqualified tax amount is equal to the lesser of the foreign income tax amount that is paid or accrued by, or considered paid or accrued by, the section 901(m) payor for the U.S. taxable year or the tentative disqualified tax amount. All calculations are determined with respect to each separate category described in § 1.904–4(m).

(ii) *Tentative disqualified tax amount.* The tentative disqualified tax amount is equal to the amount determined under paragraph (b)(2)(ii)(A) of this section reduced (but not below zero) by the amount described in paragraph (b)(2)(ii)(B) of this section.

(A) The product of—  
(1) The sum of the foreign income tax amount and the FCCTs that are paid or accrued by, or considered paid or accrued by, the section 901(m) payor, and

(2) A fraction, the numerator of which is the aggregate basis difference, but not in excess of the allocable foreign income, and the denominator of which is the allocable foreign income.

(B) The amount of the FCCT that is a disqualified tax amount of the section 901(m) payor with respect to another foreign income tax.

(iii) *Allocable foreign income*—(A) *No allocation required.* Except as provided in paragraph (b)(2)(iii)(D) of this section, if the entire foreign income tax amount is paid or accrued by, or considered paid or accrued by, a single section 901(m) payor, then the allocable foreign income is equal to the entire foreign income, determined with respect to each separate category described in § 1.904–4(m).

(B) *Allocation required.* Except as provided in paragraph (b)(2)(iii)(D) of this section, if the foreign income tax amount is allocated to, and considered paid or accrued by, more than one person, a section 901(m) payor's allocable foreign income is equal to the portion of the foreign income that

relates to the foreign income tax amount allocated to that section 901(m) payor, determined with respect to each separate category described in § 1.904–4(m).

(C) *Rules for allocations.* This paragraph (b)(2)(iii)(C) provides allocation rules that apply to determine allocable foreign income in certain cases.

(1) If the foreign payor is involved in a mid-year transaction and the foreign income tax amount is allocated under § 1.336–2(g)(3)(ii), 1.338–9(d), or 1.901–2(f)(4), then, to the extent any portion of the foreign income tax amount is allocated to, and considered paid or accrued by, a section 901(m) payor, the allocable foreign income of the section 901(m) payor is determined in accordance with the principles of § 1.1502–76(b). To the extent the foreign income tax amount is allocated to an entity that is a partnership for U.S. income tax purposes, a portion of the foreign income is first allocated to the partnership in accordance with the principles of § 1.1502–76(b), which is then allocated under the rules of paragraph (b)(2)(iii)(C)(2) of this section to determine the allocable foreign income of a section 901(m) payor that owns an interest in the partnership directly or indirectly through one or more other partnerships for U.S. income tax purposes.

(2) If the foreign income tax amount is considered paid or accrued by a section 901(m) payor for a U.S. taxable year under § 1.702–1(a)(6), the determination of the allocable foreign income must be consistent with the allocation of the foreign income tax amount that relates to the foreign income. See § 1.704–1(b)(4)(viii).

(3) If the foreign income tax amount that is allocated to, and considered paid or accrued by, a section 901(m) payor for a U.S. taxable year is determined under § 1.901–2(f)(3)(i), the allocable foreign income is determined in accordance with § 1.901–2(f)(3)(iii).

(D) *Failure to substantiate allocable foreign income.* If, pursuant to section 901(m)(3)(A), a section 901(m) payor fails to substantiate its allocable foreign income to the satisfaction of the Secretary, then allocable foreign income will equal the amount determined by dividing the sum of the foreign income tax amount and the FCCTs that are paid or accrued by, or considered paid or accrued by, the section 901(m) payor, by the highest marginal tax rate applicable to income of the foreign payor under foreign tax law.

(iv) *Special rule.* A section 901(m) payor's disqualified tax amount is zero for a U.S. taxable year if:

(A) The section 901(m) payor's aggregate basis difference for the U.S. taxable year is a negative amount;

(B) Foreign income is less than or equal to zero for the foreign taxable year of the foreign payor; or

(C) The foreign income tax amount that is paid or accrued by, or considered paid or accrued by, the section 901(m) payor for the U.S. taxable year is zero.

(3) *Examples.* The following examples illustrate the rules of paragraph (b)(2) of this section. For purposes of all the examples, unless otherwise specified: USP is a domestic corporation. CFC1, CFC2, DE1, and DE2 are organized in Country F and are treated as corporations for Country F tax purposes. CFC1 and CFC2 are section 902 corporations (as defined in section 909(d)(5)). DE1 and DE2 are disregarded entities. USP, CFC1, and CFC2 have a calendar year for both U.S. and Country F income tax purposes, and DE1 and DE2 have a calendar year for Country F tax purposes. Country F and Country G each impose a single tax that is a foreign income tax. CFC1, CFC2, DE1, and DE2 each have a functional currency of the U.S. with respect to all activities. At all relevant times, 1u equals \$1. All amounts are stated in millions. The examples assume that the applicable cost recovery method for property results in basis being recovered ratably over the life of the property beginning on the first day of the U.S. taxable year in which the property is acquired or placed into service; there is a single § 1.904–4(m) separate category with respect to a foreign income and foreign income tax amount; and a section 901(m) payor properly substantiates its allocable foreign income to the satisfaction of the Secretary.

*Example 1. Determining aggregate basis difference; multiple foreign payors*—(i) *Facts.* CFC1 wholly owns CFC2 and DE1. DE1 wholly owns DE2. Assume that the tax laws of Country F do not allow combined income reporting or the filing of consolidated income tax returns. Accordingly, CFC1, CFC2, DE1, and DE2 file separate tax returns for Country F tax purposes. USP acquires all of the stock of CFC1 in a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies for both CFC1 and CFC2.

(ii) *Result.* (A) The acquisition of CFC1 gives rise to four separate CAAs under § 1.901(m)–2(b). The acquisition of the stock of CFC1 and the deemed acquisition of the stock of CFC2 under section 338(h)(3)(B) is each a Section 338 CAA under § 1.901(m)–2(b)(1). Furthermore, because the deemed acquisition of the assets of DE1 and DE2 for U.S. income tax purposes is disregarded for Country F tax purposes, each acquisition is a CAA under § 1.901(m)–2(b)(2). Because these four CAAs occur pursuant to a plan, under § 1.901(m)–1(a)(3) they are part of an aggregated CAA transaction. Under

§ 1.901(m)–1(a)(31), CFC1 is the RFA owner (U.S.) with respect to its assets and those of DE1 and DE2. CFC2 is the RFA owner (U.S.) with respect to its assets. Under § 1.901(m)–1(a)(23), CFC1, CFC2, DE1, and DE2 are each a foreign payor for Country F tax purposes. Under § 1.901(m)–1(a)(35), CFC1 is the section 901(m) payor with respect to foreign income tax amounts for which CFC1, DE1, and DE2 are the foreign payors (see §§ 1.901–2(f)(1) and 1.901–2(f)(4)(ii)). CFC2 is the section 901(m) payor with respect to foreign income tax amounts for which CFC2 is the foreign payor (see § 1.901–2(f)(1)).

(B) In determining aggregate basis difference under § 1.901(m)–1(a)(1) for a U.S. taxable year of CFC1, CFC1 has three computations with respect to Country F tax, because there are three foreign payors for Country F tax purposes whose foreign income tax amount, if any, is considered paid or accrued by CFC1 as the section 901(m) payor. Furthermore, for each U.S. taxable year, CFC1 will compute a separate disqualified tax amount and aggregate basis difference Carryover (if any) under paragraph (b)(2) of this section, with respect to each foreign payor.

(C) In determining aggregate basis difference for a U.S. taxable year of CFC2

under § 1.901(m)–1(a)(1), CFC2 has a single computation with respect to Country F tax, because there is a single foreign payor (CFC2) for Country F tax purposes whose foreign income tax amount, if any, is considered paid or accrued by CFC2 as the section 901(m) payor. Furthermore, for each U.S. taxable year, CFC2 will compute a disqualified tax amount and aggregate basis difference Carryover (if any) under paragraph (b)(2) of this section.

(iii) *Alternative facts.* Assume the same facts as in paragraph (i) of this *Example 1*, except that foreign income for Country F tax purposes is based on combined income (within the meaning of § 1.901–2(f)(3)(ii)) of CFC1, CFC2, DE1, and DE2. For purposes of determining an aggregate basis difference for a U.S. taxable year of CFC1 under § 1.901(m)–1(a)(1), CFC1, DE1, and DE2 are treated as a single foreign payor because all of the items of income, deduction, gain, or loss with respect to CFC1, DE1, and DE2 are included in the earnings and profits of CFC1 for U.S. income tax purposes. For each U.S. taxable year, CFC1 will therefore compute a single aggregate basis difference, disqualified tax amount, and aggregate basis difference carryover. The result for CFC2 under the

alternative facts is the same as in paragraph (ii)(C) of this *Example 1*.

*Example 2. Computation of disqualified tax amount—(i) Facts.* On December 31 of Year 0, USP acquires all of the stock of CFC1 in a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies (Acquisition). CFC1 owns four assets (Asset A, Asset B, Asset C, and Asset D, and collectively, Assets) and conducts activities in Country F and in a Country G branch. The activities conducted by CFC1 in Country G are not subject to tax in Country F. The tax rate is 25% in Country F and 30% in Country G. For Country F tax purposes, CFC1’s foreign income and foreign income tax amount for each foreign taxable year 1 through 15 is 100u and \$25 (25u translated at the exchange rate of \$1 = 1u), respectively. For Country G tax purposes, CFC1’s foreign income and foreign income tax amount for each foreign taxable year 1 through 5 is 400u and \$120 (120u translated at the exchange rate of \$1 = 1u), respectively. No dispositions occur for any of the Assets during the applicable cost recovery period. Additional facts relevant to each of the Assets are summarized below.

Assets	Relevant foreign income tax	Basis difference	Applicable cost recovery period (years)	Cost recovery amount
Asset A .....	Country F tax .....	150u	15	10u (150u/15).
Asset B .....	Country F tax .....	50u	5	10u (50u/5).
Asset C .....	Country G tax .....	300u	5	60u (300u/5).
Asset D .....	Country G tax .....	(100u)	5	negative 20u (negative 100/5).

(ii) *Result.* (A) Under § 1.901(m)–2(b)(1), the Acquisition of the stock of CFC1 is a Section 338 CAA. Under § 1.901(m)–2(c)(1), Assets A and B are RFAs with respect to Country F tax, because they are relevant in determining foreign income of CFC1 for Country F tax purposes and were owned by CFC1 when the Acquisition occurred. Assets C and D are RFAs with respect to Country G tax, because they are relevant in determining foreign income of CFC1 for Country G tax purposes and were owned by CFC1 when the Acquisition occurred. Under § 1.901(m)–1(a)(31), CFC1 is the RFA owner (U.S.) with respect to all of the RFAs. Under § 1.901(m)–1(a)(35) and (a)(23), CFC1 is the section 901(m) payor and the foreign payor for Country F and Country G tax purposes.

(B) In determining aggregate basis difference for a U.S. taxable year of CFC1, CFC1 has two computations, one with respect to Country F tax and one with respect to Country G tax. Under § 1.901(m)–1(a)(1), the aggregate basis difference for a U.S. taxable year with respect to Country F tax is equal to the sum of the allocated basis differences with respect to Assets A and B for the U.S. taxable year. Under § 1.901(m)–1(a)(5), allocated basis differences are comprised of cost recovery amounts and disposition amounts. Because there are no dispositions, the only allocated basis differences taken into account in determining an aggregate basis difference are cost

recovery amounts. Under § 1.901(m)–5(b), any cost recovery amounts are attributed to CFC1, because CFC1 is the section 901(m) payor and RFA owner (U.S.) with respect to all of the Assets. For each U.S. taxable year, CFC1 will compute a separate disqualified tax amount and aggregate basis difference carryover (if any) with respect to Country F tax and Country G tax under paragraph (b)(2) of this section. For purposes of both disqualified tax amount computations, because CFC1 is the section 901(m) payor and foreign payor, the foreign income tax amount paid or accrued by CFC1 with respect to Country F tax and Country G tax, respectively, will be the entire foreign income tax amount and CFC1’s allocable foreign income will be the entire foreign income.

(C) With respect to Country F tax, in U.S. taxable years 1 through 5, CFC1 has an aggregate basis difference of 20u each year (10u cost recovery amount with respect to Asset A plus 10u cost recovery amount with respect to Asset B). For U.S. taxable years 1 through 5, under paragraph (b)(2) of this section, the disqualified tax amount each year is \$5, the lesser of two amounts: the tentative disqualified tax amount, in this case, \$5 (\$25 foreign income tax amount × (20u aggregate basis difference/100u allocable foreign income)), or the foreign income tax amount paid or accrued by CFC1, in this case, \$25. After U.S. taxable year 5,

Asset B has no unallocated basis difference with respect to Country F tax. Accordingly, in U.S. taxable years 6 through 15, CFC1 has an aggregate basis difference of 10u each year. Accordingly, for U.S. taxable years 6 through 15, the disqualified tax amount each year is \$2.50, the lesser of two amounts: the tentative disqualified tax amount, in this case, \$2.50 (\$25 foreign income tax amount × (10u aggregate basis difference/100u allocable foreign income)), or the foreign income tax amount paid or accrued by CFC1, in this case, \$25. After U.S. taxable year 15, Asset A has no unallocated basis difference with respect to Country F tax and, therefore, CFC1 has no disqualified tax amount with respect to Country F Tax.

(D) With respect to Country G tax, in U.S. taxable years 1 through 5, CFC1 has an aggregate basis difference of 40u each year (60u cost recovery amount with respect to Asset C + (20u) cost recovery amount with respect to Asset D). For U.S. taxable years 1 through 5, under paragraph (b)(2) of this section, the disqualified tax amount each year is \$12, the lesser of two amounts: the tentative disqualified tax amount, in this case, \$12 (\$120 foreign income tax amount × (40u aggregate basis difference/400u allocable foreign income)), or the foreign income tax amount paid or accrued by CFC1, in this case, \$120. After U.S. taxable year 5, Asset C and Asset D have no unallocated basis difference with respect to Country G

tax. Accordingly, in U.S. taxable years 6 through 15, CFC1 has no disqualified tax amount with respect to Country G Tax.

**Example 3. FCCT—(i) Facts.** In U.S. taxable year 1, USP acquires all of the interests in DE1 in a transaction (Transaction) that is treated as a stock acquisition for Country F tax purposes. Immediately after the Transaction, DE1 owns assets (Pre-Transaction Assets), all of which are used in a Country G branch and give rise to income that is taken into account for Country F tax and Country G tax purposes. After the Transaction, DE1 acquires additional assets (Post-Transaction Assets), which are not used by the Country G branch. Both Country F and Country G have a tax rate of 30%. Country F imposes worldwide tax on its residents and provides a foreign tax credit for taxes paid to other jurisdictions. In foreign taxable year 3, 100u of income is attributable to DE1's Post-Transaction Assets and 100u of income is attributable to DE1's Pre-Transaction Assets. For Country G tax purposes, the foreign income is 100u and foreign income tax amount is 30u (30% × 100u). For Country F tax purposes, the foreign income is 200u and the pre-foreign tax credit tax is 60u (30% × 200u). The 60u of Country F pre-foreign tax credit tax is reduced by the 30u foreign income tax amount imposed for Country G tax purposes. Thus, the foreign income tax amount for Country F tax purposes is \$30 (30u translated into dollars at the exchange rate of \$1 = 1u). Assume that for U.S. taxable year 3 USP has 100u aggregate basis difference with respect to Country F tax and 100u aggregate basis difference with respect to Country G tax. USP does not dispose of DE1 or any assets of DE1 in U.S. taxable year 3.

(ii) **Result.** (A) Under § 1.901(m)–2(b)(2), the Transaction is a CAA. Under § 1.901(m)–2(c)(1), the Pre-Transaction Assets are RFAs with respect to both Country F tax and Country G tax, because they are relevant in determining the foreign income of DE1 for Country F tax and Country G tax purposes and were owned by DE1 when the Transaction occurred. Under § 1.901(m)–1(a)(31), USP is the RFA owner (U.S.) with respect to the RFAs. Under § 1.901(m)–1(a)(23), DE1 is a foreign payor for Country F tax and Country G tax purposes. Under § 1.901(m)–1(a)(35), USP is the section 901(m) payor with respect to foreign income tax amounts for which DE1 is the foreign payor (see § 1.901–2(f)(4)(ii)). Because the Country G foreign income tax amount is claimed as a credit for purposes of determining the Country F foreign income tax amount, the Country G foreign income tax amount is an FCCT under § 1.901(m)–1(a)(17).

(B) Under § 1.901(m)–1(a)(1), for each U.S. taxable year, USP will separately compute the aggregate basis difference with respect to Country F tax and with respect to Country G tax, and will use those amounts to separately compute a disqualified tax amount and aggregate basis difference carryover (if any) with respect to each foreign income tax. Because DE1 is a disregarded entity owned by USP during the entire U.S. taxable year 3, the foreign income tax amount paid or accrued by DE1 is not subject to allocation.

Accordingly, for purposes of each of the disqualified tax amount computations, the foreign income tax amount paid or accrued by USP with respect to Country F tax and Country G tax, respectively, is the entire foreign income tax amount paid or accrued by DE1, and, under paragraph (b)(2)(iii)(A) of this section, USP's allocable foreign income will be equal to DE1's entire foreign income.

(C) As stated in paragraph (i) of this Example 3, for U.S. taxable year 3 USP has 100u aggregate basis difference with respect to Country F tax and 100u aggregate basis difference with respect to Country G tax. With respect to Country G tax, in U.S. taxable year 3, under paragraph (b)(2) of this section, the disqualified tax amount is \$30, the lesser of the two amounts: the tentative disqualified tax amount, in this case, \$30 (\$30 foreign income tax amount × (100u aggregate basis difference/100u allocable foreign income)), or the foreign income tax amount considered paid or accrued by USP, in this case, \$30.

(D) With respect to Country F tax, in U.S. taxable year 3, under paragraph (b)(2) of this section, the disqualified tax amount is \$0, the lesser of two amounts: the tentative disqualified tax amount, in this case \$0 ((\$30 foreign income tax amount + \$30 Country G FCCT) × (100u aggregate basis difference/200u foreign income) = \$30 reduced by \$30 Country G FCCT that is a disqualified tax amount of USP), or the foreign income tax amount considered paid or accrued by USP, in this case, \$30.

(c) **Aggregate basis difference carryover—(1) In general.** If a section 901(m) payor has an aggregate basis difference carryover for a U.S. taxable year, as determined under this paragraph (c), the aggregate basis difference carryover is taken into account in computing the section 901(m) payor's aggregate basis difference for the next U.S. taxable year. For successor rules that apply to an aggregate basis difference carryover, see § 1.901(m)–6(c).

(2) **Amount of aggregate basis difference carryover.** (i) If a section 901(m) payor's disqualified tax amount is zero, all of the section 901(m) payor's aggregate basis difference (positive or negative) for the U.S. taxable year gives rise to an aggregate basis difference carryover to the next U.S. taxable year.

(ii) If a section 901(m) payor's disqualified tax amount is not zero, then aggregate basis difference carryover can arise in either or both of the following two situations:

(A) If a section 901(m) payor's aggregate basis difference for the U.S. taxable year exceeds its allocable foreign income, the excess gives rise to an aggregate basis difference carryover.

(B) If the tentative disqualified tax amount exceeds the disqualified tax amount, the excess tentative disqualified tax amount is converted into aggregate basis difference carryover by multiplying such excess by a

fraction, the numerator of which is the allocable foreign income, and the denominator of which is the sum of the foreign income tax amount and the FCCTs that are paid or accrued by, or considered paid or accrued by, the section 901(m) payor.

(3) **Example.** The following example illustrates the rule of paragraph (c) of this section.

**Example. Aggregate basis difference carryover; section 901(m) payor's U.S. taxable year differs from the foreign taxable year of foreign payor—(i) Facts.** (A) On July 1 of Year 1, CFC1 acquires all of the interests of DE1 in a transaction (Transaction) that is treated as a stock acquisition for Country F tax purposes. CFC1 and DE1 are organized in Country F and are treated as corporations for Country F tax purposes. CFC1 is a section 902 corporation (as defined in section 909(d)(5)), and DE1 is a disregarded entity. CFC1 has a calendar year for U.S. income tax purposes, and DE1 has a June 30 year-end for Country F tax purposes. Country F imposes a single tax that is a foreign income tax. CFC1 and DE1 each have a functional currency of the u with respect to all activities. Immediately after the Transaction, DE1 owns one asset, Asset A, that gives rise to income that is taken into account for Country F tax purposes. For the first U.S. taxable year (U.S. taxable year 1) there is a cost recovery amount with respect to Asset A of 9u, and for each subsequent U.S. taxable year until the U.S. basis is fully recovered, there is a cost recovery amount with respect to Asset A of 18u. There is no disposition of Asset A.

(ii) **Result.** (A) Under § 1.901(m)–2(b)(2), the Transaction is a CAA. Under § 1.901(m)–2(c)(1), Asset A is an RFA with respect to Country F tax because it is relevant in determining the foreign income of DE1 for Country F tax purposes and was owned by DE1 when the Transaction occurred. Under § 1.901(m)–1(a)(31), CFC1 is the RFA owner (U.S.) with respect to Asset A. Under § 1.901(m)–1(a)(23), DE1 is a foreign payor for Country F tax purposes. Under § 1.901(m)–1(a)(35), CFC1 is the section 901(m) payor with respect to foreign income tax amounts for which DE1 is the foreign payor (see § 1.901–2(f)(4)(ii)).

(B) Under § 1.901(m)–1(a)(1), in determining the aggregate basis difference for U.S. taxable year 1, CFC1 has one computation with respect to Country F tax. Under § 1.901(m)–1(a)(1), aggregate basis difference with respect to Country F tax is equal to the sum of allocated basis differences with respect to all RFAs, which, in this case, is only Asset A. Under § 1.901(m)–1(a)(5), allocated basis differences are comprised of cost recovery amounts and disposition amounts. Because there is no disposition of Asset A, the only allocated basis difference taken into account in determining an aggregate basis difference are cost recovery amounts with respect to Asset A. Under § 1.901(m)–5(b), any cost recovery amounts are assigned to a U.S. taxable year of CFC1, because CFC1 is the section 901(m) payor and RFA owner (U.S.) with respect to Asset A. Under paragraph (b)(2) of this

section, for each U.S. taxable year, CFC1 will compute a disqualified tax amount and aggregate basis difference carryover with respect to the aggregate basis difference. Because DE1 is a disregarded entity owned by CFC1, the foreign income tax amount paid or accrued by DE1 is not subject to allocation. Accordingly, for purposes of the disqualified tax amount computation, the foreign income tax amount paid or accrued by CFC1 with respect to Country F tax is the entire foreign income tax amount paid or accrued by DE1, and under paragraph (b)(2)(iii)(A) of this section, CFC1's allocable foreign income will be equal to DE1's entire foreign income.

(C) In U.S. taxable year 1, CFC1 has an aggregate basis difference of 9u (the 9u cost recovery amount with respect to Asset A for U.S. taxable year 1). However, because the foreign taxable year of DE1, the foreign payor, will not end between July 1 and December 31, there will not be a foreign income tax amount for U.S. taxable year 1. Because the foreign income tax amount considered paid or accrued by CFC1 for U.S. taxable year 1 is zero, under paragraph (b)(2)(iv) of this section, the disqualified tax amount for U.S. taxable year 1 of CFC1 is also zero. Furthermore, because the disqualified tax amount is zero, under paragraph (c)(2)(i) of this section, CFC1 has an aggregate basis difference carryover equal to 9u, the entire amount of the aggregate basis difference for U.S. taxable year 1. Under paragraph (c)(1) of this section, the 9u aggregate basis difference carryover is taken into account in computing CFC1's aggregate basis difference for U.S. taxable year 2. Accordingly, in U.S. taxable year 2, CFC1 has an aggregate basis difference of 27u (18u cost recovery amount for U.S. taxable year 2, plus 9u aggregate basis difference carryover from U.S. taxable year 1).

(d) *Effective/applicability date.* This section applies to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, and §§ 1.901(m)-4 through 1.901(m)-8 (excluding § 1.901(m)-4(e)) to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 6.** Section 1.901(m)-4 is added to read as follows:

**§ 1.901(m)-4 Determination of basis difference.**

(a) through (b) [The text of proposed §§ 1.901(m)-4(a) through (b) is the same as the text of §§ 1.901(m)-4T(a) through

(b) published elsewhere in this issue of the **Federal Register**.]

(c) *Foreign basis election.* (1) An election (foreign basis election) may be made to apply section 901(m)(3)(C)(i)(II) by reference to the foreign basis immediately after the CAA instead of the U.S. basis immediately before the CAA. Accordingly, if a foreign basis election is made, basis difference is the U.S. basis in the RFA immediately after the CAA, less the foreign basis in the RFA immediately after the CAA. For this purpose, the foreign basis immediately after the CAA takes into account any adjustment to that foreign basis resulting from the CAA for purposes of the foreign income tax .

(2) Except as otherwise provided in this paragraph (c), a foreign basis election is made by the RFA owner (U.S.). If, however, the RFA owner (U.S.) is a partnership, each partner in the partnership (and not the partnership) may independently make a foreign basis election. In the case of one or more tiered partnerships, the foreign basis election is made at the level at which a partner is not also a partnership.

(3) The election may be made separately for each CAA, and with respect to each foreign income tax and each foreign payor. For purposes of making the foreign basis election, all CAAs that are part of an aggregated CAA transaction are treated as a single CAA. Furthermore, for purposes of making the foreign basis election, if foreign law imposes tax on the combined income (within the meaning of § 1.901-2(f)(3)(ii)) of two or more foreign payors, all foreign payors whose items of income, deduction, gain, or loss for U.S. income tax purposes are included in the U.S. taxable income or earnings and profits of a single section 901(m) payor are treated as a single foreign payor.

(4) A foreign basis election is made by using foreign basis to determine basis difference for purposes of computing a disqualified tax amount and an aggregate basis difference carryover for the U.S. taxable year, as provided under § 1.901(m)-3. A separate statement or form evidencing the foreign basis election need not be filed. Except as provided in paragraph (c)(5) and (6) of this section, in order for a foreign basis election to be effective, the election must be reflected on a timely filed original federal income tax return (including extensions) for the first U.S. taxable year that the foreign basis election is relevant to the computation of any amounts reported on such return, including on any required schedules.

(5) If the RFA owner (U.S.) is a partnership, a foreign basis election

reflected on a partner's timely filed amended federal income tax return is also effective if all of the following conditions are satisfied:

(i) The partner's timely filed original federal income tax return (including extensions) for the first U.S. taxable year of the partner in which a foreign basis election is relevant to the computation of any amounts reported on such return, including on any required schedules, does not reflect the application of section 901(m);

(ii) The information provided by the partnership to the partner for purposes of applying section 901(m) and any information required to be reported by the partnership is based solely on computations that use foreign basis to determine basis difference; and

(iii) Prior to the due date of the original federal income tax return (including extensions) described in paragraph (c)(5)(i) of this section, the partner delegated the authority to the partnership to choose whether to provide the partner with information to apply section 901(m) using foreign basis, either pursuant to a written partnership agreement (within the meaning of § 1.704-1(b)(2)(ii)(h)) or written notice provided by the partner to the partnership.

(6) If, pursuant to paragraph (g)(3) of this section, a taxpayer chooses to have this section apply to CAAs occurring on or after January 1, 2011, a foreign basis election will be effective if the election is reflected on a timely filed amended federal income tax return (or tax returns, as applicable) filed no later than one year following the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(7) The foreign basis election is irrevocable. Relief under § 301.9100-1 is not available for the foreign basis election.

(d) *Determination of basis difference in a section 743(b) CAA*—(1) [The text of proposed § 1.901(m)-4(d)(1) is the same as the text of § 1.901(m)-4T(d)(1) published elsewhere in this issue of the **Federal Register**.]

(2) *Foreign basis election.* If a foreign basis election is made with respect to a section 743(b) CAA, then, for purposes of paragraph (d)(1) of this section, the section 743(b) adjustment is determined by reference to the foreign basis of the RFA, determined immediately after the CAA.

(e) [The text of proposed § 1.901(m)-4(e) is the same as the text of § 1.901(m)-4T(e) published elsewhere in this issue of the **Federal Register**.]

(f) *Examples.* The following examples illustrate the rules of this section:

*Example 1. Scope of basis choice; identifying separate CAAs, RFA owners (U.S.), and foreign payors in an aggregated CAA transaction*—(i) *Facts.* CFC1 wholly owns CFC2, both of which are section 902 corporations (as defined in section 909(d)(5)), organized in Country F, and treated as corporations for Country F tax purposes. CFC1 also wholly owns DE1, and DE1 wholly owns DE2. DE1 and DE2 are entities organized in Country F treated as corporations for Country F tax purposes and as disregarded entities for U.S. income tax purposes. Country F imposes a single tax that is a foreign income tax. All of the stock of CFC1 is acquired in a qualified stock purchase (within the meaning of section 338(d)(3)) to which section 338(a) applies for both CFC1 and CFC2. For Country F tax purposes, the transaction is treated as an acquisition of the stock of CFC1.

(ii) *Result.* (A) The acquisition of CFC1 gives rise to four separate CAAs described in § 1.901(m)–2. Under § 1.901(m)–2(b)(1), the acquisition of the stock of CFC1 and the deemed acquisition of the stock of CFC2 under section 338(h)(3)(B) are each a section 338 CAA. Furthermore, because the deemed acquisition of the assets of each of DE1 and DE2 for U.S. income tax purposes is disregarded for Country F tax purposes, the deemed acquisitions are CAAs under § 1.901(m)–2(b)(2). Because the four CAAs occurred pursuant to a plan, under § 1.901(m)–1(a)(3), all of the CAAs are part of an aggregated CAA transaction. Under § 1.901(m)–1(a)(31), CFC1 is the RFA owner (U.S.) with respect to its assets and the assets of DE1 and DE2 that are RFAs. CFC2 is the RFA owner (U.S.) with respect to its assets that are RFAs. Under § 1.901(m)–1(a)(23), CFC1, CFC2, DE1, and DE2 are each a foreign payor for Country F tax purposes.

(B) Under paragraph (c) of this section, a foreign basis election may be made by the RFA owner (U.S.). The election is made separately with respect to each CAA (for this purpose, treating all CAAs that are part of an aggregated CAA transaction as a single CAA) and with respect to each foreign income tax and foreign payor. Thus, in this case, CFC1 can make a separate foreign basis election for one or more of the following three groups of RFAs: RFAs that are relevant in determining foreign income of CFC1; RFAs that are relevant in determining foreign income of DE1; and RFAs that are relevant in determining foreign income of DE2. Furthermore, CFC2 can make a foreign basis election for all of its RFAs that are relevant in determining its foreign income.

*Example 2. Scope of basis choice; RFA owner (U.S.) is a partnership*—(i) *Facts.* USPS is a domestic partnership for which a section 754 election is in effect. USPS owns two assets, the stock of DE1 and DE2. DE1 is an entity organized in Country X and treated as a corporation for Country X tax purposes. DE2 is an entity organized in Country Y and treated as a corporation for Country Y tax purposes. DE1 and DE2 are disregarded entities. Country X and Country Y each impose a single tax that is a foreign income tax. US1 and US2, unrelated domestic corporations, and FP, a foreign person unrelated to US1 and US2, acquire

partnership interests in USPS from existing partners of USPS pursuant to the same plan.

(ii) *Result.* Under § 1.901(m)–2(b)(3), the acquisitions of the partnership interests in USPS by US1, US2, and FP each give rise to separate section 743(b) CAAs, but under § 1.901(m)–1(a)(3), they are treated as an aggregated CAA transaction because they occur as part of a plan. Under § 1.901(m)–1(a)(31), USPS is the RFA owner (U.S.) with respect to the assets of DE1 and DE2 that are RFAs. Under § 1.901(m)–1(a)(23), DE1 is a foreign payor for Country X tax purposes and DE2 is a foreign payor for Country Y tax purposes. Because the RFA owner (U.S.) is a partnership, paragraph (c)(2) of this section provides that US1, US2, and FP (the relevant partners in USPS) separately choose whether to make a foreign basis election for purposes of determining basis difference. Furthermore, under paragraph (c)(3) of this section, the choice to make the election is made separately by each partner with respect to each foreign payor. Thus, in this case, each partner may make separate elections for the RFAs that are relevant in determining foreign income of DE1 for Country X tax purposes and the RFAs that are relevant in determining foreign income of DE2 for Country Y tax purposes.

(g) *Effective/applicability date*—(1) [The text of proposed § 1.901(m)–4(g)(1) is the same as the text of § 1.901(m)–4T(g)(1) published elsewhere in this issue of the **Federal Register**.]

(2) Except for paragraphs (a), (b), (d)(1), and (e) of this section, this section applies to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(3) Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section (excluding paragraph (e) of this section), § 1.704–1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)–1, § 1.901(m)–3, and §§ 1.901(m)–5 through 1.901(m)–8 to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)–2 (excluding § 1.901(m)–2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 7.** Section 1.901(m)–5 is added to read as follows:

**§ 1.901(m)–5 Basis difference taken into account.**

(a) *In general.* This section provides rules for determining the amount of basis difference with respect to an RFA that is taken into account in a U.S. taxable year for purposes of determining the disqualified portion of a foreign income tax amount. Paragraph (b) of this section provides rules for determining a cost recovery amount and assigning that

amount to a U.S. taxable year of a single section 901(m) payor when the RFA owner (U.S.) is the section 901(m) payor. Paragraph (c) of this section provides rules for determining a disposition amount and assigning that amount to a U.S. taxable year of a single section 901(m) payor when the RFA owner (U.S.) is the section 901(m) payor. Paragraph (d) of this section provides rules for allocating cost recovery amounts and disposition amounts when the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes. Paragraph (e) of this section provides special rules for allocating cost recovery amounts and disposition amounts with respect to certain section 743(b) CAAs. Paragraph (f) of this section provides special rules for allocating certain disposition amounts when a foreign payor is transferred in a mid-year transaction. Paragraph (g) of this section provides special rules for allocating both cost recovery amounts and disposition amounts in certain cases in which the RFA owner (U.S.) either is a reverse hybrid or a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid. Paragraph (h) of this section provides examples illustrating the application of this section. Paragraph (i) of this section provides the effective/applicability date.

(b) *Basis difference taken into account under applicable cost recovery method*—(1) *In general.* When the RFA owner (U.S.) is a section 901(m) payor, all of a cost recovery amount is attributed to the section 901(m) payor and assigned to the U.S. taxable year of the section 901(m) payor in which the corresponding U.S. basis deduction is taken into account under the applicable cost recovery method. This is the case regardless of whether the deduction is deferred or disallowed for U.S. income tax purposes. If instead the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes, a cost recovery amount is allocated to one or more section 901(m) payors under paragraph (d) of this section, except as provided in paragraphs (e) and (g) of this section. If a cost recovery amount arises from an RFA with respect to a section 743(b) CAA, in certain cases the cost recovery amount is allocated to a section 901(m) payor under paragraph (e) of this section. In certain cases in which the RFA owner (U.S.) either is a reverse hybrid or a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid, a cost recovery amount is allocated to one

or more section 901(m) payors under paragraph (g) of this section.

(2) *Determining a cost recovery amount*—(i) [The text of proposed § 1.901(m)–5(b)(2)(i) is the same as the text of § 1.901(m)–5T(b)(2)(i) published elsewhere in this issue of the **Federal Register**.]

(ii) *U.S. basis subject to multiple cost recovery methods*. If the entire U.S. basis is not subject to the same cost recovery method, the applicable cost recovery method for determining the cost recovery amount is the cost recovery method that applies to the portion of the U.S. basis that corresponds to the basis difference.

(3) *Applicable cost recovery method*. For purposes of section 901(m), an applicable cost recovery method includes any method for recovering the cost of property over time for U.S. income tax purposes (each application of a method giving rise to a “U.S. basis deduction”). Such methods include depreciation, amortization, or depletion, as well as a method that allows the cost (or a portion of the cost) of property to be expensed in the year of acquisition or in the placed-in-service year, such as under section 179. Applicable cost recovery methods do not include any provision allowing the U.S. basis to be recovered upon a disposition of an RFA.

(c) *Basis difference taken into account as a result of a disposition*—(1) *In general*. Except as provided in paragraph (f) of this section, when the RFA owner (U.S.) is a section 901(m) payor, all of a disposition amount is attributed to the section 901(m) payor and assigned to the U.S. taxable year of the section 901(m) payor in which the disposition occurs. If instead the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes, except as provided in paragraphs (e), (f), and (g) of this section, a disposition amount is allocated to one or more section 901(m) payors under paragraph (d) of this section. If a disposition amount arises from an RFA with respect to a section 743(b) CAA, in certain cases the disposition amount is allocated to a section 901(m) payor under paragraph (e) of this section. If there is a disposition of an RFA in a foreign taxable year of a foreign payor during which there is a mid-year transaction, in certain cases a disposition amount is allocated under paragraph (f) of this section. In certain cases in which the RFA owner (U.S.) either is a reverse hybrid or a fiscally transparent entity for both U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid, a disposition amount is allocated to one or more

section 901(m) payors under paragraph (g) of this section.

(2) [The text of proposed § 1.901(m)–5(c)(2) is the same as the text of § 1.901(m)–5T(c)(2) published elsewhere in this issue of the **Federal Register**.]

(d) *General rules for allocating and assigning a cost recovery amount or a disposition amount when the RFA owner (U.S.) is a fiscally transparent entity*—(1) *In general*. Except as provided in paragraphs (e), (f), and (g) of this section, this paragraph (d) provides rules for allocating a cost recovery amount or a disposition amount when the RFA owner (U.S.) is a fiscally transparent entity for U.S. income tax purposes in which a section 901(m) payor directly or indirectly owns an interest, as well as for assigning the allocated amount to a U.S. taxable year of the section 901(m) payor. For purposes of this paragraph (d), unless otherwise indicated, a reference to direct or indirect ownership in an entity means for U.S. income tax purposes. For purposes of this paragraph (d), a person indirectly owns an interest in an entity for U.S. income tax purposes if the person owns the interest through one or more fiscally transparent entities for U.S. income tax purposes, and at least one of the fiscally transparent entities is not a disregarded entity. For purposes of this paragraph (d), a person indirectly owns an interest in an entity for foreign income tax purposes if the person owns the interest through one or more fiscally transparent entities for foreign income tax purposes. If the RFA owner (U.S.) is a lower-tier fiscally transparent entity for U.S. income tax purposes in which the section 901(m) payor indirectly owns an interest, the rules of this section apply in a manner consistent with the application of these rules when the section 901(m) payor directly owns an interest in the RFA owner (U.S.).

(2) *Allocation of a cost recovery amount*. A cost recovery amount is allocated to a section 901(m) payor that directly or indirectly owns an interest in the RFA owner (U.S.) to the extent the U.S. basis deduction that corresponds to the cost recovery amount is (or will be) included in the section 901(m) payor's distributive share of the income of the RFA owner (U.S.) for U.S. income tax purposes.

(3) *Allocation of a disposition amount attributable to foreign disposition gain or foreign disposition loss*—(i) *In general*. Except as provided in paragraph (f) of this section, a disposition amount attributable to foreign disposition gain or foreign disposition loss (as determined under paragraph (d)(5) of this section) is

allocated under paragraph (d)(3)(ii) or (d)(3)(iii) of this section to a section 901(m) payor that directly or indirectly owns an interest in the RFA owner (U.S.).

(ii) *First allocation rule*. This paragraph (d)(3)(ii) applies when a section 901(m) payor, or a disregarded entity directly owned by a section 901(m) payor, is the foreign payor whose foreign income includes a distributive share of the foreign income of the RFA owner (foreign) and, therefore, all of the foreign income tax amount of the foreign payor is paid or accrued by, or considered paid by, the section 901(m) payor. Thus, this paragraph (d)(3)(ii) applies when the RFA owner (U.S.) is a fiscally transparent entity for both U.S. and foreign income tax purposes and a section 901(m) payor either directly owns an interest in the RFA owner (U.S.) or directly owns an interest in another fiscally transparent entity for U.S. and foreign income tax purposes, which, in turn, directly or indirectly owns an interest in the RFA owner (U.S.) for both U.S. and foreign income tax purposes. In these cases, the section 901(m) payor is allocated the portion of a disposition amount that is equal to the product of the disposition amount attributable to foreign disposition gain or foreign disposition loss, as applicable, and a fraction, the numerator of which is the portion of the foreign disposition gain or foreign disposition loss recognized by the RFA owner (foreign) for foreign income tax purposes that is (or will be) included in the foreign payor's distributive share of the foreign income of the RFA owner (foreign), and the denominator of which is the foreign disposition gain or foreign disposition loss.

(iii) *Second allocation rule*. This paragraph (d)(3)(iii) applies when neither a section 901(m) payor nor a disregarded entity directly owned by a section 901(m) payor is the foreign payor with respect to the foreign income of the RFA owner (foreign). Instead, a section 901(m) payor directly or indirectly owns an interest in the foreign payor, which is a fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by the section 901(m) payor), and, therefore, the section 901(m) payor is considered to pay or accrue only its allocated portion of the foreign income tax amount of the foreign payor. This will be the case when the foreign payor is either the RFA owner (U.S.), another fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by a section

901(m) payor) that directly or indirectly owns an interest in the RFA owner (U.S.) for both U.S. and foreign income tax purposes, or a disregarded entity directly owned by the RFA owner (U.S.). In these cases, the section 901(m) payor is allocated the portion of a disposition amount that is equal to the product of the disposition amount attributable to foreign disposition gain or foreign disposition loss, as applicable, and a fraction, the numerator of which is the portion of the foreign disposition gain or foreign disposition loss that is included in the allocable foreign income of the section 901(m) payor, and the denominator of which is the foreign disposition gain or foreign disposition loss. If allocable foreign income is not otherwise required to be determined because there is no foreign income tax amount, the numerator is the portion of the foreign disposition gain or foreign disposition loss that would be included in the allocable foreign income of the section 901(m) payor if there were a foreign income tax amount.

(4) *Allocation of a disposition amount attributable to U.S. disposition gain or U.S. disposition loss.* A section 901(m) payor that directly or indirectly owns an interest in the RFA owner (U.S.) is allocated the portion of a disposition amount that is equal to the product of the disposition amount attributable to U.S. disposition gain or U.S. disposition loss (as determined under paragraph (d)(5) of this section), as applicable, and a fraction, the numerator of which is the portion of the U.S. disposition gain or U.S. disposition loss that is (or will be) included in the section 901(m) payor's distributive share of income of the RFA owner (U.S.) for U.S. income tax purposes, and the denominator of which is the U.S. disposition gain or U.S. disposition loss.

(5) *Determining the extent to which a disposition amount is attributable to foreign or U.S. disposition gain or loss—*

(i) *RFA with a positive basis difference.* When there is a disposition of an RFA with a positive basis difference and the disposition results in either a foreign disposition gain or a U.S. disposition loss, but not both, the entire disposition amount is attributable to foreign disposition gain or U.S. disposition loss, as applicable, even if the disposition amount exceeds the foreign disposition gain or the absolute value of the U.S. disposition loss. If the disposition results in both a foreign disposition gain and a U.S. disposition loss, the disposition amount is attributable first to foreign disposition gain to the extent thereof, and the excess disposition amount, if any, is attributable to the U.S.

disposition loss, even if the excess disposition amount exceeds the absolute value of the U.S. disposition loss.

(ii) *RFA with a negative basis difference.* When there is a disposition of an RFA with a negative basis difference and the disposition results in either a foreign disposition loss or a U.S. disposition gain, but not both, the entire disposition amount is attributable to foreign disposition loss or U.S. disposition gain, as applicable, even if the absolute value of the disposition amount exceeds the absolute value of the foreign disposition loss or the U.S. disposition gain. If the disposition results in both a foreign disposition loss and a U.S. disposition gain, the disposition amount is attributable first to foreign disposition loss to the extent thereof, and the excess disposition amount, if any, is attributable to the U.S. disposition gain, even if the absolute value of the excess disposition amount exceeds the U.S. disposition gain.

(6) *U.S. taxable year of a section 901(m) payor to which an allocated cost recovery amount or disposition amount is assigned.* A cost recovery amount or a disposition amount allocated to a section 901(m) payor under paragraph (d) of this section is assigned to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the RFA owner (U.S.) in which, in the case of a cost recovery amount, the RFA owner (U.S.) takes into account the corresponding U.S. basis deduction (without regard to whether the deduction is deferred or disallowed for U.S. income tax purposes), or in the case of a disposition amount, the disposition occurs.

(e) *Special rules for certain section 743(b) CAAs.* If a section 901(m) payor acquires a partnership interest in a section 743(b) CAA, including a section 743(b) CAA with respect to a lower-tier partnership that results from a direct acquisition by the section 901(m) payor of an interest in an upper-tier partnership, and subsequently there is a cost recovery amount or a disposition amount that arises from an RFA with respect to that section 743(b) CAA, all of the cost recovery amount or the disposition amount is allocated to that section 901(m) payor. The U.S. taxable year of the section 901(m) payor to which the cost recovery amount or the disposition amount is assigned is the U.S. taxable year in which, in the case of a cost recovery amount, the section 901(m) payor takes into account the corresponding U.S. basis deduction (without regard to whether the deduction is deferred or disallowed for U.S. income tax purposes), or in the

case of a disposition amount, the disposition occurs.

(f) *Mid-year transactions—*(1) *In general.* When a disposition of an RFA occurs in the same foreign taxable year that a foreign payor is involved in a mid-year transaction, the portion of the disposition amount that is attributable to foreign disposition gain or foreign disposition loss (as determined under paragraph (d)(5) of this section) is allocated to a section 901(m) payor and assigned to a U.S. taxable year of the section 901(m) payor under this paragraph (f). To the extent the disposition amount is attributable to U.S. disposition gain or U.S. disposition loss (as determined under paragraph (d)(5) of this section), see paragraph (c)(1) or (d) of this section, as applicable.

(2) *Allocation rule.* To the extent a disposition amount is attributable to foreign disposition gain or foreign disposition loss, a section 901(m) payor is allocated the portion of the disposition amount equal to the product of the disposition amount attributable to foreign disposition gain or foreign disposition loss, as applicable, and a fraction, the numerator of which is the portion of the foreign disposition gain or foreign disposition loss that is included in the allocable foreign income of the section 901(m) payor, and the denominator of which is the foreign disposition gain or foreign disposition loss. If allocable foreign income is not otherwise required to be determined because there is no foreign income tax amount, the numerator is the portion of the foreign disposition gain or foreign disposition loss that would be included in the allocable foreign income of the section 901(m) payor if there were a foreign income tax amount.

(3) *Assignment to a U.S. taxable year of a section 901(m) Payor.* A disposition amount allocated to a section 901(m) payor under paragraph (f)(2) of this section is assigned to the U.S. taxable year of the section 901(m) payor in which the foreign disposition gain or foreign disposition loss (or portion thereof) is included in allocable foreign income of the section 901(m) payor or, if allocable foreign income is not otherwise required to be determined because there is no foreign income tax amount, the U.S. taxable year in which the foreign disposition gain or foreign disposition loss would be included in allocable foreign income if there were a foreign income tax amount.

(g) *Reverse hybrids—*(1) *In general.* This paragraph (g) provides rules for allocating a cost recovery amount or a disposition amount when the RFA owner (U.S.) is either a reverse hybrid

or a fiscally transparent entity for U.S. and foreign income tax purposes that is directly or indirectly owned by a reverse hybrid for U.S. and foreign income tax purposes, and in each case, the foreign payor whose foreign income includes a distributive share of the foreign income of the RFA owner (foreign) directly or indirectly owns an interest in the reverse hybrid for foreign income tax purposes. Application of the allocation rules under paragraphs (g)(2) and (g)(3) of this section depend upon whether a section 901(m) payor or a disregarded entity directly owned by a section 901(m) payor is the foreign payor, or, instead, a section 901(m) payor directly or indirectly owns an interest in the foreign payor. For purposes of this paragraph (g), unless otherwise indicated, a reference to direct or indirect ownership in an entity means for U.S. income tax purposes. For purposes of this paragraph (g), a person indirectly owns an interest in an entity for U.S. income tax purposes if the person owns the interest through one or more fiscally transparent entities for U.S. income tax purposes, and at least one of the fiscally transparent entities is not a disregarded entity. For purposes of this paragraph (g), a person indirectly owns an interest in an entity for foreign income tax purposes if the person owns the interest through one or more fiscally transparent entities for foreign income tax purposes. If the RFA owner (U.S.) is a lower-tier fiscally transparent entity for U.S. income tax purposes in which the reverse hybrid indirectly owns an interest, the rules of this section apply in a manner consistent with the application of these rules when the reverse hybrid directly owns an interest in the RFA owner (U.S.).

(2) *First allocation rule*—(i) *Allocation to a section 901(m) payor.* This paragraph (g)(2)(i) applies when a section 901(m) payor, or a disregarded entity directly owned by a section 901(m) payor, is the foreign payor whose foreign income includes a distributive share of the foreign income of the RFA owner (foreign), and, therefore, all of the foreign income tax amount of the foreign payor is paid or accrued by, or considered paid or accrued by, the section 901(m) payor. Thus, this paragraph (g)(2)(i) applies when a section 901(m) payor either directly owns an interest in the reverse hybrid or directly owns an interest in a fiscally transparent entity for U.S. and foreign income tax purposes, which, in turn, directly or indirectly owns an interest in the reverse hybrid for both U.S. and foreign income tax purposes. In these cases, the section 901(m) payor

is allocated the portions of cost recovery amounts or disposition amounts (or both) with respect to RFAs that are equal to the product of the sum of the cost recovery amounts and the disposition amounts and a fraction, the numerator of which is the portion of the foreign income of the RFA owner (foreign) that is included in the foreign income of the foreign payor, and the denominator of which is the foreign income of the RFA owner (foreign).

(ii) *Assignment to a U.S. taxable year of a section 901(m) Payor.* This paragraph (g)(2)(ii) applies when a cost recovery amount or a disposition amount, or portion thereof, is allocated to a section 901(m) payor under paragraph (g)(2)(i) of this section. If the reverse hybrid is the RFA owner (U.S.), a cost recovery amount or disposition amount, or portion thereof, is assigned to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the reverse hybrid in which, in the case of a cost recovery amount, the reverse hybrid takes into account the corresponding U.S. basis deduction (without regard to whether the deduction is deferred or disallowed for U.S. income tax purposes), or, in the case of a disposition amount, the disposition occurs. If the reverse hybrid is not the RFA owner (U.S.) but instead the reverse hybrid directly or indirectly owns an interest in the RFA owner (U.S.) for both U.S. and foreign income tax purposes, a cost recovery amount or disposition amount, or portion thereof, is assigned to the U.S. taxable year of the section 901(m) payor that includes the last day of the U.S. taxable year of the reverse hybrid, which, in turn, includes the last day of the U.S. taxable year of the RFA owner (U.S.) in which, in the case of a cost recovery amount, the RFA owner (U.S.) takes into account the corresponding U.S. basis deduction (without regard to whether the deduction is deferred or disallowed for U.S. income tax purposes), or, in the case of a disposition amount, the disposition occurs.

(3) *Second allocation rule*—(i) *Allocation to a section 901(m) payor.* This paragraph (g)(3)(i) applies when neither a section 901(m) payor nor a disregarded entity directly owned by a section 901(m) payor is the foreign payor with respect to the foreign income of the RFA owner (foreign). Instead, a section 901(m) payor directly or indirectly owns an interest in the foreign payor, which is a fiscally transparent entity for U.S. income tax purposes (other than a disregarded entity directly owned by the section 901(m) payor), and, therefore, the

section 901(m) payor is considered to pay or accrue only its allocated portion of the foreign income tax amount of the foreign payor. In these cases, the section 901(m) payor is allocated the portions of cost recovery amounts or disposition amounts (or both) with respect to RFAs that are equal to the product of the sum of the cost recovery amounts and the disposition amounts and a fraction, the numerator of which is the portion of the foreign income of the RFA owner (foreign) that is included in the foreign income of the foreign payor and included in the allocable foreign income of the section 901(m) payor, and the denominator of which is the foreign income of the RFA owner (foreign). If allocable foreign income is not otherwise required to be determined for a section 901(m) payor because there is no foreign income tax amount, the numerator is the foreign income of the RFA owner (foreign) that is included in the foreign income of the foreign payor and that would be included in allocable foreign income of the section 901(m) payor if there were a foreign income tax amount.

(ii) *Assignment to a U.S. taxable year of a section 901(m) payor.* A cost recovery amount or a disposition amount, or portion thereof, that is allocated to a section 901(m) payor under paragraph (g)(3)(i) of this section is assigned to the U.S. taxable year of the section 901(m) payor in which the foreign income of the RFA owner (foreign) described in paragraph (g)(3)(i) of this section is included in the allocable foreign income of the section 901(m) payor, or, if there is no foreign income tax amount, the U.S. taxable year of the section 901(m) payor in which the foreign income of the RFA owner (foreign) described in paragraph (g)(3)(i) of this section would be included in allocable foreign income if there were a foreign income tax amount.

(h) *Examples.* The following examples illustrate the rules of this section. In addition to any facts described in a particular example, the following facts apply to all the examples unless otherwise specified: CFC1, CFC2, and DE are organized in Country F and treated as corporations for Country F tax purposes. CFC1 and CFC2 are each a section 902 corporation (as defined in section 909(d)(5)) that is wholly owned by the same U.S. corporation, and DE is a disregarded entity. CFC1 and CFC2 have a U.S. taxable year that is a calendar year, and CFC1, CFC2, and DE have a foreign taxable year that is a calendar year. Country F imposes a single tax that is a foreign income tax. CFC1, CFC2, and DE each have a functional currency of the u with

respect to all activities. At all relevant times, 1u equals \$1. All amounts are stated in millions. The examples assume that the applicable cost recovery method for property results in basis being recovered ratably over the life of the property beginning on the first day of the U.S. taxable year in which the property is acquired or placed into service.

*Example 1. CAA followed by disposition: fully taxable for both U.S. income tax and foreign income tax purposes—(i) Facts.* (A)

On January 1, Year 1, USP acquires all of the stock of CFC1 in a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies (Section 338 Acquisition). At the time of the Section 338 Acquisition, CFC1 owns a single asset (Asset A) that is located in Country F. Asset A gives rise to income that is taken into account for Country F tax purposes. Asset A is tangible personal property that, under the applicable cost recovery method in the hands of CFC1, is depreciable over 5 years. There are no cost recovery deductions available for Country F tax purposes with respect to Asset A. Immediately before the Section 338 Acquisition, Asset A has a U.S. basis of 10u and a foreign basis of 40u. Immediately after the Section 338 Acquisition, Asset A has a U.S. basis of 100u and foreign basis of 40u.

(B) On July 1, Year 2, Asset A is transferred to an unrelated third party in exchange for 120u in a transaction in which all realized gain is recognized for both U.S. income tax and Country F tax purposes (subsequent transaction). For U.S. income tax purposes, CFC1 recognizes U.S. disposition gain of 50u (amount realized of 120u, less U.S. basis of 70u (100u cost basis, less 30u of accumulated depreciation)) with respect to Asset A. The 30u of accumulated depreciation is the sum of 20u of depreciation in Year 1 (100u cost basis/5 years) and 10u of depreciation in Year 2 ((100u cost basis/5 years) × 6/12). For Country F tax purposes, CFC1 recognizes foreign disposition gain of 80u (amount realized of 120u, less foreign basis of 40u) with respect to Asset A. Immediately after the subsequent transaction, Asset A has a U.S. basis and a foreign basis of 120u.

(ii) *Result.* (A) Under § 1.901(m)-2(b)(1), USP's acquisition of the stock of CFC1 in the Section 338 Acquisition is a section 338 CAA. Under § 1.901(m)-2(c)(i), Asset A is an RFA with respect to Country F tax because it is relevant in determining the foreign income of CFC1 for Country F tax purposes. Under § 1.901(m)-4(b), the basis difference with respect to Asset A is 90u (100u - 10u). Under Section 901(m)-1(a)(31), CFC1 is the RFA owner (U.S.) with respect to Asset A. Under § 1.901(m)-1(a)(23), CFC1 is a foreign payor for Country F tax purposes. Under § 1.901(m)-1(a)(35), CFC1 is the section 901(m) payor with respect to a foreign income tax amount for which CFC1 is the foreign payor (see § 1.901-2(f)(1)).

(B) Under § 1.901(m)-1(a)(5), allocated basis differences are comprised of cost recovery amounts and disposition amounts. In Year 1, Asset A has an allocated basis difference that includes only a cost recovery amount. Under paragraph (b)(2) of this

section, the cost recovery amount for Year 1 is determined by applying the applicable cost recovery method of Asset A in the hands of CFC1 to the basis difference with respect to Asset A. Accordingly the cost recovery amount is 18u (90u basis difference/5 years). Under paragraph (b)(1) of this section, all of the 18u cost recovery amount is attributed to CFC1 and assigned to Year 1, because CFC1 is a section 901(m) payor and RFA owner (U.S.) with respect to Asset A and Year 1 is the U.S. taxable year of CFC1 in which it takes into account the corresponding 20u of depreciation. Immediately after Year 1, under § 1.901(m)-1(a)(40), unallocated basis difference is 72u with respect to Asset A (90u - 18u).

(C) In Year 2, Asset A has an allocated basis difference that includes both a cost recovery amount and a disposition amount. Under paragraph (b)(2) of this section, the cost recovery amount for Year 2, as of the date of the subsequent transaction, is 9u ((90u basis difference/5 years) × 6/12). Under § 1.901(m)-1(a)(10), the subsequent transaction is a disposition of Asset A, because the subsequent transaction is an event that results in an amount of gain being recognized for U.S. income tax and Country F tax purposes. Because all realized gain in Asset A is recognized for U.S. income tax and Country F tax purposes, the rule in paragraph (c)(2)(i) of this section applies to determine the disposition amount. Under that rule, the disposition amount for Year 2 is the unallocated basis difference of 63u (90u basis difference, less total 27u taken into account as cost recovery amounts in Year 1 and Year 2). Accordingly, the allocated basis difference for Year 2 is 72u (9u of cost recovery amount, plus 63u of disposition amount). Under paragraphs (b)(1) and (c)(1) of this section, all of the 72u of allocated basis difference is attributed to CFC1 and assigned to Year 2, because CFC1 is a section 901(m) payor and the RFA owner (U.S.) with respect to Asset A and Year 2 is the U.S. taxable year of CFC1 in which it takes into account the corresponding 10u of depreciation and in which the disposition occurred.

(D) Unallocated basis difference with respect to Asset A, as determined immediately after the subsequent transaction, is 0u (90u basis difference less 90u basis difference taken into account as 27u total cost recovery amount in Year 1 and Year 2 and as a 63u disposition amount in Year 2). Accordingly, because there is no unallocated basis difference with respect to Asset A attributable to the Section 338 Acquisition, the subsequent transaction is not a successor transaction as defined in § 1.901(m)-6(b)(2). Furthermore, the subsequent transaction is not a CAA under § 1.901(m)-2(b). For these reasons, section 901(m) no longer applies to Asset A.

*Example 2. CAA followed by Disposition: nontaxable for U.S. income tax purposes and taxable for foreign income tax purposes—(i) Facts.* The facts are the same as in paragraph (i)(A) of *Example 1* but the facts in paragraph (i)(B) of *Example 1* are instead that on July 1, Year 2, Asset A is transferred to CFC2, in exchange for 100u of stock of CFC2 (subsequent transaction). For U.S. income tax purposes, CFC1 does not recognize any U.S.

disposition gain or U.S. disposition loss with respect to Asset A. For Country F tax purposes, CFC1 recognizes foreign disposition gain of 60u (amount realized of 100u, less foreign basis of 40u) with respect to Asset A. Immediately after the subsequent transaction, Asset A has a U.S. basis of 70u (100u cost basis less 30u accumulated depreciation) and a foreign basis of 100u. The 30u of accumulated depreciation is the sum of 20u of depreciation in Year 1 (100u cost basis/5 years) and 10u in Year 2 ((100u cost basis/5 years) × 6/12).

(ii) *Result.* (A) The results described in paragraph (ii)(A) of *Example 1* also apply to this *Example 2*.

(B) The result for Year 1 is the same as in paragraph (ii)(B) of *Example 1*.

(C) In Year 2, Asset A has an allocated basis difference that includes both a cost recovery amount and a disposition amount. Under paragraph (b)(2) of this section, the cost recovery amount for Year 2, as of the date of the subsequent transaction, is 9u ((90u basis difference/5 years) × 6/12). Under § 1.901(m)-1(a)(10), the Transaction is a disposition of Asset A, because the subsequent transaction is an event that results in an amount of gain being recognized for Country F tax purposes. Because the disposition is not also fully taxable for U.S. income tax purposes, the rule in paragraph (c)(2)(ii) of this section applies to determine the disposition amount. Under that rule, the disposition amount is 60u, the lesser of (i) 60u (60u foreign disposition gain plus absolute value of 0u U.S. disposition loss), and (ii) 63u unallocated basis difference (90u basis difference less total 27u taken into account as cost recovery amounts, 18u in Year 1 and 9u in Year 2). Accordingly, the allocated basis difference for the first half of Year 2 is 69u (9u of cost recovery amount, plus 60u of disposition amount). Under paragraphs (b)(1) and (c)(1) of this section, all of the 69u of allocated basis difference is attributed to CFC1 and assigned to Year 2, because CFC1 is a section 901(m) payor and the RFA owner (U.S.) with respect to Asset A and Year 2 is the U.S. taxable year of CFC1 in which it takes into account the corresponding 10u of depreciation and in which the disposition occurred.

(D) Unallocated basis difference with respect to Asset A immediately after the subsequent transaction is 3u (90u basis difference less 87u basis difference taken into account as a 27u total cost recovery amount in Year 1 and Year 2 and as a 60u disposition amount in Year 2). Accordingly, because there is unallocated basis difference of 3u with respect to Asset A attributable to the Section 338 Acquisition, as determined immediately after the subsequent transaction, the subsequent transaction is a successor transaction as defined in § 1.901(m)-6(b)(2). Following the subsequent transaction, the unallocated basis difference of 3u must be taken into account as cost recovery amounts or disposition amounts (or both) by CFC2, the new section 901(m) payor and RFA owner (U.S.) of Asset A. See § 1.901(m)-6(b)(3)(ii). Because the subsequent transaction is not a CAA under § 1.901(m)-2(b), there is no additional basis difference with respect to Asset A as a result of the subsequent transaction.

*Example 3. CAA followed by disposition: nontaxable for both U.S. income tax and foreign income tax purposes—(i) Facts.* The facts are the same as in paragraph (i)(A) of *Example 1* but the facts in paragraph (i)(B) of *Example 1* are instead that on July 1, Year 2, CFC1 transfers Asset A to CFC2, in exchange for 110u of stock of CFC2 (subsequent transaction). For U.S. income tax purposes, CFC1 does not recognize any U.S. disposition gain or U.S. disposition loss with respect to Asset A as a result of the subsequent transaction. Furthermore, for Country F tax purposes, CFC1 recognizes no foreign disposition gain or foreign disposition loss with respect to Asset A as a result of the subsequent transaction. Immediately after the subsequent transaction, Asset A has a U.S. basis of 70u (100u cost basis less 30u accumulated depreciation) and a foreign basis of 40u. The 30u of accumulated depreciation is the sum of 20u of depreciation in Year 1 (100u cost basis/5 years) and 10u in Year 2 ((100u cost basis/5 years) × 6/12).

(ii) *Result.* (A) The result for Year 1 is the same as in paragraph (ii)(A) of *Example 1*.

(B) The result for Year 1 is the same as in paragraph (ii)(B) of *Example 1*.

(C) In Year 2, Asset A has an allocated basis difference that includes only a cost recovery amount. Under paragraph (b)(2) of this section, the cost recovery amount for Year 2, as of the date of the subsequent transaction, is 9u (90u basis difference/5 years) × 6/12. Under § 1.901(m)-1(a)(10), the subsequent transaction does not constitute a disposition of Asset A, because the subsequent transaction is not an event that results in an amount of gain or loss being recognized for U.S. income tax or for Country F tax purposes. Therefore, no disposition amount is taken into account for Asset A in Year 2. Under paragraph (b)(1) of this section, all of the 9u of allocated basis difference is attributed to CFC1 and assigned to Year 2, because CFC1 is a section 901(m) payor and RFA owner (U.S.) with respect to Asset A and Year 2 is the U.S. taxable year of CFC1 in which it takes into account the corresponding 10u of depreciation.

(D) Unallocated basis difference with respect to Asset A immediately after the subsequent transaction is 63u (90u basis difference, less 27u total cost recovery amounts, 18u in Year 1 and 9u in Year 2). Accordingly, because there is unallocated basis difference of 63u with respect to Asset A attributable to the CAA, as determined immediately after the subsequent transaction, the subsequent transaction is a successor transaction as defined in § 1.901(m)-6(b)(2). Following the subsequent transaction, the unallocated basis difference of 63u must be taken into account as cost recovery amounts or disposition amounts (or both) by CFC2, the new section 901(m) payor and RFA owner (U.S.) of Asset A. See § 1.901(m)-6(b)(3)(ii). Because the subsequent transaction is not a CAA under § 1.901(m)-2(b), there is no additional basis difference with respect to Asset A as a result of the subsequent transaction.

(i) *Effective/applicability date.* (1) Except for paragraphs (b)(2)(i) and (c)(2) of this section, this section applies to

CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(2) [The text of proposed § 1.901(m)-5(i)(2) is the same as the text of § 1.901(m)-5T(i)(2) published elsewhere in this issue of the **Federal Register**.]

(3) Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, § 1.901(m)-3, § 1.901(m)-4 (excluding § 1.901(m)-4(e)), § 1.901(m)-6, § 1.901(m)-7, and § 1.901(m)-8 to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 8.** Section 1.901(m)-6 is added to read as follows:

**§ 1.901(m)-6 Successor rules.**

(a) through (b)(2) [The text of proposed §§ 1.901(m)-6(a) through (b)(2) is the same as the text of §§ 1.901(m)-6T(a) through (b)(2) published elsewhere in this issue of the **Federal Register**.]

(3) *Special considerations.* (i) If an asset is an RFA with respect to more than one foreign income tax, this paragraph (a) applies separately with respect to each foreign income tax.

(ii) Any subsequent cost recovery amount for an RFA transferred in a successor transaction is determined based on the post-transaction applicable cost recovery method, as described in § 1.901(m)-5(b)(3), that applies to the U.S. basis (or portion thereof) that corresponds to the unallocated basis difference.

(4)(i) [The text of proposed § 1.901(m)-6(b)(4)(i) is the same as the text of § 1.901(m)-6T(b)(4)(i) published elsewhere in this issue of the **Federal Register**.]

(ii) *Foreign basis election.* If a foreign basis election is made under § 1.901(m)-4(c) with respect to a foreign income tax in a subsequent CAA, any unallocated basis difference with respect to one or more prior CAAs will not be taken into account under section 901(m). The only basis difference that will be taken into account after the subsequent CAA with respect to that foreign income tax is the basis difference with respect to the subsequent CAA.

(b)(4)(iii) [The text of proposed § 1.901(m)-6(b)(4)(iii) is the same as the text of § 1.901(m)-6T(b)(4)(iii)

published elsewhere in this issue of the **Federal Register**.]

(5) [The text of proposed § 1.901(m)-6(b)(5) is the same as the text of § 1.901(m)-6T(b)(5) published elsewhere in this issue of the **Federal Register**.]

(c) *Successor rules for aggregate basis difference carryover—(1) Transfers of a section 901(m) payor's aggregate basis difference carryover to another person.* If a corporation acquires the assets of a section 901(m) payor in a transaction to which section 381 applies, that corporation succeeds to any aggregate basis difference carryovers of the section 901(m) payor.

(2) *Transfers of a section 901(m) payor's aggregate basis difference carryover with respect to a foreign payor to another foreign payor.* If a section 901(m) payor has an aggregate basis difference carryover, with respect to a foreign income tax and a foreign payor, and substantially all of the assets of the foreign payor are transferred to another foreign payor in which the section 901(m) payor owns an interest, the section 901(m) payor's aggregate basis difference carryover with respect to the first foreign payor is transferred to the section 901(m) payor's aggregate basis difference carryover with respect to the other foreign payor. In such a case, the section 901(m) payor's aggregate basis difference carryover with respect to the first foreign payor is reduced to zero.

(3) *Anti-abuse rule.* If a section 901(m) payor has an aggregate basis difference carryover with respect to a foreign income tax and a foreign payor and, with a principal purpose of avoiding the application of section 901(m), assets of the foreign payor are transferred to another foreign payor in a transaction not described in paragraph (c)(1) or (2) of this section, then a portion of the aggregate basis difference carryover of the section 901(m) payor is transferred either to the aggregate basis difference carryover of the section 901(m) payor with respect to the other foreign payor or to another section 901(m) payor, as appropriate. The portion of the aggregate basis difference carryover transferred is determined based on the ratio of fair market value of the assets transferred to the fair market value of all of the assets of the foreign payor that transferred the assets. Similar principles apply when, with a principle purpose of avoiding the application of section 901(m), there is a change in the allocation of foreign income for foreign income tax purposes or the allocation of foreign income tax amounts for U.S. income tax purposes that would otherwise separate foreign income tax

amounts from the related aggregate basis difference carryover.

(4) *Ownership.* For purposes of this paragraph (c), a section 901(m) payor owns an interest in a foreign payor if the section 901(m) payor owns the interest directly or indirectly through one or more fiscally transparent entities for U.S. income tax purposes.

(d) *Effective/applicability date.* (1) [The text of proposed § 1.901(m)-6(d)(1) is the same as the text of § 1.901(m)-6T(d)(1) published elsewhere in this issue of the **Federal Register**.]

(2) Paragraphs (b)(3), (b)(4)(ii), and (c) of this section apply to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(3) Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, §§ 1.901(m)-3 through 1.901(m)-5 (excluding § 1.901(m)-4(e)), § 1.901(m)-7, and § 1.901(m)-8 to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 9.** Section 1.901(m)-7 is added to read as follows:

**§ 1.901(m)-7 De minimis rules.**

(a) *In general.* This section provides rules describing basis difference that is not taken into account under section 901(m) because a CAA results in a de minimis amount of basis difference. Paragraph (b) of this section sets forth the general rule for determining whether the de minimis threshold is met. Paragraph (c) of this section provides modifications to the general rule in the case of CAAs involving related persons and CAAs that are part of an aggregated CAA transaction. Paragraph (d) of this section provides rules for applying this section, and paragraph (e) of this section provides an anti-abuse rule applicable to related persons. Paragraph (f) of this section provides examples that illustrate the application of this section. Paragraph (g) of this section provides the effective/applicability date.

(b) *General rule—(1) In general.* A basis difference with respect to an RFA and a foreign income tax is not taken into account under section 901(m) if the requirements under either the cumulative basis difference exemption or the RFA class exemption are satisfied.

(2) *Cumulative basis difference exemption.* Except as provided in paragraph (c) of this section, a basis difference, with respect to an RFA and a foreign income tax, is not taken into account under section 901(m) (cumulative basis difference exemption) if the sum of that basis difference and all other basis differences (including negative basis differences), with respect to a single CAA and a single RFA owner (U.S.), is less than the greater of:

- (i) \$10 million, or
- (ii) 10 percent of the total U.S. basis of all the RFAs immediately after the CAA.

(3) *RFA class exemption—(i)* Except as provided in paragraph (c) of this section, a basis difference, with respect to an RFA and a foreign income tax, is not taken into account under section 901(m) (RFA class exemption) if the RFA is part of a class of RFAs and the absolute value of the sum of the basis differences (including negative basis differences), with respect to a single CAA and a single RFA owner, for all the RFAs in that class is less than the greater of:

- (A) \$2 million, or
- (B) 10 percent of the total U.S. basis of all the RFAs in that class of RFAs immediately after the CAA.

(ii) For purposes of this paragraph (b)(3), the classes of RFAs are the seven asset classes defined in § 1.338-6(b), regardless of whether the CAA is a section 338 CAA.

(c) *Special rules—(1) Modification of de minimis rules for related persons.* If the transferor and transferee in the CAA are related persons (as described in section 267(b) or 707(b)), the cumulative basis difference exemption and the RFA class exemption, as described in paragraph (b) of this section, are applied by replacing the terms “\$10 million,” “10 percent,” and “\$2 million” wherever they occur in that paragraph with the terms “\$5 million,” “5 percent,” and “\$1 million,” respectively.

(2) *CAA part of an aggregated CAA transaction.* If a CAA is part of an aggregated CAA transaction and a single RFA owner (U.S.) does not own all the RFAs attributable to the CAAs that are part of the aggregated CAA transaction, the cumulative basis difference exemption and the RFA class exemption apply to such CAA only if, in addition to satisfying the requirements of paragraph (b)(2) or (b)(3) of this section, respectively, determined without regard to this paragraph (c)(2), the cumulative basis difference exemption or the RFA class exemption, as modified by this paragraph (c)(2), is satisfied. Solely for purposes of this paragraph (c)(2), the

cumulative basis difference exemption and the RFA class exemption are applied taking into account all the basis differences with respect to all the RFAs owned by all the RFA owners (U.S.) that are attributable to the CAAs that are part of the aggregated CAA transaction.

(d) *Rules of application.* The following rules apply for purposes of this section.

(1) Whether a basis difference qualifies for the cumulative basis difference exemption or the RFA class exemption is determined when an asset first becomes an RFA with respect to a CAA. In the case of a subsequent CAA described in § 1.901(m)-6(b)(4), the application of the cumulative basis difference exemption and the RFA class exemption is based on basis difference, if any, that results from the subsequent CAA.

(2) If there is an aggregated CAA transaction, the cumulative basis difference exemption and each RFA class exemption are applied by treating all CAAs that are part of the aggregated CAA transaction as a single CAA.

(3) Basis difference is computed in accordance with § 1.901(m)-4 except that a foreign basis election need not be evidenced if either the cumulative basis difference exemption or an RFA class exemption apply to all RFAs with respect to the CAA.

(4) Basis difference is translated into U.S. dollars (if necessary) using the spot rate determined under the principles of § 1.988-1(d) on the date of the CAA.

(e) *Anti-abuse rule.* The cumulative basis difference exemption and an RFA class exemption are not available if the transferor and transferee in the CAA are related persons (as described in section 267(b) or 707(b)) and the CAA was entered into, or structured, with a principal purpose of avoiding the application of section 901(m). See also § 1.901(m)-8(c), which provides that certain built-in loss assets are not taken into account for purposes of applying this section.

(f) *Examples.* The following examples illustrate the rules of this section:

*Example 1. De minimis; cumulative basis difference exemption—(i) Facts.* USP, a domestic corporation, as part of a plan, purchases all of the stock of CFC1 and CFC2 from a single seller. CFC1 and CFC2 are section 902 corporations (as defined in section 909(d)(5)), organized in Country F, and treated as corporations for Country F tax purposes. Country F imposes a single tax that is a foreign income tax. Each acquisition is a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies. A foreign basis election is not made under § 1.901(m)-4(c). Immediately after the acquisition of the stock of CFC1 and CFC2, the assets of CFC1 and CFC2 give rise to

income that is taken into account for Country F tax purposes, and those assets are in a single class, as defined in § 1.338-6(b). At all relevant times, 1u equals \$1. All amounts are stated in millions. The additional facts are summarized below.

Relevant foreign assets	Total U.S. basis immediately before	Total U.S. basis immediately after	Total basis difference
Assets of CFC1 .....	48u	60u	12u
Assets of CFC2 .....	100u	96u	(4)u
<b>Total .....</b>	<b>148u</b>	<b>156u</b>	<b>8u</b>

(ii) *Result.* (A) Under § 1.901(m)-2(b)(1), USP's acquisitions of the stock of CFC1 and CFC2 are each a section 338 CAA. Under 1.901(m)-1(a)(3), the two section 338 CAAs constitute an aggregated CAA transaction because the acquisitions occur as part of a plan. Under § 1.901(m)-2(c)(1), the assets of CFC1 and CFC2 are RFAs for Country F tax purposes because they are relevant in determining foreign income of CFC1 and CFC 2, respectively, for Country F tax purposes. Under § 1.901(m)-1(a)(31), CFC1 is the RFA owner (U.S.) with respect to its assets, and CFC2 is the RFA owner (U.S.) with respect to its assets.

(B) Under paragraph (b)(2) of this section, the application of the cumulative basis difference exemption is based on a single CAA and a single RFA owner (U.S.), subject to the requirements under paragraph (c)(2) of this section that apply when there is an aggregated CAA transaction. In the case of the section 338 CAA with respect to CFC1, without regard to paragraph (c)(2) of this section, the requirements of the cumulative basis difference exemption are satisfied if the sum of the basis differences is less than the threshold of \$10 million, the greater of \$10 million or \$6 million (10% of the total U.S. basis of \$60 million (60 million u translated into dollars at the exchange rate of \$1 = 1u)). In this case, the sum of the basis differences is \$12 million (12 million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of \$12 million is not less than the threshold of \$10 million, the requirements of the cumulative basis difference exemption are

not satisfied. Because the requirements of the cumulative basis difference exemption are not satisfied, without regard to paragraph (c)(2) of this section, paragraph (c)(2) of this section is not applicable. Finally, the RFA class exemption is not relevant because all of the RFAs of CFC1 are in a single class. Accordingly, the basis differences with respect to all of the RFAs of CFC1 must be taken into account under section 901(m).

(C) In the case of the section 338 CAA with respect to CFC2, without regard to paragraph (c)(2) of this section, the requirements of the cumulative basis difference exemption are satisfied if the sum of the basis differences is less than the threshold of \$10 million, the greater of \$10 million or \$ 9.6 million (10% of the total U.S. basis of \$96 million (96 million u translated into dollars at the exchange rate of \$1 = 1u)). In this case, the sum of the basis differences is (\$4) million ((4) million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of (\$4) million is less than the threshold of \$10 million, the requirements of the cumulative basis difference exemption are satisfied. However, because the section 338 CAA with respect to CFC2 is part of an aggregate CAA transaction that includes the section 338 CAA with respect to CFC1, paragraph (c)(2) of this section is applicable. Under paragraph (c)(2) of this section, the requirements of the cumulative basis difference exemption must also be satisfied taking into account all of the RFAs of both CFC2 and CFC1. In this case, the requirements of the cumulative basis difference exemption for purposes of

paragraph (c)(2) of this section are satisfied if the sum of the basis differences with respect to all of the RFAs of CFC2 and CFC1 is less than the threshold of \$15.6 million, the greater of \$10 million or \$15.6 million (10% of the total U.S. basis of \$156 million (156 million u translated into dollars at the exchange rate of \$1 = 1u)) In this case, the sum of the basis differences is \$8 million (8 million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of \$8 million is less than the threshold of \$15.6 million, the requirements of the cumulative basis difference exemption are satisfied in the case of the section 338 CAA with respect to CFC2. Accordingly, none of the basis differences with respect to the RFAs of CFC2 are taken into account under section 901(m).

*Example 2. De minimis; RFA Class Exemption*—(i) *Facts.* USP, a domestic corporation, acquires all the stock of CFC, a section 902 corporation (as defined in section 909(d)(5)) organized in Country F and treated as a corporation for Country F tax purposes, in a qualified stock purchase (as defined in section 338(d)(3)) to which section 338(a) applies. Country F imposes a single tax that is a foreign income tax . A foreign basis election is not made under § 1.901(m)-4(c). Immediately after the acquisition of CFC, the assets of CFC give rise to income that is taken into account for Country F tax purposes. At all relevant times, 1u equals \$1. All amounts are stated in millions. The additional facts are summarized below.

Relevant foreign assets	Total U.S. basis immediately before	Total U.S. basis immediately after	Total basis difference
Cash (Class I) .....	10u	10u	0u
Inventory (Class IV) .....	14u	15u	1u
Buildings (Class V) .....	19u	30u	11u
<b>Total .....</b>	<b>43u</b>	<b>55u</b>	<b>12u</b>

(ii) *Result.* (A) Under § 1.901(m)-2(b)(1), USP's acquisition of the stock of CFC is a section 338 CAA. Under § 1.901(m)-2(c)(1), the assets of CFC are RFAs for Country F tax purposes because they are relevant in determining foreign income of CFC for Country F tax purposes.

(B) Under paragraph (b)(2) of this section, the requirements of the cumulative basis difference exemption are satisfied if the sum of the basis differences is less than the

threshold of \$10 million, the greater of \$10 million or \$5.5 million (10% of the total U.S. basis of \$55 million (55 million u translated into dollars at the exchange rate of \$1 = 1u)). In this case, the sum of the basis differences is \$12 million (12 million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of \$12 million is not less than the threshold of \$10 million, the requirements of the

cumulative basis difference exemption are not satisfied.

(C) Under paragraph (b)(3) of this section, each of CFC's assets is allocated to its class under § 1.338-6(b) for purposes of the RFA class exemption. The requirements of the RFA class exemption with respect to the Class IV RFAs (in this case, inventory) are satisfied if the absolute value of the sum of the basis differences with respect to the Class IV RFAs is less than the threshold of \$2

million, the greater of \$2 million or \$1.5 million (10% of the total U.S. basis of Class IV RFAs of \$15 million (15 million u translated into dollars at the exchange rate of \$1 = 1u)) In this case, the absolute value of the sum of the basis differences is \$1 million (1 million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of \$1 million is less than the threshold of \$2 million, the requirements of the RFA class exemption are satisfied. Accordingly, the basis differences with respect to the Class IV RFAs are not taken into account under section 901(m).

(D) The requirements of the RFA class exemption with respect to the Class V RFAs (in this case, buildings) is satisfied if the absolute value of the sum of the basis differences with respect to the Class V RFAs is less than the threshold of \$3 million, the greater of \$2 million or \$3 million (10% of the total U.S. basis of Class V RFAs of \$30 million (30 million u translated into dollars at the exchange rate of \$1 = 1u)). In this case, the absolute value of the sum of the basis differences is \$11 million (11 million u translated into dollars at the exchange rate of \$1 = 1 u). Because the sum of the basis differences of \$11 million is not less than the threshold of \$3 million, the requirements of the RFA class exemption are not satisfied. Accordingly, the basis differences with respect to the Class V RFAs are taken into account under section 901(m).

(E) The Class I RFAs (in this case, cash) are irrelevant because there is no basis differences with respect to those RFAs.

(g) *Effective/applicability date.* This section applies to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they

both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, §§ 1.901(m)-3 through 1.901(m)-6 (excluding § 1.901(m)-4(e)), and § 1.901(m)-8 to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

■ **Par. 10.** Section 1.901(m)-8 is added to read as follows:

**§ 1.901(m)-8 Miscellaneous.**

(a) *In general.* This section provides guidance on other matters under section 901(m). Paragraph (b) of this section provides guidance on the application of section 901(m) to pre-1987 foreign income taxes. Paragraph (c) of this section provides anti-abuse rules relating to built-in loss assets. Paragraph (d) of this section provides the effective/applicability date.

(b) *Application of section 901(m) to pre-1987 foreign income taxes.* Section 901(m) and §§ 1.901(m)-1 through -8 apply to pre-1987 foreign income taxes (as defined in § 1.902-1(a)(10)(iii)) of a section 902 corporation.

(c) *Anti-abuse rule for built-in loss RFAs.* A basis difference with respect to an RFA described in section 901(m)(3)(C)(ii) (built-in loss RFA) will not be taken into account for purposes of computing an allocated basis difference for a U.S. taxable year of a section 901(m) payor if any RFA,

including an RFA other than built-in loss RFAs, is acquired with a principal purpose of using one or more built-in loss RFAs to avoid the application of section 901(m). Furthermore, a basis difference with respect to a built-in loss RFA will not be taken into account for purposes of the cumulative basis difference exemption or the RFA class exemption under § 1.901(m)-7 if any RFAs, including RFAs other than built-in loss RFAs, are acquired with a principal purpose of avoiding the application of section 901(m).

(d) *Effective/applicability date.* This section applies to CAAs occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers may, however, rely on this section prior to the date this section is applicable provided that they both consistently apply this section, § 1.704-1(b)(4)(viii)(c)(4)(v) through (vii), § 1.901(m)-1, and §§ 1.901(m)-3 through 1.901(m)-7 (excluding § 1.901(m)-4(e)) to all CAAs occurring on or after January 1, 2011, and consistently apply § 1.901(m)-2 (excluding § 1.901(m)-2(d)) to all CAAs occurring on or after December 7, 2016. For this purpose, persons that are related (within the meaning of section 267(b) or 707(b)) will be treated as a single taxpayer.

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

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