DEPARTMENT OF THE TREASURY

Internal Revenue Service

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Guidance Under Section 367(b) Related to Certain Triangular Reorganizations and Inbound Nonrecognition Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes regulations announced and described in Notice 2014–32 and Notice 2016–73, with modifications. The proposed regulations relate to the treatment of property used to acquire parent stock or securities in connection with certain triangular reorganizations involving one or more foreign corporations; the consequences to persons that receive parent stock or securities pursuant to such reorganizations; and the treatment of certain subsequent inbound nonrecognition transactions following such reorganizations and certain other transactions. The proposed regulations affect corporations engaged in certain triangular reorganizations involving one or more foreign corporations, certain shareholders of foreign corporations acquired in such reorganizations, and foreign corporations that participate in certain inbound nonrecognition transactions.

DATES: Written or electronic comments and requests for a public hearing must be received by December 5, 2023. Requests for a public hearing must be submitted as prescribed in the ''Comments and Request for Public Hearing'' section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–117614–14) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted electronically and on paper, to its public docket. Send paper submissions to: CC:PA:LPD:PR (REG–117614–14), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brady Plastaras at (202) 317–6937; concerning submission of comments, requests for a public hearing, and access to a public hearing, Vivian Hayes at (202) 317–5306 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

On May 19, 2011, the Treasury Department and the IRS published final regulations (TD 9526) in the **Federal Register** (76 FR 28890) under section 367(b) that relate to the treatment of property used to acquire parent stock or securities in certain triangular reorganizations involving one or more foreign corporations (the Final Regulations). On April 25, 2014, the Treasury Department and the IRS issued Notice 2014–32 (2014–20 IRB 1006), which identified transactions designed to exploit certain aspects of the Final Regulations and announced that regulations would be issued under section 367 to address these transactions. On December 2, 2016, the Treasury Department and the IRS issued Notice 2016–73 (2016–52 IRB 908), which identified other transactions designed to exploit the Final Regulations, as modified by the rules announced in Notice 2014–32, and announced that additional regulations would be issued under section 367. The Treasury Department and the IRS believe that the transactions described in each notice raise significant policy concerns.

This document sets forth the regulations described in Notice 2014–32 and Notice 2016–73, modified as discussed in this preamble. In response to a request for comments in Notice 2016–73, one comment was received and is discussed in this preamble. No comments were received on Notice 2014–32.

Explanation of Provisions; Summary of Comment in Response to Notice 2016–73

I. Overview

A. Section 367—In General

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. Under section 367(a)(5), the Secretary has broad authority to exempt transactions from the application of section 367(a)(1) in order to carry out the purposes of section 367(a).

Section 367(b)(1) provides that, in the case of any exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. Section 367(b)(2) provides that the regulations prescribed pursuant to section 367(b)(1) shall include (but shall not be limited to) regulations dealing with the sale or exchange of stock or securities in a foreign corporation by a United States person, including regulations providing the circumstances under which gain is recognized currently, amounts are included in gross income as a dividend, or both; and the extent to which adjustments are made to earnings and profits, the basis of stock or securities, and the basis of assets.

B. Policies of Section 367(b)

Section 367(b) was enacted to help ensure that international tax considerations are adequately addressed when the provisions in chapter 1, subchapter C, of subtitle A of the Internal Revenue Code (the Code) apply to an exchange involving a foreign corporation. Thus, the regulations under section 367(b) require that adjustments or inclusions be made to prevent the material distortions of income that can occur when the subchapter C provisions apply to an exchange involving a foreign corporation.

The legislative history to section 367(b) describes Congress's particular concern with the need ''to protect against tax avoidance . . . upon the repatriation of previously untaxed foreign earnings'' and its intent to grant the Treasury Department broad authority to promulgate regulations to prevent the avoidance of Federal income taxes. H.R. Rep. No. 94–658, at 241 (1975). Moreover, Congress specifically identified ''transfers constituting a repatriation of foreign earnings'' as a type of transfer to be covered by such regulations. *Id.* at 245. The Final Regulations were promulgated in part to address these concerns. More specifically, one of the purposes of the Final Regulations is to require adjustments to address the avoidance of U.S. tax, including the repatriation of foreign earnings without

being subject to U.S. tax, through the separation of earnings and profits of a corporation from property distributed by such corporation in connection with certain triangular reorganizations.

C. Effect of the Tax Cuts and Jobs Act

In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA) (Pub. L. 115–97), which added and amended a number of international tax provisions. One effect of these new provisions, and in particular sections 951A and 965, was to increase the amount of foreign earnings or income subject to immediate U.S. taxation. Section 965 imposed a one-time transition tax on certain earnings and profits of foreign corporations, and section 951A subjects certain income of a controlled foreign corporation (CFC) (as defined in section 957(a)) to current U.S. taxation in the hands of the CFC's United States shareholders (as defined in section 951(b)). The TCJA also generally retained the existing anti-deferral rules in subpart F of the Code (sections 951 through 965, as amended), under which, for example, a CFC's passive income, subject to certain exceptions, is similarly subject to current U.S. taxation. The combined effect of sections 951, 951A, and 965 is that an increased amount of foreign earnings and profits will have been subject to U.S. tax regardless of whether the earnings and profits are in fact repatriated. Under section 959, such previously taxed earnings and profits (PTEP) are not again subject to U.S. tax upon their repatriation.

The TCJA also added section 245A to the Code, under which certain United States shareholders of a specified 10-percent owned foreign corporation (SFC) (as defined in section 245A(b)(1)) generally are entitled to a 100-percent dividends received deduction with respect to dividends received from the SFC. As a result of the TCJA, an increased amount of earnings and profits of foreign corporations are thus not taxable when distributed—either because the earnings and profits constitute PTEP or give rise to dividends (including deemed dividends under section 367(b)) that are eligible for the section 245A dividends received deduction.

Although as a result of the TCJA a lesser amount of earnings and profits of foreign corporations may give rise to taxable dividends when distributed, the Final Regulations remain necessary to carry out the policies of section 367(b). The adjustments required by the Final Regulations are intended to ensure that property transfers that are in substance distributions are treated as such, and thus give rise to income, capital gain, or a reduction in basis under section 301(c). Furthermore, incentives to avoid treating property transfers as distributions remain. For example, a taxpayer may seek to avoid distribution treatment because the distribution would not qualify for the section 245A dividends received deduction due to the application of the hybrid dividend rules under section 245A(e) or the extraordinary disposition rules under § 1.245A–5, or because the taxpayer seeks to, for example, preserve PTEP or other earnings and profits to cover a future distribution.

D. The Final Regulations

The Final Regulations apply to certain triangular reorganizations in which a subsidiary (S) purchases, in connection with the reorganization, stock or securities of its parent corporation (P) in exchange for property and exchanges the stock or securities of P for the stock or property of a target corporation (T), but only if P or S (or both) is a foreign corporation. The Final Regulations and this preamble refer to such exchange of stock or securities of P for property as the ''P acquisition.'' This preamble also refers to the P acquisition together with the related triangular reorganization as an ''applicable triangular reorganization.''

When applicable, the Final Regulations require that adjustments be made that have the effect of a distribution of property from S to P under section 301 (deemed distribution), followed by a contribution from P to S of an amount equal to the deemed distribution (deemed contribution). The amount of the deemed distribution is the sum of the amount of money transferred by S, the amount of any liabilities that are assumed by S and constitute property, and the fair market value of other property that S transferred to P in the P acquisition. The deemed distribution is treated as a dividend to the extent of S's earnings and profits.

There are several exceptions to the application of the Final Regulations. Under § 1.367(b)–10(a)(2)(iii) (the section 367(a) priority rule), the Final Regulations do not apply to transactions otherwise described in the Final Regulations if the amount of gain that T's shareholders would recognize under section 367(a)(1) is at least equal to the sum of the amount of the deemed distribution that P would treat as a dividend under section 301(c)(1) and the amount of the deemed distribution that P would treat as gain under section 301(c)(3) were the Final Regulations to apply. This preamble refers to the hypothetical amount of gain recognized under section 367(a)(1) and the hypothetical amount of the deemed distribution treated either as dividend or gain under section 301(c) as ''section 367(a) income'' and ''section 367(b) income,'' respectively. Section 1.367(a)–3(a)(2)(iv) provides a similar priority rule (the section 367(b) priority rule) that turns off the application of section 367(a)(1) with respect to transactions described in the Final Regulations if the amount of section 367(a) income that T's shareholders would otherwise recognize under section 367(a)(1) (without regard to any exceptions thereto) is less than the amount of section 367(b) income that would result from the deemed distribution. In this way, the priority rules subject an applicable triangular reorganization to whichever section 367 regime would give rise to the most income under section 367.

Section 1.367(b)–10(a)(2)(ii) provides another exception to the application of the Final Regulations. Under this exception, the Final Regulations generally do not apply if S is a domestic corporation and P would not be subject to U.S. tax on a dividend received from S. This preamble refers to this exception as the ''no-U.S.-tax exception.''

The Final Regulations also contain a broad anti-abuse rule under which appropriate adjustments are made if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of the Final Regulations. *See* § 1.367(b)–10(d). The anti-abuse rule contains an example illustrating that the earnings and profits of S may, under certain circumstances, be deemed to include the earnings and profits of a corporation related to P or S for purposes of determining the consequences of the adjustments provided for in the Final Regulations.

E. Notice 2014–32

Notice 2014–32 identified transactions designed to exploit certain aspects of the Final Regulations. In particular, Notice 2014–32 described transactions in which taxpayers applied the section 367(a) and (b) priority rules and no-U.S.-tax exception in a manner that, contrary to their intended operation, resulted in the taxpayer being subject to the more favorable of the section 367(a) or (b) regimes. Notice 2014–32 accordingly announced that regulations would be issued under section 367(b) to (i) modify the priority rules such that only section 367(b) income that would actually be subject to U.S. tax would be considered and (ii) narrow the scope of the no-U.S.-tax exception. Notice 2014–32 further

announced that regulations would be issued to remove the deemed contribution rule in § 1.367(b)–10(b)(2) and clarify the broad application of the anti-abuse rule in § 1.367(b)–10(d).

F. Notice 2016–73

Notice 2016–73 identified additional transactions designed to exploit the Final Regulations, as modified by the rules announced in Notice 2014–32. The transactions identified in Notice 2016–73 include, as one example, a two-step transaction where an applicable triangular reorganization is followed by a purportedly unrelated inbound nonrecognition transaction to which § 1.367(b)–3 applies.

In that example, USP, a domestic corporation, owns all of the stock of FP, and FP owns all of the stock of FS. Both FP and FS are foreign corporations. USP also owns all of the stock of USS, a domestic corporation, and USS owns all of the stock of FT, a foreign corporation. In step one of the example transaction, FP, FS, and FT engage in an applicable triangular reorganization that is designed to result in no section 367(b) income and only a de minimis amount of section 367(a) income. Specifically, FS acquires newly issued stock of FP for property and transfers the stock of FP to USS in exchange for all the stock of FT in a triangular reorganization described in section 368(a)(1)(B). In addition, USS files a gain recognition agreement with respect to its transfer of the stock of FT. The taxpayer takes the position that the section 367(a) priority rule applies to turn off the Final Regulations with respect to the applicable triangular reorganization and therefore does not treat FP as having received a deemed distribution. Under this position, the effect of this first step of the transaction is a transfer of property from FS to FP without a distribution that would result in a corresponding decrease in the earnings and profits of FS and increase in the earnings and profits of FP associated with that property.

In step two of the example transaction, on a later date FP transfers its assets (including the cash, note, or other property received from FS) to USP or a domestic corporation whose stock is owned directly or indirectly by USP in a nonrecognition transaction described in § 1.367(b)–3. The taxpayer asserts that USP accordingly includes in its income a deemed dividend of the ''all earnings and profits amount'' (as described in § 1.367(b)–2(d)) with respect to its stock in FP, but, because that amount does not take into account the earnings and profits of lower-tier foreign corporations, the deemed dividend does not include the earnings and profits associated with the property that FP received from FS in the P acquisition (because such earnings and profits remain at FS under the position taken by the taxpayer). The desired effect of the overall transaction is a repatriation of property from FS to USP (or a domestic corporation held by USP) without a corresponding income inclusion attributable to untaxed earnings and profits of FS.

Notice 2016–73 announced that additional regulations would be issued under section 367(b) to address transactions such as these types of two-step transactions. To address step one of the transaction, the regulations would, in addition to the modifications described in Notice 2014–32, prevent the section 367(a) priority rule from applying where T is foreign and instead subject certain T shareholders to rules under § 1.367(b)–4 that could result in an income inclusion or gain recognition with respect to their exchange of T stock. To address step two of the transaction, the regulations would subject any inbound nonrecognition transaction to a new set of ''excess asset basis'' (EAB) rules to be issued under § 1.367(b)–3 that, for purposes of determining the all earnings and profits amount, would take into account certain earnings and profits of lower-tier foreign corporations. Step two of the transaction was subject to the EAB rules because a taxpayer may have completed an applicable triangular reorganization described in step one (but not yet an inbound nonrecognition transaction described in step two) before the issuance of Notice 2016–73. Such partially completed transactions would go unaddressed if the regulations were limited to modifying the section 367(a) priority rule. Notice 2016–73 further announced that the EAB rules would apply to any inbound nonrecognition transaction, regardless of whether the taxpayer had previously engaged in an applicable triangular reorganization, out of concern that transactions other than applicable triangular reorganizations might also position taxpayers to achieve an improper repatriation of property through a subsequent inbound nonrecognition transaction.

Notice 2016–73 also described a variation of the foregoing two-step transaction where the P acquisition is between FP and USP. In this variation of the transaction, FP (which has no earnings and profits) acquires stock of USP in exchange for nonqualified preferred stock of FP, and FP uses the stock of USP to acquire the stock of FT in an applicable triangular reorganization. After the applicable triangular reorganization, the taxpayer causes FP to redeem its nonqualified preferred stock from USP in exchange for cash or a note. The taxpayer takes the position that (i) the Final Regulations do not apply to FP's transfer of nonqualified preferred stock to USP because nonqualified preferred stock is not ''property'' under the Final Regulations, and (ii) FP's redemption of the nonqualified preferred stock does not cause USP to have an income inclusion because FP has no earnings and profits. The desired effect of this variation is similarly a repatriation of property from FP to USP at no U.S. tax cost.

To address this type of transaction, Notice 2016–73 announced that future regulations would modify the definition of property in § 1.367(b)–10(a)(3)(ii) to include stock of S that is nonqualified preferred stock (as defined in section 351(g)(2)).

II. Rules Applicable to Inbound Nonrecognition Transactions

A. § 1.367(b)–3 and Notice 2016–73

Section 1.367(b)–3 generally applies to an acquisition by a domestic corporation (the domestic acquiring corporation) of the assets of a foreign corporation (the foreign acquired corporation) in a liquidation described in section 332 or an asset acquisition described in section 368(a)(1) (in each case, an inbound nonrecognition transaction). Upon an inbound nonrecognition transaction, § 1.367(b)–3 requires certain shareholders of the foreign acquired corporation to include in income as a deemed dividend the all earnings and profits amount with respect to their stock in the foreign acquired corporation.[1] Under § 1.367(b)–2(d), that amount is generally determined under the principles of section 1248 when computing the amount of earnings and profits attributable to stock, subject to certain adjustments. For example, the all earnings and profits amount does not take into account earnings and profits of subsidiaries of the foreign acquired corporation notwithstanding section 1248(c)(2). *See* § 1.367(b)–2(d)(3)(ii).

Section 1.367(b)–3 is intended to ensure the appropriate carryover of tax attributes from the foreign acquired corporation to the domestic acquiring corporation. The preamble to proposed regulations issued in 1991 describes the section 367(b) principles relevant to inbound nonrecognition transactions and specifically identifies the

[1] Certain other shareholders of the foreign acquired corporation may be required to recognize realized gain with respect to their exchanged stock. *See* § 1.367(b)–3(c)(2).

prevention of ''the repatriation of earnings and profits without tax'' as one such principle. 56 FR 41993, 41996. The 1991 proposed regulations accordingly introduced the concept of including in income the all earnings and profits amount, which was intended to reflect ''the proper measure of the earnings and profits [of the foreign acquired corporation] that should be subject to tax.'' *Id.* The preamble to final regulations issued in 2000 further explained that the inclusion of the all earnings and profit amount ''generally ensures that the section 381 carryover basis reflects an after-tax amount'' and describes ''the appropriate carryover of attributes from foreign to domestic corporations'' as ''the principal policy consideration of section 367(b) with respect to inbound nonrecognition transactions.'' TD 8862, 65 FR 3589, 3590. Section 1.367(b)–3 therefore ensures that when asset basis is repatriated the basis either reflects after-tax earnings and profits or is accompanied by an income inclusion attributable to the untaxed earnings and profits that gave rise to that basis.

As illustrated in Notice 2016–73 and summarized above in Part I.F of the Explanation of Provisions section of this preamble, there are some circumstances where the earnings and profits of the foreign acquired corporation do not accurately reflect the basis in its assets. In particular, the earnings and profits of the foreign acquired corporation may be insufficient to the extent that earnings and profits that gave rise to the foreign acquired corporation's asset basis reside in lower-tier foreign corporations as a result of an applicable triangular reorganization that does not give rise to a deemed distribution. Because the all earnings and profits amount does not account for the earnings and profits of lower-tier foreign corporations, a deemed dividend of the all earnings and profits amount will not have the intended effect of ensuring the appropriate carryover of asset basis in such cases.

To address this concern, Notice 2016–73 announced that § 1.367(b)–3 would be modified to require certain shareholders of the foreign acquired corporation to adjust their all earnings and profits amount upon an inbound nonrecognition transaction. Specifically, an exchanging shareholder that exchanges stock in a foreign acquired corporation with respect to which there is EAB would increase its all earnings and profits amount by certain earnings and profits of lower-tier foreign corporations, referred to in Notice 2016–73 as ''specified earnings.'' Notice 2016–73 defined EAB as the amount by which the inside asset basis of the foreign acquired corporation exceeded the sum of its earnings and profits, its outside stock basis, and its liabilities assumed by the domestic acquiring corporation. The EAB concept is in furtherance of a balanced tax-basis balance sheet. In other words, the EAB concept recognizes that the tax basis in a corporation's assets generally is derived from these three sources, with outside stock basis serving as a proxy for contributed capital. While basis derived from contributed capital reflects after-tax amounts (or, in the case of liabilities assumed by the domestic acquiring corporation, is expected to be satisfied by after-tax amounts of the domestic acquiring corporation), basis derived from a foreign corporation's untaxed earnings and profits might not be subject to U.S. tax until those earnings are repatriated. For this reason, a foreign corporation's untaxed earnings and profits are subject to tax via a deemed dividend of the all earnings and profits amount. This deemed dividend inclusion in effect requires that the exchanging shareholder ''pay for'' the tax basis in repatriated assets before that basis is used within the U.S. tax system.

Specified earnings are defined in Notice 2016–73 as the least of the following amounts: (i) the aggregate earnings and profits of foreign subsidiaries of the foreign acquired corporation attributable to the exchanging shareholder, (ii) the amount of the foreign acquired corporation's EAB attributable to the exchanging shareholder, and (iii) the exchanging shareholder's built-in gain in the stock of the foreign acquired corporation. The addition of specified earnings to the all earnings and profits amount is thereby intended to correct the basis imbalance of the foreign acquired corporation by taking into account certain earnings and profits residing in foreign subsidiaries that are presumed to have given rise to the EAB. Thus, the all earnings and profits amount, after taking into account specified earnings, should more accurately reflect the asset basis of the foreign acquired corporation that is repatriated pursuant to the inbound nonrecognition transaction.

The proposed regulations generally would adopt the rules described in Notice 2016–73, modified as discussed in the remainder of this preamble. This preamble uses the term ''EAB rules'' to refer collectively to the modifications that are proposed to be made to § 1.367(b)–3.

B. General Scope of the EAB Rules

As described in Notice 2016–73, the EAB rules would apply to any inbound nonrecognition transaction regardless of whether the taxpayer had previously engaged in an applicable triangular reorganization. This scope reflected the possibility that EAB policy concerns could arise as a result of other transactions and that taxpayers may attempt to achieve similar results through such other transactions.

The comment recommended that the EAB rules be applied to a narrower set of transactions, citing, among other reasons, the significant compliance burden that would otherwise be imposed on legitimate business transactions. The comment thus recommended that the EAB rules be applied only to taxpayers that had completed an applicable triangular reorganization before the issuance of Notice 2016–73 that involved a foreign target corporation; did not make adjustments that have the effect of a distribution of property from S to P; and engage in a future inbound nonrecognition transaction. If narrowed in this way, the comment further suggested that the EAB rules apply on only a transitional basis; for example, for the 10-year period following Notice 2016–73. The comment asserted that a broader application of the EAB rules would be unnecessary in light of Notice 2016–73's proposed modification to the section 367(a) priority rule, which, by requiring adjustments for a deemed distribution whenever the target is a foreign corporation, should prevent taxpayers from separating basis from earnings and profits in future transactions. As an alternative, the comment suggested that the EAB rules be applied only to inbound nonrecognition transactions that follow an applicable triangular reorganization or other specifically enumerated transactions.

The Treasury Department and the IRS agree that it would be appropriate to narrow the scope of the EAB rules for the reasons noted in the comment. In general, the proposed regulations accordingly would limit the application of the EAB rules to those inbound nonrecognition transactions where (i) S previously acquired stock or securities of P in exchange for property in connection with a triangular reorganization and (ii) adjustments were not made that have the effect of a distribution of property from S to P under section 301. *See* proposed § 1.367(b)–3(g)(1)(i). However, to address avoidance situations that would have been subject to the EAB rules under the broad scope announced in Notice 2016–73 (which did not predicate the application of the EAB rules on there having been an applicable

triangular reorganization), the proposed regulations would also provide that the EAB rules apply to inbound nonrecognition transactions where EAB was previously created in connection with a transaction other than a triangular reorganization if the principal purpose of such other transaction was to create EAB. *See* proposed § 1.367(b)–3(g)(1)(ii). This more limited application of the EAB rules is anticipated to relieve taxpayers from the need to comply with the EAB rules with respect to non-tax motivated transactions while still addressing the policy concerns identified in Notice 2016–73.

The proposed regulations would not adopt the comment's suggestion to apply the EAB rules only to situations where an applicable triangular reorganization involving a foreign target was completed before the issuance of Notice 2016–73. The Treasury Department and the IRS are concerned that such a limitation would prevent the application of the EAB rules to future transactions designed to create EAB. For example, a subsequent applicable triangular reorganization could give rise to EAB where the target corporation is domestic because the section 367(a) priority rule continues to apply in that context. EAB could thus arise if the section 367(a) priority rule applies to prevent the application of the Final Regulations and P and S are both foreign corporations. An ongoing application of the EAB rules is also necessary to address the case where the target is a foreign corporation but the taxpayer asserts that its transaction is not subject to § 1.367(b)–10 under a novel or unforeseen theory. For this reason, the proposed regulations also would not condition the applicability of the EAB rules on the taxpayer having participated in an applicable triangular reorganization. The proposed regulations instead would provide that the EAB rules may apply to EAB created by any triangular reorganization (provided that the other conditions described in the preceding paragraph are met—that is, S acquired stock or securities of P for property in connection with the reorganization, and adjustments were not made that have the effect of a distribution of property from S to P under section 301) and to EAB created in other transactions that have a principal purpose of creating EAB. *See* proposed § 1.367(b)–3(g)(1).

C. EAB Reduction Rule

Under Notice 2016–73, all EAB with respect to a foreign acquired corporation is taken into account upon an inbound nonrecognition transaction, regardless of how the EAB arose. However, if the taxpayer could demonstrate that EAB was not attributable to property provided by a foreign subsidiary, then EAB is reduced to the extent of such EAB (the EAB reduction rule).

The comment asserted that the EAB reduction rule amounted to a presumption that all EAB originated from the earnings and profits of foreign subsidiaries. The comment stated that overcoming this presumption would place a significant burden on taxpayers because it would require a comprehensive review of the foreign acquired corporation's historic transactions to determine the extent to which EAB should be reduced. The comment therefore recommended that the EAB rules be revised such that taxpayers be permitted to take into account only the EAB created by an applicable triangular reorganization (or any other specifically identified transaction).

The Treasury Department and the IRS expect that the more limited scope of the EAB rules set forth in the proposed regulations would address the concern reflected in the comment. As proposed in these regulations and discussed in Part II.B of the Explanation of Provisions section of this preamble, the EAB rules would apply only to those inbound nonrecognition transactions that follow certain triangular reorganizations (or other transactions having a principal purpose of creating EAB) as opposed to any inbound nonrecognition transaction. This narrower scope would substantially reduce the burden of complying with the proposed EAB rules by eliminating the need for many taxpayers to determine whether EAB exists with respect to a foreign acquired corporation.

This narrowed scope also would obviate the rationale for the EAB reduction rule, which was intended to provide relief where a taxpayer could demonstrate that EAB was not attributable to an avoidance transaction. Such a relief measure would not be appropriate under the proposed regulations, however, because the proposed regulations would apply only to tax-motivated transactions. The EAB reduction rule would therefore be removed with respect to transactions completed after the issuance of the proposed regulations. *But see* the EAB reduction rule in proposed § 1.367(b)–3(g)(7)(ii)(C) for certain transactions completed before the issuance of the proposed regulations. The proposed regulations accordingly would provide that a taxpayer subject to the EAB rules by reason of having engaged in a triangular reorganization must take into account all EAB with respect to the foreign acquired corporation, regardless of how that EAB arose and without the ability to reduce EAB to the extent it is not attributable, directly or indirectly, to property provided by a foreign subsidiary of the foreign acquired corporation.

D. Treatment of Unrelated Minority Shareholders

As discussed in Part II.A of the Explanation of Provisions section of this preamble, one element of the EAB computation is the amount of aggregate outside basis in the stock of the foreign acquired corporation. An exchanging shareholder that would be subject to the EAB rules would thus potentially need to identify the outside bases of other, unrelated shareholders of the foreign acquired corporation to calculate the amounts of EAB and specified earnings. The comment asserted that it may not be possible for an exchanging shareholder to obtain this information and accordingly suggested that the outside bases of such unrelated minority shareholders be disregarded (along with any related share of inside basis, liabilities, and earnings and profits) when calculating EAB and specified earnings.

The Treasury Department and the IRS recognize that the presence of unrelated minority shareholders may create some uncertainty but expect that narrowing the application of the EAB rules to only a limited set of inbound nonrecognition transactions would appropriately address the concern reflected in the comment. The transactions of which the Treasury Department and the IRS are aware, and which the proposed regulations are generally intended to address, are typically internal restructurings that by their nature are unlikely to involve unrelated shareholders. *See* Notice 2016–73, Section 3. Moreover, modifying the EAB rules as the comment suggests would require additional rules to specify how an exchanging shareholder would disregard unrelated minority shareholders, thereby adding complexity to the EAB calculations to accommodate an unlikely fact pattern. Therefore, the proposed regulations would not adopt this suggestion.

E. Computation of Specified Earnings

As discussed in Part II.A of the Explanation of Provisions section of this preamble, the rules described in Notice 2016–73 seek to correct the basis imbalance of the foreign acquired corporation by increasing an exchanging shareholder's all earnings and profits amount by the amount of ''specified

earnings.'' Specified earnings are limited, in part, to the sum of the earnings and profits with respect to each foreign subsidiary of the foreign acquired corporation that are attributable under section 1248(c)(2) to the stock of the foreign acquired corporation that is exchanged pursuant to the inbound nonrecognition transaction. Accordingly, specified earnings under the notice are not sourced from PTEP of foreign subsidiaries of the foreign acquired corporation because PTEP is not included in earnings and profits for purposes of section 1248. *See* section 1248(d)(1). In other words, the rules described in Notice 2016–73 would not allow the foreign acquired corporation's basis imbalance to be corrected by a deemed distribution of lower-tier PTEP, even though a taxpayer may have created EAB by separating asset basis from earnings and profits that are characterized as PTEP.

In light of the TCJA, which increased the prevalence of PTEP, the Treasury Department and the IRS are of the view that the policies of the EAB rules are better served if, instead of adjusting an exchanging shareholder's all earnings and profits amount as described in Notice 2016–73, the foreign acquired corporation is treated as receiving a deemed distribution under section 301 from its foreign subsidiaries, and the exchanging shareholder then accounts for the effects of the deemed distribution in the inbound nonrecognition transaction. Such a deemed distribution more accurately addresses the basis imbalance of the foreign acquired corporation because the deemed distribution may be sourced from both PTEP and non-PTEP earnings and profits, reflecting that the basis imbalance may be associated with either type of earnings and profits. A deemed distribution from a foreign subsidiary to the foreign acquired corporation is also more likely to align the EAB rules with the substance of the taxpayer's transaction because EAB generally arises where a taxpayer fails to treat a property transfer as a distribution under section 301. Furthermore, taking into account the effects of a section 301 distribution is consistent with the Final Regulations, which address applicable triangular reorganizations by taking into account the effects of a deemed distribution under section 301 from S to P.

The proposed regulations accordingly would modify the EAB rules by providing that an exchanging shareholder of the foreign acquired corporation computes its all earnings and profits amount after accounting for the effects of a deemed distribution from the foreign subsidiaries of the foreign acquired corporation to the foreign acquired corporation. *See* proposed § 1.367(b)–3(g)(1). The deemed distribution, which occurs immediately before the inbound nonrecognition transaction, would be equal to the amount of ''specified earnings.'' The term specified earnings would be defined under the proposed regulations as the lesser of (i) the aggregate earnings and profits of foreign subsidiaries of the foreign acquired corporation (with no exclusion for those earnings and profits characterized as PTEP) (collectively, lower-tier earnings), and (ii) the EAB of the foreign acquired corporation. *See* proposed § 1.367(b)–2(g)(2)(vii). The limitations on specified earnings described in Notice 2016–73 and Part II.A of the Explanation of Provisions section of this preamble (other than the EAB limitation, which is retained with modification) are removed because those limitations, which were designed in part to approximate a reasonable allocation of EAB among the shareholders of the foreign acquired corporation, are not necessary where the foreign acquired corporation's basis imbalance is addressed by a deemed distribution. Thus, for example, the definition of specified earnings in the proposed regulations would not be limited to the earnings and profits of each foreign subsidiary attributable under section 1248(c)(2) to the stock of the foreign acquired corporation exchanged, but instead would include all of the earnings and profits of lower-tier foreign subsidiaries (and therefore does not exclude PTEP). The proposed regulations would adopt this approach because under the deemed distribution model all such earnings and profits would be available to increase the earnings and profits of the foreign acquired corporation if actually distributed to it through the chain of ownership.

Where specified earnings are drawn from multiple foreign subsidiaries, specified earnings would be drawn from all foreign subsidiaries on a pro rata basis (in proportion to each foreign subsidiary's share of aggregate earnings and profits of the foreign subsidiaries). *See* proposed § 1.367(b)–3(g)(3). In addition, and consistent with § 1.367(b)–2(e)(2), specified earnings drawn from foreign subsidiaries would be treated as being distributed to the foreign acquired corporation through all tiers of intermediate owners, rather than directly to the foreign acquired corporation. *See* proposed § 1.367(b)–3(g)(1).

The Treasury Department and the IRS are aware that limiting the amount of the deemed distribution by the amount of lower-tier earnings would preclude the deemed distribution from giving rise to a return of basis under section 301(c)(2) or gain recognition under section 301(c)(3) and in that respect would differ from the deemed distribution described in the Final Regulations. *See* § 1.367(b)–10(b). The approach taken in the proposed regulations reflects administrability concerns that could arise from adopting a more complete distribution model which could require, for example, rules to allocate the appropriate amount of basis recovery and section 301(c)(3) gain among tiers of foreign subsidiaries. That additional complexity may not be justified when balanced against the limited application of the EAB rules, which apply only where a taxpayer has previously engaged in a transaction described in proposed § 1.367(b)–3(g)(1). The Treasury Department and the IRS continue to study transactions that could give rise to EAB, including whether EAB principles should be applied to other types of inbound nonrecognition transactions.

F. Definition of Foreign Subsidiary

Notice 2016–73 used, but did not define, the term ''foreign subsidiary'' when referring to entities held by the foreign acquired corporation for purposes of computing specified earnings and making adjustments to EAB. The proposed regulations similarly use the term ''foreign subsidiary'' for purposes of the EAB rules and would define the term based, in part, on the ownership rules in section 1248(c)(2)(B). *See* proposed § 1.367(b)–3(g)(2)(ii).

G. EAB Anti-Abuse Rule and Prohibition Against Affirmative Use

Notice 2016–73 announced that an anti-abuse rule would address transactions engaged in with a view to avoid the purposes of the EAB rules. As described in Notice 2016–73, the anti-abuse rule would provide for adjustments, including disregarding the effects of transactions, to carry out the purposes of the EAB rules. As one example, the anti-abuse rule stated that a transaction engaged in with a view to reduce EAB would be disregarded for purposes of computing EAB.

The comment requested that the Treasury Department and the IRS clarify the scope of the anti-abuse rule and purpose of the EAB rules. While the comment acknowledged that § 1.367(b)–3 is intended to ensure that a domestic acquiring corporation does not succeed

to the asset basis of the foreign acquired corporation unless the earnings and profits associated with such basis have been subject to U.S. tax, the comment asserted that it was unclear if certain transactions that would reduce EAB would violate this purpose. The comment provided several examples of such transactions, including a section 332 liquidation of a foreign subsidiary into the foreign acquired corporation. The comment explained that, if the liquidated subsidiary has high outside basis in its stock but low inside basis in its assets, then the liquidation would reduce the foreign acquired corporation's EAB because the subsidiary's high outside stock basis would be eliminated and replaced with its low inside asset basis.

The Treasury Department and the IRS are of the view that the more limited scope of the EAB rules set forth in the proposed regulations would largely mitigate the concern reflected in the comment, because under the proposed regulations, the EAB rules would apply only where a taxpayer has created EAB in an earlier tax-motivated transaction, thereby significantly narrowing the context in which the anti-abuse rule may apply. With respect to the limited cases that would be subject to the EAB rules, the Treasury Department and the IRS continue to see a need to prevent transactions engaged in with a view to reducing EAB, which could lead to results inconsistent with the purposes articulated in Notice 2016–73 and in Part II.A of the Explanation of Provisions section of this preamble; that is, ensuring the appropriate carryover of tax attributes from the foreign acquired corporation to the domestic acquiring corporation.

The Treasury Department and the IRS are also aware of transactions that may attempt to affirmatively apply the EAB rules to avoid Federal income tax. The proposed regulations accordingly would provide that a taxpayer may not apply the EAB rules to a transaction if the taxpayer created EAB with a principal purpose of avoiding any tax imposed under the Code. *See* proposed § 1.367(b)–3(g)(5).

H. Notice Reporting

Section 1.367(b)–1(c) requires that certain participants to a ''section 367(b) exchange'' (as defined in § 1.367(b)–1(a)) disclose information concerning such exchange on a statement attached to a timely filed Federal tax return or Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations), as applicable, in the taxable year in which income is realized in the exchange (such statement, the section 367(b) notice). To enhance compliance and administration with respect to the EAB rules, the proposed regulations would require that the section 367(b) notice include certain information related to EAB, including how it arose and how the amount was determined. *See* proposed § 1.367(b)–1(c)(4)(ix). The proposed regulations also would extend the section 367(b) notice requirement to participants in transactions that implicate § 1.367(b)–10, as discussed in Part III.E of the Explanation of Provisions section of this preamble.

I. Exchange Gain or Loss With Respect to PTEP

In general, § 1.367(b)–2(j)(2)(ii) provides that, if an exchanging shareholder that is a foreign corporation includes in income a deemed dividend of either the all earnings and profits amount under § 1.367(b)–3 or the section 1248 amount under § 1.367(b)–4, the exchanging shareholder is treated as receiving a deemed distribution of PTEP from the appropriate foreign corporation (deemed PTEP distribution). However, if the exchanging shareholder that has an income inclusion is a United States person, the exchanging shareholder is treated as receiving the deemed PTEP distribution solely for the purpose of computing exchange gain or loss under section 986(c). *See* § 1.367(b)–2(j)(2)(i). Because the deemed PTEP distribution is created where there is an income inclusion, however, a taxpayer might assert that no exchange gain or loss is recognized under § 1.367(b)–2(j)(2)(i) where the all earnings and profits amount or section 1248 amount is zero, even though the exchange gain or loss would have been recognized had all the earnings and profits or the section 1248 amount been a positive number. The proposed regulations therefore would clarify that there is a deemed PTEP distribution under § 1.367(b)–2(j)(2)(i) regardless of whether the all earnings and profits amount or the section 1248 amount is greater than zero. A similar change would be made to § 1.367(b)–2(j)(2)(ii).

The Treasury Department and the IRS are studying more broadly the treatment of section 986(c) amounts and PTEP in transactions subject to section 367(b) and request comments on the application of § 1.367(b)–2(j)(2) more generally.

J. Calculation of Net Investment Income Under Section 1411

The Treasury Department and the IRS are also concerned that in certain exchanges subject to section 367(b), earnings and profits that are characterized as PTEP might not be taken into account for purposes of calculating net investment income (NII) under section 1411. In cases where an exchanging shareholder does not make the election described in § 1.1411–10(g), a distribution that would otherwise constitute a distribution of PTEP under section 959(a)—and thus would not be treated as a dividend for purposes of chapter 1 of the Code under section 959(d)—generally is treated as a dividend for purposes of calculating NII. *See* § 1.1411–10(c)(1)(i)(A)(*1*). This rule seeks to preserve the NII tax base, as amounts that are characterized as PTEP will not also have been previously taxed under section 1411 (absent the election in § 1.1411–10(g)) and so should be included in NII.

The NII tax base may not be fully preserved, however, in certain exchanges subject to section 367(b). For example, an inbound asset reorganization subject to § 1.367(b)–3 will eliminate earnings and profits that are characterized as PTEP without creating a deemed distribution of those earnings, because PTEP is excluded from the all earnings and profits amount. *See* § 1.367(b)–2(d)(2)(ii). An exchanging shareholder would thus never recognize a dividend of those earnings for purposes of calculating NII; further, gain that the exchanging shareholder may recognize on a subsequent sale of stock of the domestic acquiring corporation may be netted against certain losses (as NII includes net gains, but gross income from dividends). Certain foreign-to-foreign transactions described in § 1.367(b)–4, or section 355 distributions described in § 1.367(b)–5, could similarly fail to preserve the NII tax base because PTEP is also excluded from the section 1248 amount. *See* § 1.367(b)–2(c)(1). For example, while an exchanging shareholder's annual PTEP accounts would not be eliminated as a result of a foreign-to-foreign transaction that results in a loss of section 1248 shareholder or CFC status, an exchanging shareholder could nevertheless distort the character of its NII by selling its stock in the foreign acquiror before its PTEP is distributed. The proposed regulations therefore would modify § 1.1411–10(c)(3) such that (with respect to stock of a foreign corporation for which an election under § 1.1411–10(g) is not in effect) the all earnings and profits amount and the section 1248 amount include PTEP for purposes of section 1411, consistent with how section 1248 is applied in this context. *See* proposed § 1.1411–10(c)(3)(ii). The proposed regulations

also would provide for conforming basis adjustments for purposes of section 1411. *See* proposed § 1.1411–10(d)(5).[2]

III. Rules Applicable to Triangular Reorganizations

A. Priority Rules

As discussed in Notice 2016–73 and summarized in Part I.F of the Explanation of Provisions section of this preamble, the Treasury Department and the IRS are aware of transactions that are designed to repatriate basis without a corresponding repatriation of the earnings and profits associated with that basis. As part of these transactions, the taxpayer exploits the section 367(a) priority rule by filing a gain recognition agreement with respect to all, or all but a de minimis amount, of the foreign target corporation stock exchanged in the applicable triangular reorganization. The taxpayer accordingly recognizes no, or a de minimis amount of, section 367(a) income with respect to the target stock. Because the taxpayer also takes the position that a deemed distribution would not result in any section 367(b) income, the taxpayer applies the section 367(a) priority rule to prevent the application of the Final Regulations. The taxpayer also takes the position that the anti-abuse rule would not apply to cause this transaction to be subject to § 1.367(b)–10 and therefore does not make adjustments that have the effect of a distribution of property from S to P, with the result that S would have transferred property to P without a corresponding transfer of the earnings and profits associated with that property.

Notice 2016–73 announced that future regulations would modify the section 367(a) priority rule such that it would not apply to an applicable triangular reorganization involving a foreign target corporation. Any such applicable triangular reorganization would thus be subject to the Final Regulations with the result that adjustments would be made that have the effect of a distribution of property from S to P under section 301. A similar modification was announced with respect to the section 367(b) priority rule.

The comment supported the proposed modification to the section 367(a) priority rule. As an alternative, the comment suggested that the existing formulation of the section 367(a) priority rule (that is, without taking into account the modifications described in Notice 2014–32 that would limit the ''amount'' of section 367(a) income to the amount giving rise to U.S. tax) be retained in cases where the target is a foreign corporation. Under that formulation, the ''amount'' of section 367(a) income is compared to the ''amount'' of section 367(b) income, regardless of whether such amounts are subject to U.S. tax. The comment asserted that this formulation would cause a greater amount of section 367(b) income to be taken into account, thereby making it more difficult for taxpayers to exploit the section 367(a) priority rule to avoid the Final Regulations.

The Treasury Department and the IRS expect that the modification to the section 367(a) priority rule described in Notice 2016–73 would best address such exploitation by ensuring that adjustments that have the effect of a deemed distribution of property from S to P are made whenever the target is a foreign corporation. This result would reinforce one of the purposes of the Final Regulations by ensuring that property transfers that are in substance distributions are treated as such, thereby preventing the separation of property from the earnings and profits associated with that property. The comment's alternative approach could also, as the comment acknowledged, invite the avoidance of section 301(c)(2) basis reduction in situations where a small amount of section 367(a) income is compared to a large amount of section 301(c)(2) basis reduction. Because a return of basis is not considered section 367(b) income, a small amount of section 367(a) income could be sufficient to trigger the section 367(a) priority rule. Accordingly, the proposed regulations would adopt the modifications to the section 367(a) and section 367(b) priority rules described in Notice 2016–73. *See* proposed §§ 1.367(a)–3(a)(2)(iv) and 1.367(b)–10(a)(2)(iii).

As discussed in Part I.E of the Explanation of Provisions section of this preamble, Notice 2014–32 announced that the section 367(a) and section 367(b) priority rules would be modified to take into account only the portion of a distribution that would be actually subject to U.S. tax, including the extent to which a distribution would give rise to an inclusion under section 951(a) that would be subject to U.S. tax. In light of the TCJA, the proposed regulations also would modify the priority rules to take into account the extent to which a distribution would give rise to an inclusion under section 951A(a) that would be subject to U.S. tax (even though it is unlikely that a distribution from S to P would give rise to a section 951A(a) inclusion).

B. § 1.367(b)–4 and Notice 2016–73

1. Overview

Notice 2016–73 announced that regulations to be issued under § 1.367(b)–4 would apply to the exchange of a foreign target corporation's stock that occurs in connection with an applicable triangular reorganization. As described in Notice 2016–73, the regulations under § 1.367(b)–4 would require all shareholders of the target corporation to both include in income as a deemed dividend the section 1248 amount with respect to the target stock exchanged and, after taking into account the increase in basis resulting from such deemed dividend, recognize all realized gain with respect to such stock that would not otherwise be recognized. This treatment would be required only to the extent that the target shareholders exchanged target stock for P stock or securities that S previously acquired for property in the P acquisition (tainted P stock or securities); section 367(a) would continue to apply to the exchange of target stock to the extent the target shareholders did not receive such tainted P stock or securities. The proposed regulations would adopt the rules as described in Notice 2016–73 without significant modification. *See* proposed § 1.367(b)–4(g).

2. Authority Under Section 367

The comment questioned whether section 367(b) could be applied to an applicable triangular reorganization in a manner that both requires adjustments that have the effect of a distribution of property from S to P and requires the shareholders of a foreign target corporation to recognize the full amount of gain with respect to the target corporation stock that is exchanged for tainted P stock or securities. The comment asserted that this application of section 367(b) effectively achieves the same result as if the applicable triangular reorganization were concurrently subject to taxation under both section 367(b) (with respect to the P acquisition) and section 367(a) (with respect to the target shareholders' exchange of target stock). According to the comment, section 367 may not apply to cause such concurrent taxation because the statutory language in section 367(b)(1) provides that section 367(b) may apply only where there is no transfer of property described in section 367(a). The comment cited to § 1.367(a)–3(b)(2), under which transactions that could be subject to tax under both

[2] The Treasury Department and the IRS recognize that certain rules in § 1.1411–10 involving domestic partnerships and certain S corporations have not been updated to reflect changes made to the application of § 1.958–1 pursuant to TD 9866, 84 FR 29288, and TD 9960, 87 FR 3648, and intend to update them in a future guidance project.

section 367(a) and (b) are subject to taxation under only one of those sections. The comment also noted that the section 367(a) and (b) priority rules, as currently effective, likewise operate in a manner that results in only one or the other of section 367(a) or (b) applying to an applicable triangular reorganization.

The Treasury Department and the IRS are of the view that the proposed application of § 1.367(b)–4 is appropriate and within section 367's statutory grant of authority. Under section 367(a)(5), the Secretary has broad authority to exempt certain transactions from the application of section 367(a)(1) in order to carry out the purposes of section 367(a). Deliberately failing to file a gain recognition (or filing a partial gain recognition agreement) to exploit the section 367(a) priority rule is inconsistent with the purposes of section 367(a), and section 367(b) is better suited to address these transactions. Accordingly, it is appropriate to exercise the authority in section 367(a)(5) to make the section 367(a) priority rule inapplicable to certain exchanges of target stock. Section 367(b) may therefore apply to the target shareholders' exchange of target stock because the exchange, by virtue of section 367(a)(5), is not described in section 367(a)(1). *See* section 367(b)(1). Furthermore, section 367(b)(1) is clear that the Secretary may issue any regulations ''which are necessary or appropriate to prevent the avoidance of Federal income taxes.'' Section 367(b)(2) provides that such regulations ''shall include . . . the circumstances under which gain shall be recognized currently, or amounts included in gross income currently as a dividend, or both . . . .'' Nothing within this broad grant of rulemaking authority prevents section 367(b) from concurrently applying to both the P acquisition and the exchange of target stock such that both of these components of an applicable triangular reorganization give rise to income or gain.

3. Section 367(b) Policy

The comment further asserted that requiring adjustments that have the effect of a distribution of property from S to P where the target is a foreign corporation sufficiently addresses the concerns raised in Notice 2016–73 and thus questioned the rationale in also subjecting the target shareholders to current taxation under § 1.367(b)–4. According to the comment, the target shareholders remain subject to U.S. taxing jurisdiction through their carryover basis in the stock of P and continued indirect equity interest in the target. The comment claimed that historic section 367(b) policy has recognized the permissibility of deferral where U.S. taxing rights remain intact, and in particular where section 1248 amounts are preserved.

The Treasury Department and the IRS maintain that it is appropriate for the proposed regulations to require all target shareholders to recognize the full amount of their gain with respect to the stock of target exchanged for tainted stock or securities of P. As noted above, section 367(b) provides the Secretary with a broad grant of authority to issue regulations applicable to nonrecognition transactions that are subject to section 367(b), and the exercise of this broad rulemaking authority is not conditioned on addressing a particular or historic policy concern. The Treasury Department and the IRS further note that applicable triangular reorganizations have long been identified as tax-motivated transactions, not only with respect to S's acquisition of the stock of P but also with respect to the exchange of stock of T. *See* Notice 2006–85; Notice 2014–32 (addressing situations where taxpayers attempted to manipulate the section 367(b) priority rule to effectuate an inversion without the T shareholders being subject to § 1.367(a)–3(c)). Moreover, a more limited application of the rules under section 367 has led to repeated attempts by taxpayers to structure around the rules. Requiring all target shareholders to recognize the full amount of their gain in the stock of the target corporation in connection with such transactions limits opportunities to selectively trigger this gain.

C. Deemed Contribution Rule

Initially proposed in Notice 2007–48 (2007–25 IRB 1428), the deemed contribution rule in § 1.367(b)–10(b)(2) was intended to address the scenario where S purchases P stock or securities from a person other than P (for example, from the public on the open market) instead of directly from P itself. In such cases, the adjustments required by the deemed distribution effectively adopt a ''consent dividend'' model, which would treat P as receiving a distribution of property from S even though P did not actually receive the property transferred in the P acquisition. The deemed contribution rule, under this model, accounts for P's lack of property by requiring adjustments that have the effect of a contribution of property (with no built-in gain or loss) by P to S in an amount equal to the amount of the deemed distribution. In particular, these adjustments require that P increase its basis in its S stock by the amount of the deemed contribution. Under the Final Regulations, the deemed contribution rule applies regardless of whether S acquires P stock or securities from P or from a person other than P.

As discussed in Notice 2014–32, the Treasury Department and the IRS are aware of transactions designed to avoid U.S. tax by exploiting the deemed contribution rule. In one such transaction, for example, S has no earnings and profits but a high outside stock basis. The taxpayer effects an applicable triangular reorganization where the amount of property transferred to P in the P acquisition is less than the amount of the outside stock basis in S. The taxpayer applies the Final Regulations to make the adjustments required by the deemed distribution, which results solely in a return of the outside stock basis in S under section 301(c)(2). The adjustments required by the deemed contribution rule, however, immediately restore that basis. The applicable triangular reorganization thus does not result in a net reduction to the outside stock basis in S, effectively negating the intended consequences of the deemed distribution. Further, the taxpayer could attempt to repeatedly effect applicable triangular reorganizations to transfer property from S to P with no net reduction to the outside stock basis in S despite each transaction being treated as a deemed distribution. As a result, and consistent with the regulations announced in Notice 2014–32, the proposed regulations remove the deemed contribution rule.

D. Anti-Abuse Rule

The Final Regulations contain an anti-abuse rule under which appropriate adjustments are made if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of the Final Regulations. *See* § 1.367(b)–10(d). The anti-abuse rule contains an example illustrating that the earnings and profits of S may, under certain circumstances, be deemed to include the earnings and profits of a corporation related to P or S for purposes of determining the consequences of the adjustments provided for in the Final Regulations.

As illustrated in Notice 2014–32 and Notice 2016–73, taxpayers have taken the position that the anti-abuse rule does not apply to a given transaction under the theory that the one example provided by the anti-abuse rule does not explicitly describe the transaction. Notice 2014–32 accordingly announced that future regulations would clarify

that the anti-abuse rule may apply broadly to support a variety of adjustments, including adjusting earnings and profits between previously unrelated corporations. The proposed regulations would implement the clarifications to the anti-abuse rule described in Notice 2014–32.

To illustrate the broad application of the anti-abuse rule, the proposed regulations would include additional examples. First, the proposed regulations would add an example illustrating that the anti-abuse rule may apply to a ''downstream'' transfer of property made in connection with a triangular reorganization. Because a downstream transfer (whereby property being separated from earnings and profits is initially transferred downstream, rather than upstream from S to P) can be structured so as not to fall within the literal application of the Final Regulations, which equate the P acquisition with a section 301 distribution, taxpayers otherwise might assert that a downstream transfer of property made in connection with a triangular reorganization cannot be subject to the Final Regulations. *See* proposed § 1.367(b)–10(d)(3) (*Example 2*). The proposed regulations also would add an example illustrating that certain debt exchanges may implicate the anti-abuse rule. *See* proposed § 1.367(b)–10(d)(4) (*Example 3*).

For the avoidance of doubt, the application of the anti-abuse rule is not limited to the particular fact patterns described in the examples. In addition, the proposed regulations would not modify the operative text of the anti-abuse rule, which remains unchanged from the Final Regulations, such that the examples included in the proposed regulations would illustrate transactions subject to the anti-abuse rule.

E. Other Rules

Notice 2014–32 described transactions designed to avoid the application of the no-U.S.-tax exception in § 1.367(b)–10(a)(2)(ii) and also expressed a concern that taxpayers may attempt to interpret that exception in a narrower manner than was intended or is appropriate. Notice 2014–32 accordingly announced that future regulations would modify the no-U.S.-tax exception, in part to clarify its scope. The proposed regulations would adopt the modifications to the no-U.S.-tax exception described in Notice 2014–32. *See* proposed § 1.367(b)–10(a)(2)(ii).

As noted above in Part I.F of the Explanation of Provisions section of this preamble, Notice 2016–73 announced that the definition of ''property'' in § 1.367(b)–10(a)(3)(ii) would be modified to include nonqualified preferred stock of S. The proposed regulations would adopt this rule without modification. *See* proposed § 1.367(b)–10(a)(3)(ii)(C).

Section 1.367(b)–10(b)(3) provides that the deemed distribution is generally treated as occurring immediately before the P acquisition, and Notice 2016–73 requested comments on whether this rule should be modified in light of the modifications announced in the notice. The comment suggested that the current rule be retained because no reason has been identified to warrant its modification. The Treasury Department and the IRS agree with the comment and therefore no changes would be made with respect to this rule.

The proposed regulations also would modify the reporting requirements under § 1.367(b)–1(c) to require corporations that acquire stock or securities of P in a transaction described in the Final Regulations to disclose such acquisitions by attaching a section 367(b) notice (within the meaning of § 1.367(b)–1(c)) to the corporation's tax return (or Form 5471, as applicable) for the year in which the stock or securities of P are acquired. *See* proposed § 1.367(b)–1(c)(2)(vi). Under the proposed regulations, corporations would be required to describe the circumstances of the acquisition of stock or securities of P, any related transactions involving the acquired stock or securities, and whether any adjustments were made pursuant to § 1.367(b)–10. *See* proposed § 1.367(b)–1(c)(4)(viii). The information required to be disclosed would supplement (rather than replace) any information already required to be disclosed in the section 367(b) notice.

IV. Applicability Dates

With respect to those rules described in Notice 2014–32, the proposed regulations generally would be applicable to transactions completed on or after April 25, 2014, subject to limited exceptions. *See* proposed §§ 1.367(a)–3(g)(1)(viii) and 1.367(b)–10(e)(2).

With respect to those rules described in Notice 2016–73, the proposed regulations generally would be applicable to transactions completed on or after December 2, 2016. *See* proposed §§ 1.367(a)–3(g)(1)(viii), 1.367(b)–3(g)(7)(i), 1.367(b)–4(i), and 1.367(b)–10(e)(3). To the extent the proposed regulations contain rules not previously announced in Notice 2016–73, the proposed regulations would be applicable to transactions completed on or after the date the proposed regulations are filed in the **Federal Register**. *See* proposed §§ 1.367(b)–3(g)(7)(i), 1.367(b)–6(a)(1)(v) and (vi), and 1.1411–10(i); *see also* proposed § 1.367(b)–3(g)(7)(ii) for transition rules for certain transactions completed before the issuance of the proposed regulations.

Taxpayers and their related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply the rules of Notice 2014–32 and Notice 2016–73 or the proposed regulations to any open taxable year beginning before the date the proposed regulations are filed as final regulations in the **Federal Register**, provided that taxpayers and their related parties consistently apply either the entirety of Notice 2014–32 and Notice 2016–73 or the entirety of the proposed regulations for such years and each subsequent taxable year beginning before the date the proposed regulations are filed as final regulations in the **Federal Register**.

The comment requested that the Treasury Department and IRS reconsider the December 2, 2016, applicability date given that Notice 2016–73 proposed to apply the EAB rules to all inbound nonrecognition transactions, regardless of whether the taxpayer had previously effected an applicable triangular reorganization. The comment did, however, recognize the immediate need for the EAB rules to apply to already-completed applicable triangular reorganizations where the taxpayer did not apply the Final Regulations. Because the proposed regulations would apply the EAB rules only to those inbound nonrecognition transactions that follow certain triangular reorganizations and other transactions designed to create EAB, the Treasury Department and IRS maintain that the December 2, 2016, effective date is appropriate.

No inference is intended regarding the treatment of applicable triangular reorganizations, transactions undertaken with a principal purpose of creating EAB, or subsequent inbound nonrecognition transactions completed before the applicability date of the proposed regulations. Such transactions may be subject to challenge before the applicability dates, for example, under the anti-abuse rule in § 1.367(b)–10(d), applicable Code provisions, or judicial doctrines.

Effect on Other Documents

The proposed regulations would, as of the date they are filed as final regulations with the **Federal Register**, obsolete Notice 2014–32 and Notice 2016–73. Until such time, taxpayers may continue to rely on Notice 2014–32 and Notice 2016–73 as noted in Part IV

of the Explanation of Provisions section of this preamble.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

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

The collections of information in the proposed regulations are in proposed § 1.367(b)–1(c)(4)(viii) and (ix) and apply to taxpayers that engage in transactions described in § 1.367(b)–3(g) or § 1.367(b)–10. This information is necessary for the IRS's audit and examination purposes, and in particular to identify transactions that should be subject to the proposed regulations. The proposed information collection is a statement by corporations attached to their timely filed Federal tax returns (or Form 5471, as applicable) that describes certain transactions and computations relevant to the proposed regulations. Because such statements have not been required for transactions that predate the proposed regulations, the Treasury Department and the IRS are limited in their ability to estimate how many taxpayers are likely to be affected by the proposed information collection. Based on available data and the profile of taxpayers that have historically undertaken the types of transactions at issue (large, publicly traded corporations), it is estimated that no more than 50 taxpayers would be affected by the proposed information collection in a given year. The likely respondents are foreign and domestic corporations.

Because the collections of information in proposed § 1.367(b)–1(c)(4)(viii) and (ix) are proposed to apply to taxable years ending on or after the date the proposed regulations are filed with the **Federal Register**, the Treasury Department and the IRS have submitted the collection of information in proposed § 1.367(b)–1(c)(4)(viii) and (ix) to the OMB for review in accordance with the PRA and requested a temporary OMB control number (1545–NEW). After the rulemaking is finalized, burdens associated with the proposed information collection will be incorporated into OMB control number 1545–0123. OMB control number 1545–0123 represents a total estimated burden time for all forms and schedules and regulations for corporations. REG–117614–14 will be included in the future; however, the burden estimates in 1545–0123 will not isolate the estimated burden for the information collection contained in these proposed, and subsequent final, regulations. The Treasury Department and the IRS estimate burdens based on a taxpayer-type basis rather than a provision-specific basis.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Commenters are strongly encouraged to submit public comments electronically. Comments and recommendations for the proposed information collection should be sent to *www.reginfo.gov/public/do/PRAMain,* with electronic copies to the IRS at *pra.comments@irs.gov* (indicate ''REG–117614–14'' on the subject line). This particular information collection can be found by selecting ''Currently under Review—Open for Public Comments'' then by using the search function. Comments can also be mailed to OMB, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies mailed to the IRS, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by December 5, 2023.

III. Regulatory Flexibility Act

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA) requires the agency ''to prepare and make available for public comment an initial regulatory flexibility analysis'' that will ''describe the impact of the proposed rule on small entities.'' *See* 5 U.S.C. 603(a). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities. A small entity is defined as a small business, small nonprofit organization, or small governmental jurisdiction. *See* 5 U.S.C. 601(3) through (6).

The Treasury Department and the IRS do not have data readily available to assess the number of small entities potentially affected by the proposed regulations. However, the taxpayers affected by the proposed regulations would generally be domestic and foreign corporations that participate in certain triangular reorganizations. The triangular reorganizations at issue represent a narrow set of abusive transactions that have typically been engaged in by large, publicly traded corporations. Such transactions are highly sophisticated and are thus unlikely to involve small domestic entities. Therefore, the Treasury Department and the IRS certify that the proposed regulations would not have a significant economic impact on a substantial number of small entities. The Treasury Department and the IRS invite the public to comment on the impact of these regulations on small entities.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

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

Comments and Requests for Public Hearing

Before the 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 the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed rules. The Treasury Department and the IRS also invite comments on section 367(b) more generally, including whether, and if so, how, any of the existing regulations issued under section 367(b) should be modified in light of the Tax Cuts and Jobs Act. Any electronic or paper comments submitted will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov.*

Drafting Information

The principal author of the proposed regulations is Brady Plastaras of the Office of the 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, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry for § 1.1411–10 in numerical order to read in part as follows:

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

* * * * *

Section 1.1411–10 also issued under 26 U.S.C. 367(b).

* * * * *

■ **Par. 2.** Section 1.367(a)–3 is amended by revising paragraphs (a)(2)(iv) and (g)(1)(viii) to read as follows:

§ 1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

(a) * * *

(2) * * *

(iv) *Certain triangular reorganizations described in § 1.367(b)–10.* If, in an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T (as defined in § 1.367(b)–10(a)(3)(i)) in connection with a transaction described in § 1.367(b)–10 (applying to certain acquisitions of parent stock or securities for property in triangular reorganizations), section 367(a)(1) does not apply to such U.S. persons with respect to the exchange of the stock or securities of T if the condition in paragraph (a)(2)(iv)(A) or (B) of this section is satisfied. *See* § 1.367(b)–10(a)(2)(iii) (providing a similar rule that excludes certain transactions from the application of § 1.367(b)–10).

(A) The amount of gain in the T stock or securities that would otherwise be recognized under section 367(a)(1) (without regard to any exceptions thereto) pursuant to the indirect stock transfer rules of paragraph (d) of this section is less than the sum of the amount of the deemed distribution under § 1.367(b)–10 that would be treated and subject to U.S. tax as a dividend under section 301(c)(1) (or would give rise to an inclusion under section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) and the amount of such deemed distribution that would be treated and subject to U.S. tax as gain from the sale or exchange of property under section 301(c)(3) (or would give rise to an inclusion under section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) if § 1.367(b)–10 would otherwise apply to the triangular reorganization.

(B) T is a foreign corporation, but only to the extent that the stock or securities of T are exchanged for stock or securities of P that were acquired by S in exchange for property in the P acquisition (as the terms P, S, property, and P acquisition are defined in § 1.367(b)–10(a)). Such exchange of T stock or securities is subject to the rules under § 1.367(b)–4(g). Section 367(a) applies to the exchange of T stock or securities to the extent that such stock or securities are exchanged for P stock or securities that were not acquired by S in exchange for property in the P acquisition.

* * * * *

(g) * * *

(1) * * *

(viii) Except as provided in this paragraph (g)(1)(viii), paragraph (a)(2)(iv) of this section applies to exchanges occurring on or after May 17, 2011. For exchanges that occur prior to May 17, 2011, *see* § 1.367(a)–3T(b)(2)(i)(C) as contained in 26 CFR part 1 revised as of April 1, 2011. Paragraph (a)(2)(iv)(A) of this section, to the extent it relates to amounts that would be subject to U.S. tax or give rise to an inclusion under section 951(a)(1)(A) that would be subject to U.S. tax, applies to triangular reorganizations that are completed on or after April 25, 2014, unless T was not related to P or S (within the meaning of section 267(b)) immediately before the triangular reorganization; the triangular reorganization was entered into either pursuant to a written agreement that was (subject to customary conditions) binding before April 25, 2014, and at all times afterwards, or pursuant to a tender offer announced before April 25, 2014, that is subject to section 14(d) of the Securities and Exchange Act of 1934 (15 U.S.C. 78n(d)(1)) and Regulation 14(D) (17 CFR 240.14d–1 through 240.14d–101) or that is subject to comparable foreign laws; and to the extent the P acquisition that occurs pursuant to the plan of reorganization is not completed before April 25, 2014, the P acquisition was included as part of the plan before April 25, 2014. Paragraph (a)(2)(iv)(B) of this section applies to transactions completed on or after December 2, 2016. Paragraph (a)(2)(iv)(A) of this section, to the extent it relates to amounts that would give rise to an inclusion under section 951A(a) that would be subject to U.S. tax, applies to triangular reorganizations that are completed on or after October 5, 2023.

* * * * *

■ **Par. 3.** Section 1.367(b)–1 is amended by:

■ 1. Removing the language ''and'' at the end of paragraph (c)(2)(iv)(B);

■ 2. Removing the period at the end of paragraph (c)(2)(v) and adding the language ''; and'' in its place;

■ 3. Adding paragraph (c)(2)(vi);

■ 4. In paragraph (c)(3)(ii)(A), removing the language ''paragraph (c)(2)(i) or (v)'' and adding in its place the language ''paragraph (c)(2)(i), (v), or (vi)'';

■ 5. Revising paragraph (c)(4)(v);

■ 6. Removing the language ''and'' at the end of paragraph (c)(4)(vi);

■ 7. Removing the period at the end of paragraph (c)(4)(vii)(B) and adding a semicolon in its place; and

■ 8. Adding paragraphs (c)(4)(viii) and (ix).

The additions and revision read as follows:

§ 1.367(b)–1 Other transfers.

* * * * *

(c) * * *

(2) * * *

(vi) A domestic or foreign corporation (S) that acquires stock or securities of another corporation (P) in a transaction described in § 1.367(b)–10(a)(1), without regard to the exceptions in § 1.367(b)–10(a)(2).

* * * * *

(4) * * *

(v) Any information that is or would be required to be furnished with a Federal income tax return pursuant to regulations or other guidance under section 332, 351, 354, 355, 356, 361, 368, or 381 (whether or not a Federal income tax return is required to be filed), if such information has not otherwise been provided by the person filing the section 367(b) notice;

* * * * *

(viii) In the case of a corporation (S) described in paragraph (c)(2)(vi) of this section, the rules of this paragraph (c)(4) apply by treating the acquisition of the stock or securities of P in exchange for property as the section 367(b) exchange referred to in paragraph (a) of this section. The section 367(b) notice must also include a complete description of the acquisition of the stock or securities of P in exchange for property, including a description of the property provided in exchange for the stock or securities and any related transactions involving the acquisition of the stock or securities. The section 367(b) notice must describe any adjustments made pursuant to § 1.367(b)–10 or, if no adjustments are made, explain why no such adjustments were made; and

(ix) In the case of an exchange to which § 1.367(b)–3(g) applies, a statement describing how any excess asset basis (as defined in § 1.367(b)–3(g)(2)(i)) arose, the amount of excess asset basis, and a description of the computation of the amount of excess asset basis.

* * * * *

■ **Par. 4.** Section 1.367(b)–2 is amended by:

■ 1. In paragraph (c)(1), adding a sentence after the current first sentence;

■ 2. Adding a sentence to the end of paragraph (d)(2)(ii);

■ 3. In paragraph (d)(3)(ii), removing the language ''subsidiaries of'' and adding in its place the language ''corporations owned by'';

■ 4. Adding a sentence to the end of paragraph (d)(3)(ii);

■ 5. In paragraph (e)(4) *Example 2,* removing the language ''foreign subsidiary'' and adding in its place the language ''foreign corporation''; and

■ 6. In paragraphs (j)(2)(i) and (ii), removing the language ''is required to include in income either the all earnings and profits amount or the section 1248 amount under the provisions of § 1.367(b)–3 or 1.367(b)–4'' and adding in its place the language ''exchanges stock pursuant to a transaction described in § 1.367(b)–3 or § 1.367(b)–4(b)(1)(i), (b)(2)(i), (b)(3), (e), or (g)''.

The additions read as follows:

§ 1.367(b)–2 Definitions and special rules.

* * * * *

(c) * * *

(1) * * * But *see* § 1.1411–10(c)(3)(ii), which for certain exchanges modifies the section 1248 amount for purposes of section 1411. * * *

* * * * *

(d) * * *

(2) * * *

(ii) * * * But *see* § 1.1411–10(c)(3)(ii), which for certain exchanges modifies the all earnings and profits amount for purposes of section 1411.

* * * * *

(3) * * *

(ii) * * * But *see* § 1.367(b)–3(g)(1), which adjusts the all earnings and profits amount through a deemed distribution of certain earnings and profits of foreign subsidiaries owned by the foreign acquired corporation.

* * * * *

■ **Par. 5.** Section 1.367(b)–3 is amended by adding paragraph (g) to read as follows:

§ 1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(g) *All earnings and profits amount adjusted for excess asset basis*—(1) *General rule.* If there is excess asset basis with respect to a foreign acquired corporation and the condition described in paragraph (g)(1)(i) or (ii) of this section is satisfied, then, except as provided in paragraph (g)(5) of this section, an exchanging shareholder to which paragraph (b)(3)(i) of this section applies must compute the all earnings and profits amount with respect to its stock in the foreign acquired corporation as if the foreign acquired corporation had received a distribution of property from a foreign subsidiary under section 301 in an amount equal to the specified earnings, immediately before the inbound nonrecognition transaction. The deemed distribution described in the preceding sentence is treated as occurring for all purposes of the Internal Revenue Code. For purposes of this paragraph (g)(1), the amount of the distribution from a foreign subsidiary is equal to the amount of earnings and profits of that foreign subsidiary that is designated as specified earnings under paragraph (g)(3) of this section. In the case of a foreign subsidiary the stock of which is not held directly by the foreign acquired corporation, the distribution is treated as being made through any intermediate owners. For purposes of this paragraph (g)(1), references to the foreign acquired corporation, S, and a foreign subsidiary include any predecessor corporation.

(i) S previously acquired in exchange for property stock or securities of the foreign acquired corporation in connection with a triangular reorganization described in § 1.358–6(b)(2), and the foreign acquired corporation and S did not make adjustments that have the effect of a distribution of property from S to the foreign acquired corporation under § 1.367(b)–10(b)(1).

(ii) The excess asset basis is attributable, directly or indirectly, to property previously provided by a foreign subsidiary of the foreign acquired corporation in connection with a transaction not described in paragraph (g)(1)(i) of this section and undertaken with a principal purpose to create such excess asset basis.

(2) *Definitions.* The following definitions apply for purposes of this paragraph (g).

(i) *Excess asset basis.* The term *excess asset basis* means, with respect to a foreign acquired corporation, the amount by which the inside asset basis of that corporation exceeds the sum of the following amounts:

(A) The earnings and profits of the foreign acquired corporation attributable to its outstanding stock. For purposes of paragraph (g)(2)(i) of this section, such earnings and profits are determined under the principles of § 1.367(b)–2(d) but without regard to whether the exchanging shareholder is described in paragraph (b)(1) of this section or whether the exchanging shareholder is a U.S. person or a foreign person; and such earnings and profits include amounts described in section 1248(d)(3) or (4).

(B) The aggregate basis in the outstanding stock of the foreign acquired corporation determined immediately before the nonrecognition transaction described in paragraph (a) of this section (the inbound nonrecognition transaction) and therefore without regard to any basis increase described in § 1.367(b)–

2(e)(3)(ii) resulting from such inbound nonrecognition transaction.

(C) The aggregate amount of liabilities of the foreign acquired corporation that are assumed (determined under the principles of section 357(d)) by the domestic acquiring corporation in the inbound nonrecognition transaction.

(ii) *Foreign subsidiary.* The term *foreign subsidiary* means, with respect to a foreign acquired corporation, a foreign corporation with respect to which the foreign acquired corporation satisfies the ownership requirements of section 1248(c)(2)(B) but for this purpose treating the foreign acquired corporation as the United States person referred to in section 1248(c)(2)(B).

(iii) *Inbound nonrecognition transaction.* The term *inbound nonrecognition transaction* has the meaning set forth in paragraph (g)(2)(i)(B) of this section.

(iv) *Inside asset basis.* The term *inside asset basis* means, with respect to a foreign acquired corporation, the aggregate of the adjusted basis of all the assets of that corporation in the hands of the domestic acquiring corporation determined immediately after the inbound nonrecognition transaction.

(v) *Lower-tier earnings.* The term *lower-tier earnings* means, with respect to a foreign acquired corporation, the sum of the earnings and profits (including deficits) of each foreign subsidiary.

(vi) *S.* The term *S* has the same meaning as in § 1.367(b)–10(a)(3)(i).

(vii) *Specified earnings.* The term *specified earnings* means, with respect to a foreign acquired corporation, the lesser of the following amounts:

(A) Lower-tier earnings; and

(B) The excess asset basis of the foreign acquired corporation.

(viii) *Property.* The term *property* has the same meaning as in § 1.367(b)–10(a)(3)(ii).

(3) *Designation of specified earnings.* If lower-tier earnings exceed specified earnings, then the portion of lower-tier earnings that is designated as specified earnings is determined by reference to the earnings and profits of each foreign subsidiary on a pro rata basis in proportion to each subsidiary's share of lower-tier earnings.

(4) *Anti-abuse rule.* Appropriate adjustments are made pursuant to this section if a transaction is engaged in with a view to avoid the purposes of this paragraph (g). For example, if a transaction is engaged in with a view to reduce excess asset basis, including by increasing the basis in the stock of the foreign acquired corporation without a corresponding increase in the basis of the assets of the foreign acquired corporation, that increase in the basis in the stock of the foreign acquired corporation will be disregarded for purposes of computing excess asset basis.

(5) *Prohibition against affirmative use.* This paragraph (g) does not apply to an inbound nonrecognition transaction if a transaction described in paragraph (g)(1) of this section was entered into with a principal purpose of subjecting the inbound nonrecognition transaction to this paragraph (g). For example, this paragraph (g) will not apply to an inbound nonrecognition transaction if a taxpayer engaged in a transaction described in paragraph (g)(1) of this section with a principal purpose of accessing tax attributes of lower-tier foreign subsidiaries by reason of a deemed distribution of lower-tier earnings of the foreign acquired corporation.

(6) *Examples.* The application of this paragraph (g) is illustrated by the examples in this paragraph (g)(6). In each example, all corporations have a calendar year-end and use the United States dollar as their functional currency.

(i) *Example 1*—(A) *Facts.* USP, a domestic corporation, owns all of the stock of USS, also a domestic corporation, and 80 percent of the stock of FP, a foreign corporation. USS owns the remaining 20 percent of the stock of FP. FP owns all of the stock of FS1, which in turn owns all of the stock of FS2. Both FS1 and FS2 are foreign corporations. In a reorganization described in section 368(a)(1)(F) (F reorganization), US Newco, a newly formed domestic corporation, acquires all of the assets of FP solely in exchange for stock of US Newco, which FP distributes to USP and USS in liquidation. Immediately before the F reorganization, the stock of FP owned by USP has a fair market value of $80x and an adjusted basis of $4x. The stock of FP owned by USS has a fair market value of $20x and an adjusted basis of $1x. The all earnings and profits amounts with respect to USP's stock of FP and USS's stock of FP, determined before any adjustments required by paragraph (g) of this section, are $32x and $8x, respectively. FP holds assets with an adjusted basis of $95x, has no liabilities, and has $40x of earnings and profits attributable to its outstanding stock. FS1 and FS2 have $30x and $70x of earnings and profits, respectively, all of which are described in section 959(c)(3). Dividends paid by FS2 to FS1, and by FS1 to FP, would qualify for the exception to foreign personal holding company income under section 954(c)(6). Before the applicability date described in paragraph (g)(7)(i) of this section, and separate from the F reorganization, FS1 provided property to FP in exchange for stock of FP in connection with a triangular reorganization described in § 1.358–6(b)(2), and neither FP nor FS1 made adjustments that had the effect of a distribution of property from FS1 to FP under § 1.367(b)–10(b)(1).

(B) *Analysis*—(*1*) *All earnings and profits amount.* The F reorganization is an asset acquisition described in section 368(a)(1) and is thus subject to section 367(b) and this section. Under paragraph (b)(3) of this section, USP and USS each must include in income as a deemed dividend the all earnings and profits amount with respect to their stock of FP. Because there is excess asset basis with respect to FP (as determined in paragraph (g)(6)(i)(B)(*2*) of this section), USP and USS must compute the all earnings and profits amounts attributable to their stock of FP as if FP had received a distribution of specified earnings, immediately before the F reorganization. Because the stock of FS2 is indirectly owned by FP, to the extent the specified earnings are determined by reference to the earnings and profits of FS2, FS2 is treated as making a distribution to FS1 under section 301, and FS1 is then treated as making a distribution to FP under section 301 in an amount equal to the sum of the amount of specified earnings determined by reference to the earnings and profits of FS1 (determined without regard to the deemed distribution from FS2) and the amount of the deemed distribution received from FS2.

(*2*) *Excess asset basis.* The amount of excess asset basis is $50x, calculated as the amount by which FP's inside asset basis ($95x) exceeds the sum of FP's earnings and profits ($40x), the aggregate basis in the outstanding stock of FP ($5x), and the amount of liabilities of FP assumed by US Newco in the F reorganization ($0).

(*3*) *Deemed distribution of specified earnings.* The amount of specified earnings equals $50x, the lesser of the following amounts: $100x, the sum of the earnings and profits of FS1 and FS2; and $50x, the amount of excess asset basis with respect to FP. FP is accordingly treated as receiving a distribution of $50x from FS1. Under paragraph (g)(3) of this section, $15x ($50x × ($30x/$100x)) of FS1's earnings and profits and $35x ($50x × ($70x/$100x)) of FS2's earnings and profits are designated as specified earnings. FS2 is treated as distributing $35x to FS1. Under sections 301(c)(1) and 954(c)(6), the $35x deemed distribution from FS2 to FS1 is treated as a dividend that does

not give rise to foreign personal holding company income. FS1 must accordingly increase its earnings and profits described in section 959(c)(3) by $35x to $65x, and FS2 must decrease its earnings and profits described in section 959(c)(3) by the same amount. FS1 is then treated as making a distribution of $50x to FP. Under sections 301(c)(1) and 954(c)(6), the $50x deemed distribution is also treated as a dividend that does not give rise to foreign personal holding company income. FP must accordingly increase its earnings and profits described in section 959(c)(3) by $50x to $90x, and FS1 must decrease its earnings and profits described in section 959(c)(3) by the same amount.

(*4*) *Adjusted all earnings and profits amount attributable to USP's FP stock.* Under paragraph (g)(1) of this section, USP must compute the all earnings and profits amount attributable to its stock of FP after taking into account the $50x increase to FP's earnings and profits that resulted from the deemed distribution of specified earnings. Because USP owns 80% of the stock of FP, $40x (calculated as 80% of $50x) of the specified earnings are attributable to USP's stock of FP and are included in the all earnings and profits amount attributable to USP's stock of FP. The all earnings and profits amount that USP must include in income as a deemed dividend is therefore $72x ($32x + $40x).

(*5*) *Adjusted all earnings and profits amount attributable to USS's FP stock.* Under paragraph (g)(1) of this section, USS must compute the all earnings and profits amount attributable to its stock of FP after taking into account the $50x increase to FP's earnings and profits that resulted from the deemed distribution of specified earnings. Because USS owns 20% of the stock of FP, $10x (calculated as 20% of $50x) of the specified earnings are attributable to USS's stock of FP and are included in the all earnings and profits amount attributable to USS's stock of FP. The all earnings and profits amount that USS must include in income as a deemed divided is therefore $18x ($8x + $10x).

(ii) *Example 2*—(A) *Facts.* USP, a domestic corporation, owns all of the stock of FP, which in turn owns all of the stock of FS. Both FP and FS are foreign corporations. The all earnings and profits amount with respect to USP's stock of FP, determined before any adjustments required by paragraph (g) of this section, is $50x. FP has no other earnings and profits other than the $50x that reflect USP's all earnings and profits amount. FS has $200x of earnings and profits, all of which are earnings and profits described in section 959(c)(2) (PTEP) because those earnings and profits gave rise to an earlier income inclusion under section 951 with respect to USP. Increases in stock basis were made under section 961 by reason of USP's section 951 inclusion. FP has excess asset basis of $100x as a result of a previous transaction that was undertaken with a principal purpose of creating excess asset basis in which FS provided $100x of property to FP. In a liquidation described in section 332, FP distributes all of its assets to USP and the stock of FP is cancelled (the FP liquidation).

(B) *Analysis*—(*1*) *All earnings and profits amount.* The FP liquidation is subject to section 367(b) and this section. Under paragraph (b)(3) of this section, USP must include in income as a deemed dividend the all earnings and profits amount with respect to its stock of FP. Because there is excess asset basis with respect to FP, USP must compute the all earnings and profits amount attributable to its stock of FP as if FP had received a distribution of specified earnings immediately before the FP liquidation.

(*2*) *Deemed distribution of specified earnings.* The amount of specified earnings equals $100x, the lesser of the following amounts: $200x, the earnings and profits of FS; and $100x, the amount of excess asset basis with respect to FP. FS is accordingly treated as making a distribution of $100x to FP. Under sections 301(c)(1) and 959(b), the $100x deemed distribution from FS to FP is treated as a distribution of PTEP that is not included in the gross income of FP for purposes of section 951. The distribution reduces FS's earnings and profits and PTEP with respect to USP by $100x and increases FP's earnings and profits and PTEP with respect to USP by $100x. Furthermore, appropriate adjustments are made under section 961 for the distribution of PTEP.

(*3*) *Adjusted all earnings and profits amount attributable to USP's stock of FP.* Under paragraph (g)(1) of this section, USP must compute the all earnings and profits amount attributable to its stock of FP after taking into account the $100x increase to FP's earnings and profits that resulted from the deemed distribution of specified earnings. Because the deemed distribution consisted entirely of PTEP with respect to USP, the deemed distribution does not affect USP's all earnings and profits amount of $50x. *See* § 1.367(b)–2(d)(2)(ii). USP must therefore include $50x in income as a deemed dividend under this section. USP must also recognize any foreign currency gain or loss under section 986(c) with respect to the $100x of PTEP of FP. *See* § 1.367(b)–2(j)(2).

(7) *Applicability date*—(i) *In general.* Paragraph (g) of this section (other than paragraphs (g)(2)(vii), (g)(3), and (5) of this section) applies to transactions completed on or after December 2, 2016, and to any transactions treated as completed before December 2, 2016, as a result of an entity classification election made under § 301.7701–3 of this chapter that is filed on or after December 2, 2016. Paragraphs (g)(2)(vii), (g)(3), and (5) of this section apply to transactions completed on or after October 5, 2023.

(ii) *Transactions completed (or elections made) on or after December 2, 2016, and before* October 5, 2023. Except as provided in paragraph (g)(7)(iii) of this section, the following definitions (in lieu of the corresponding definitions or in addition to the definitions in paragraph (g)(2) of this section) and rules apply with respect to transactions completed on or after December 2, 2016, and to any transactions treated as completed before December 2, 2016, as a result of an entity classification election made under § 301.7701–3 of this chapter that is filed on or after December 2, 2016, but before October 5, 2023:

(A) The term *specified earnings* means, with respect to the stock of a foreign acquired corporation that is exchanged by an exchanging shareholder, the lesser of the following amounts (but not below zero):

(*1*) The sum of the earnings and profits (including a deficit) with respect to each foreign subsidiary of the foreign acquired corporation that are attributable under section 1248(c)(2) to the stock of the foreign acquired corporation exchanged (lower-tier earnings). For purposes of the preceding sentence, the modifications described in § 1.367(b)–2(d)(2) and (d)(3)(i) apply. Thus, for example, the amount of the earnings and profits of a foreign subsidiary that are attributable to stock of the foreign acquired corporation is determined without regard to whether the foreign subsidiary was a controlled foreign corporation at any time during the five years preceding the inbound nonrecognition transaction.

(*2*) The product of the excess asset basis of the foreign acquired corporation, multiplied by the exchanging shareholder's specified percentage.

(*3*) The amount of gain that would be realized by the exchanging shareholder if, immediately before the inbound nonrecognition transaction, the exchanging shareholder had sold the stock of the foreign acquired corporation

for fair market value, reduced by the exchanging shareholder's all earnings and profits amount (for this purpose, determined without regard to the modifications described in this paragraph (g)) (specified stock gain).

(B) The term *specified percentage* means, with respect to an exchanging shareholder, a fraction (expressed as a percentage), the numerator of which is the sum of the aggregate of the specified stock gain with respect to all exchanging shareholders to which § 1.367(b)–3(b)(3) applies and the aggregate of the gain realized (regardless of whether such gain is recognized) with respect to the stock exchanged by all other exchanging shareholders.

(C) If there is excess asset basis with respect to a foreign acquired corporation, as determined under paragraph (g)(2)(i) of this section, a taxpayer may reduce the excess asset basis to the extent that the excess asset basis is not attributable, directly or indirectly, to property provided by a foreign subsidiary of the foreign acquired corporation. For example, if there was a transfer of property to the foreign acquired corporation described in section 362(e)(2), and the election described in section 362(e)(2)(C) was made to limit the basis in the stock received in the foreign acquired corporation to its fair market value, then, for purposes of determining excess asset basis, the basis in the stock of the foreign acquiring corporation may be determined without regard to the application of section 362(e)(2).

(iii) *Early application.* A taxpayer and its related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply paragraphs (g)(1) through (6) of this section to all open taxable years beginning before the date these regulations are filed as final regulations in the **Federal Register**, provided that the taxpayer and its related parties consistently apply paragraphs (g)(1) through (6) of this section and § 1.367(b)–1(c)(4)(ix) for such years.

■ **Par. 6.** Section 1.367(b)–4 is amended by:

■ 1. In paragraph (a), adding a sentence after the fifth sentence;

■ 2. In paragraph (a), removing the language ''paragraph (g)'' in the current sixth sentence and adding in its place the language ''paragraph (h)'' and removing the language ''paragraph (h)'' in the current seventh sentence and adding in its place the language ''paragraph (i)'';

■ 3. In paragraph (e)(5) *Example 2* (ii)(B), removing the language ''paragraph (g)(1)'' wherever it appears and adding in its place the language ''paragraph (h)(1)'';

■ 4. In paragraph (f)(3) *Example 2* (ii), removing the language ''paragraph (g)(1)'' wherever it appears and adding in its place the language ''paragraph (h)(1)'';

■ 5. Redesignating paragraph (h) as paragraph (i);

■ 6. Redesignating paragraph (g) as paragraph (h) and adding a new paragraph (g);

■ 7. Adding a sentence to the end of newly redesignated paragraph (i); and

■ 8. In newly redesignated paragraph (i), removing the language ''paragraph (h)'' and adding in its place the language ''paragraph (i)'', and removing the language ''paragraphs (f) and (g)(5)'' and adding in its place the language ''paragraphs (f) and (h)(5)''.

The additions read as follows:

§ 1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

(a) * * * Paragraph (g) of this section provides rules regarding exchanges that occur pursuant to a transaction described in § 1.367(b)–10(a)(1), without regard to the exceptions in § 1.367(b)–10(a)(2). * * *

* * * * *

(g) *Income inclusion and gain recognition in exchanges occurring in connection with certain triangular reorganizations*—(1) *Rule.* If, in an exchange under section 354 or 356 that occurs in connection with a transaction described in § 1.367(b)–10, an exchanging shareholder exchanges stock or securities of a foreign acquired corporation, then, to the extent that the exchanging shareholder receives stock or securities of P acquired by S in exchange for property in the P acquisition, the shareholder must:

(i) Include in income as a deemed dividend the section 1248 amount attributable to the stock that the shareholder exchanges; and

(ii) After taking into account the increase in basis in the stock provided in § 1.367(b)–2(e)(3)(ii) resulting from the deemed dividend (if any), recognize all realized gain with respect to the stock or securities that would not otherwise be recognized.

(2) *Special rules and definitions.* For the purposes of this paragraph (g), an *exchanging shareholder* is a United States person or foreign person that exchanges stock of a foreign acquired corporation in a prescribed exchange, regardless of whether such United States person is a section 1248 shareholder or such foreign person is a foreign corporation in which a United States person is a section 1248 shareholder. As used in this paragraph (g), the terms P, S, property, and P acquisition have the meanings provided in § 1.367(b)–10(a), and the term *foreign person* means a person that is not a United States person.

(3) *Example.* The following example illustrates the rules of this paragraph (g):

(i) *Facts.* USP, a domestic corporation, owns all of the stock of FP and USS. FP is a foreign corporation that owns all of the stock of FS, a foreign corporation. USS is a domestic corporation that owns all of the stock of FT, a foreign corporation. USS owns 100 shares of stock of FT, which constitutes a single block of stock with a fair market value of $100x, an adjusted basis of $20x, and a section 1248 amount of $50x. FS has earnings and profits of $60x. A dividend from FS to FP would qualify for the exception to foreign personal holding company income under section 954(c)(6). FP issues 100 shares of voting stock with a fair market value of $100x to FS, $40x of which (the 40-percent FP block) is issued in exchange for $40x of newly issued common stock of FS and $60x of which (the 60-percent FP block) is issued in exchange for $60x of cash. FS acquires all of the stock of FT held by USS solely in exchange for the $100x of voting stock of FP (that is, FS exchanges both the 40-percent FP block and the 60-percent FP block) in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization).

(ii) *Analysis*—(A) *Application of § 1.367(b)–10.* The triangular B reorganization is described in § 1.367(b)–10, and the $60x of cash constitutes property under § 1.367(b)–10(a)(3)(ii). Pursuant to § 1.367(b)–10(b)(1), adjustments must be made that have the effect of a distribution of property in the amount of $60x from FS to FP under section 301. The $60x deemed distribution is treated as separate from, and occurring immediately before, FS's acquisition of the 60-percent FP block used in the triangular B reorganization. The $60x deemed distribution from FS to FP results in $60x of dividend income to FP under section 301(c)(1) that is not foreign personal holding company income under section 954(c)(6).

(B) *Application of paragraph (g) of this section.* Pursuant to § 1.367(a)–3(a)(2)(iv)(B), paragraph (g) of this section applies to $60x of the stock of FT (the 60-percent FT block) exchanged for the 60-percent FP block. Thus, under paragraph (g)(1)(i) of this section, USS must include in income a $30x deemed dividend (representing 60 percent of USS's $50x section 1248 amount) with

respect to the 60-percent FT block exchanged for the 60-percent FP block. In addition, under paragraph (g)(1)(ii) of this section, USS must recognize its realized gain that would not otherwise be recognized with respect to the 60-percent FT block. USS's fair market value and adjusted basis in the 60-percent FT block are $60x (60 percent of the $100x fair market value of the stock of FT) and $12x (60 percent of the $20x adjusted basis of the stock of FT), respectively. USS's initial built-in gain with respect to the 60-percent FT block is accordingly $48x ($60x fair market value less $12x adjusted basis). The $30x deemed dividend increases USS's basis in the 60-percent FT block to $42 ($12x + $30x), leaving $18x ($60x − $42x) of built-in gain. USS must therefore recognize the remaining $18x of gain with respect to the 60-percent FT block.

(C) *Application of paragraph (b) of this section and regulations under section 367(a).* USS has $32x of built-in gain in the remaining $40x of stock of FT (the 40-percent FT block) that USS exchanged for the 40-percent FP block, calculated as USS's initial $80 of built-in gain in all of its stock of FT less the $48x of initial built-in gain attributable to the 60-percent FT block. USS's section 1248 amount in the 40-percent FT block is $20x, calculated as 40 percent of USS's $50x section 1248 amount. USS does not recognize a deemed dividend of the $20x section 1248 amount under paragraph (b) of this section because FT remains a controlled foreign corporation with respect to which USS is a section 1248 shareholder immediately after the triangular B reorganization. Unless USS properly files a gain recognition agreement pursuant to §§ 1.367(a)–3(b) and 1.367(a)–8, USS recognizes the $32x of built-in gain under section 367(a)(1) with respect to the 40-percent FT block.

* * * * *

(i) * * * Paragraph (g) of this section applies to transactions completed on or after December 2, 2016.

■ **Par. 7.** Section 1.367(b)–6 is amended by adding paragraphs (a)(1)(v) and (vi) to read as follows:

§ 1.367(b)–6 Effective/applicability dates and coordination rules.

(a) * * *

(1) * * *

(v) Section 1.367(b)–2(j)(2) applies to transactions completed on or after October 5, 2023 and to any transactions treated as completed before October 5, 2023 as a result of an entity classification election made under § 301.7701–3 of this chapter that is filed on or after October 5, 2023.

(vi) Section 1.367(b)–1(c)(2)(vi), (c)(4)(viii), and (c)(4)(ix) apply to taxable years ending on or after October 5, 2023. However, a taxpayer and its related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply the rules referred to in the preceding sentence to all open taxable years ending before October 5, 2023, provided that the taxpayer and its related parties consistently apply such rules and § 1.367(b–3(g) for such years.

* * * * *

■ **Par. 8.** Section 1.367(b)–10 is amended by:

■ 1. Adding two sentences to the end of paragraph (a)(1);

■ 2. Revising paragraphs (a)(2)(ii) and (iii);

■ 3. Removing the language ''and'' at the end of paragraph (a)(3)(ii)(A), removing the period at the end of paragraph (a)(3)(ii)(B) and adding the language ''; and'' in its place;

■ 4. Adding paragraph (a)(3)(ii)(C);

■ 5. Removing paragraph (b)(2);

■ 6. Redesignating paragraphs (b)(3), (4), and (5) as paragraphs (b)(2), (3), and (4), respectively;

■ 7. Revising newly redesignated paragraph (b)(2);

■ 8. Adding two sentences to the end of newly redesignated paragraph (b)(3);

■ 9. In newly redesignated paragraph (b)(4)(ii), removing the sixth sentence, revising the current seventh sentence, and adding two sentences at the end of the paragraph; and

■ 10. Revising paragraphs (c), (d), and (e).

The revisions and additions read as follows:

§ 1.367(b)–10 Acquisition of parent stock or securities for property in triangular reorganizations.

(a) * * *

(1) * * * *See* § 1.367(b)–3(g) for the treatment of certain inbound nonrecognition transactions following transactions described in this section. *See* § 1.367(b)–4(g) for rules applicable to certain exchanging shareholders that exchange stock of T in connection with a transaction described in this section.

(2) * * *

(ii) S is a domestic corporation, P is not a controlled foreign corporation (within the meaning of § 1.367(b)–2(a)), P's stock in S is not a United States real property interest (within the meaning of section 897(c)), and the deemed distribution that would result from the application of this section would not be treated as a dividend under section 301(c)(1) that would be subject to U.S. tax under either section 881 (for example, by reason of an applicable treaty or by reason of an absence of earnings and profits) or section 882; or

(iii) In an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T and the amount of gain in the T stock or securities that would otherwise be recognized under section 367(a)(1) is equal to or greater than the sum of the amount of the deemed distribution under this section that would be treated and subject to U.S. tax as a dividend under section 301(c)(1) (or would give rise to an inclusion under section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) and the amount of such deemed distribution that would be treated and subject to U.S. tax as gain from the sale or exchange of property under section 301(c)(3) (or would give rise to an inclusion under section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) if this section would otherwise apply to the triangular reorganization. The exception provided in this paragraph (a)(2)(iii) does not apply if T is a foreign corporation. *See* § 1.367(a)-3(a)(2)(iv) (providing a similar rule that excludes certain transactions from the application of section 367(a)(1)).

(3) * * *

(ii) * * *

(C) Stock of S that is nonqualified preferred stock (as defined in section 351(g)(2)).

* * * * *

(b) * * *

(2) *Timing of deemed distribution.* If P controls (within the meaning of section 368(c)) S at the time of the P acquisition, the adjustments described in paragraph (b)(1) of this section are made as if the deemed distribution is a separate transaction occurring immediately before the P acquisition. If P does not control (within the meaning of section 368(c)) S at the time of the P acquisition, the adjustments described in paragraph (b)(1) of this section are made as if the deemed distribution is a separate transaction occurring immediately after P acquires control of S, but before the reorganization.

(3) * * * Thus, P's adjustment to the basis in its S stock under § 1.358–6 is determined as if P provided the P stock or securities pursuant to the plan of reorganization, notwithstanding that S acquired the P stock or securities in exchange for property in the P acquisition. *See also* § 1.367(b)–13.

(4) * * *

(ii) * * * Pursuant to paragraph (b)(2) of this section, the adjustment described in paragraph (b)(1) of this section is made as if the deemed distribution is a separate transaction occurring immediately before FS's purchase of the P stock on the open market. * * *

US1's transfer of its FT stock in exchange for P stock is subject to § 1.367(b)–4(g). If, contrary to the facts in this paragraph (b)(4), US1 had built-in gain with respect to its FT stock, then such gain would be recognized in accordance with § 1.367(b)–4(g).

(c) *Collateral adjustments.* This paragraph (c) provides additional rules that apply by reason of the deemed distribution described in paragraph (b)(1) of this section. A deemed distribution described in paragraph (b)(1) of this section is treated as occurring for all purposes of the Internal Revenue Code. Thus, for example, the ordering rules of section 301(c) apply to characterize the deemed distribution to P as a dividend from the earnings and profits of S, return of stock basis, or gain from the sale or exchange of property, as the case may be. Furthermore, section 959 may apply to the deemed distribution if S is a foreign corporation, and sections 881, 882, 897, 1442, or 1445 may apply to the deemed distribution if S is a domestic corporation. Appropriate corresponding adjustments must be made to S's earnings and profits consistent with the principles of section 312.

(d) *Anti-abuse rule*—(1) *Rule.* Appropriate adjustments must be made pursuant to this section if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of this section. For example, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of another corporation, the earnings and profits of S (or any successor corporation) may be deemed to include the earnings and profits of such other corporation (or any successor corporation) for purposes of determining the consequences of the adjustments provided in this section, and appropriate corresponding adjustments may be made to account for the application of this section to the earnings and profits of such other corporation (or any successor corporation). Adjustments may be made under this paragraph (d) whether S is funded before or after a triangular reorganization, and such funding may include capital contributions, loans, and distributions. The following examples illustrate the application of this paragraph (d), the application of which is not limited to the particular situations described in the examples.

(2) *Example 1: Deemed increase to S's earnings and profits*—(i) *Facts.* FP is a foreign corporation that owns all of the stock of USS, a domestic corporation. USS has no assets, liabilities, or earnings and profits. FP issues $10x of voting stock to USS in exchange for $10x of newly issued stock of USS, and FP also issues $90x of voting stock to USS in exchange for a note newly issued by USS with a fair market value of $90x (USS note). FP would be subject to U.S. tax under section 881 on a distribution from USS if, contrary to the facts, USS had earnings and profits for purposes of applying section 301(c) to the distribution. USS acquires all the stock of UST, a domestic corporation that is unrelated to FP and USS, from a foreign person in exchange for the $100x of voting stock of FP in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization). UST has $100x of earnings and profits. USS's purchase of the $90x of stock of FP in exchange for the USS note in connection with the triangular B reorganization is engaged in with a view to avoid the purpose of this section.

(ii) *Analysis.* Because USS's purchase of the $90x of stock of FP in exchange for the USS note is engaged in with a view to avoid the purpose of this section, the anti-abuse rule applies and appropriate adjustments are made. In particular, for purposes of determining the consequences of the deemed distribution provided for in paragraph (b)(1) of this section, the earnings and profits of USS are deemed to include the earnings and profits of UST. USS is therefore treated as having made a deemed distribution equal to $90x, which reflects the portion of the stock of FP that USS acquired in exchange for property (the USS note). Because USS is deemed to have $100x of earnings and profits, the entire $90x deemed distribution is treated as a dividend under section 301(c)(1). The deemed distribution is treated as separate from, and occurring immediately before, USS's acquisition of the stock of FP used in the triangular B reorganization. No adjustments are made by FP to the basis in its stock of USS except as provided in § 1.358–6. Under paragraph (b)(3) of this section, FP's adjustment to the basis in its stock of USS under § 1.358–6 is determined as if FP provided all $100x of the stock of FP pursuant to the plan of reorganization.

(3) *Example 2: Downstream property transfer*—(i) *Facts.* USP is a domestic corporation that owns all of the stock of FS1, a foreign corporation, FS1 holds a note receivable issued by USP with a fair market value of $100x (USP note), and FS1 has more than $100x of earnings and profits. USP has no income inclusion under section 951(a)(1)(B) with respect to the USP note after the application of § 1.956–1(a)(2). FS1 forms USS Newco, a domestic corporation, to which it transfers the USP note in exchange for voting stock of USS Newco. USS Newco then forms FS2 Newco, a foreign corporation, and FS1 transfers all of its remaining assets (except for its stock in USS Newco) to FS2 Newco in exchange for additional voting stock of USS Newco in a transaction intended to qualify as a triangular reorganization described in section 368(a)(1)(C) (triangular C reorganization). FS1 liquidates into USP pursuant to the triangular C reorganization, and USP receives the stock of USS Newco held by FS1. FS1's transfer of the USP note to USS Newco in connection with the intended triangular C reorganization is engaged in with a view to avoid the purpose of this section.

(ii) *Analysis.* Because FS1's transfer of the USP note to USS Newco is in connection with a triangular reorganization and is engaged in with a view to avoid the purpose of this section, the anti-abuse rule applies and appropriate adjustments are made. FS1's formation of USS Newco and transfer of the USP note to USS Newco, together with the distribution of the shares of USS Newco pursuant to the liquidation of FS1, is treated under the anti-abuse rule as a distribution of $100x, consistent with its substance. Accordingly, adjustments are made consistent with there having been such a distribution. Because FS1 has more than $100x of earnings and profits, the adjustments made are consistent with USS Newco having received a $100x dividend from FS1 separate from, and immediately before, the triangular C reorganization. USS Newco must therefore include $100x in gross income as if it had received that amount as a dividend and increase its earnings and profits by the same amount. FS1 must decrease its earnings and profits by $100x. For purposes of determining USS Newco's basis in its stock of FS2 Newco, § 1.367(b)–13 applies by treating USS Newco as P (within the meaning of § 1.367(b)–13(a)(2)(ii)). Under paragraph (b)(3) of this section, USS Newco's adjustment to the basis in its FS2 Newco stock under § 1.367(b)–13 is determined as if USS Newco provided the stock of USS Newco stock pursuant to the plan of reorganization.

(4) *Example 3: Taxable debt exchange*—(i) *Facts.* USP is a domestic corporation that owns all of the stock of FP, a foreign corporation, and USS, a domestic corporation. Furthermore, FP owns all of the stock of FS, a foreign corporation, and USS owns all of the stock of UST, a domestic corporation. FP has no earnings and profits, and FS has more than $100x of earnings and

profits. USP has held its stock in FP for fewer than 365 days and thus does not satisfy the requirements of sections 245A and 246(c) with respect to dividends received from FP. FS transfers a note issued by FS with a fair market value of $100x (FS note) to FP in exchange for $100x of voting stock of FP, and FS then uses the stock of FP to acquire all of the stock of UST held by USS in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization). Because a dividend from FS to FP would not constitute foreign personal holding company income under section 954(c)(6), the taxpayer asserts that the exception in paragraph (a)(2)(iii) of this section applies and therefore does not make any adjustments pursuant to this section. FP then transfers the FS note to USP in exchange for a note issued by USP with a fair market value of $100x (USP note). The USP note constitutes United States property within the meaning of section 956(c), and USP would otherwise have an inclusion under section 951(a)(1)(B) and § 1.956–1(a)(2) if FP had earnings and profits. FS's transfer of the FS note to FP, and FP's subsequent transfer of the FS note to USP in connection with the triangular B reorganization, are engaged in with a view to avoid the purpose of this section.

(ii) *Analysis.* Because the transfers of the FS note are in connection with a triangular reorganization and are engaged in with a view to avoid the purpose of this section, the anti-abuse rule applies and appropriate adjustments are made. FS is therefore treated as having made a distribution to FP of $100x, reflecting the value of the stock of FP that FS acquired in exchange for property (the FS note). The deemed distribution is treated as separate from, and occurring immediately before, FS's acquisition of the stock of FP stock used in the triangular B reorganization. Because FS has more than $100x of earnings and profits, the entire deemed distribution is treated as a dividend under section 301(c)(1). The deemed dividend causes FP to increase its earnings and profits by $100x but does not constitute foreign personal holding company income to FP under section 954(c)(6). FP thus has $100x of earnings and profits available to support inclusions under section 951(a)(1)(B) in connection with FP's subsequent acquisition of the USP note. No adjustments are made by FP to the basis in its stock of FS except as provided in § 1.358–6. Under paragraph (b)(3) of this section, FP's adjustment to the basis in its stock of FS under § 1.358–6 is determined as if FP provided the stock of FP pursuant to the plan of reorganization.

(e) *Applicability dates*—(1) *General rule.* This section applies to triangular reorganizations occurring on or after May 17, 2011. For triangular reorganizations that occur before May 17, 2011, *see* § 1.367(b)–14T as contained in 26 CFR part 1 revised as of April 1, 2011.

(2) *Triangular reorganizations completed on or after April 25, 2014.* The following paragraphs apply to triangular reorganizations that are completed on or after April 25, 2014, unless T was not related to P or S (within the meaning of section 267(b)) immediately before the triangular reorganization; the triangular reorganization was entered into either pursuant to a written agreement that was (subject to customary conditions) binding before April 25, 2014, and at all times afterwards, or pursuant to a tender offer announced before April 25, 2014, that is subject to section 14(d) of the Securities and Exchange Act of 1934 (15 U.S.C. 78n(d)(1)) and Regulation 14(D) (17 CFR 240.14d–1 through 240.14d–101) or that is subject to comparable foreign laws; and to the extent the P acquisition that occurs pursuant to the plan of reorganization is not completed before April 25, 2014, the P acquisition was included as part of the plan before April 25, 2014:

(i) Paragraph (a)(2)(ii) of this section, to the extent it does not apply where P is a controlled foreign corporation, and to the extent it relates to dividends that would be subject to U.S. tax;

(ii) Paragraph (a)(2)(iii) of this section, to the extent it relates to amounts that would be subject to U.S. tax or give rise to an inclusion under section 951(a)(1)(A) that would be subject to U.S. tax;

(iii) Paragraph (b)(3) of this section, to the extent it relates to P's provision of its stock or securities pursuant to the plan of reorganization; and

(iv) Paragraphs (b) and (c) of this section, to the extent they do not reference the rule described in former paragraph (b)(2) of this section (relating to the deemed contribution), as contained in 26 CFR part 1 revised as of April 1, 2021.

(3) *Transactions completed on or after December 2, 2016.* The following paragraphs apply to transactions completed on or after December 2, 2016:

(i) Paragraph (a)(2)(iii) of this section, to the extent it does not apply where T is a foreign corporation; and

(ii) Paragraph (a)(3)(ii)(C) of this section.

(4) *Deemed distributions that occurred in taxable years ending before November 2, 2020.* Former paragraph (c)(1) of this section, as contained in 26 CFR part 1 revised as of April 1, 2021, to the extent it references section 902, applies to deemed distributions that occur in taxable years ending before November 2, 2020.

(5) *Triangular reorganizations completed on or after October 5, 2023.* Paragraph (a)(2)(iii) of this section, to the extent it relates to amounts that would give rise to an inclusion under section 951A(a) that would be subject to U.S. tax, applies to triangular reorganizations that are completed on or after October 5, 2023.

■ **Par. 9.** Section 1.1248–1 is amended by adding a sentence to the end of paragraph (a)(1) to read as follows:

§ 1.1248–1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

(a) * * *

(1) * * * *See* § 1.1411–10(c)(3) for additional rules concerning the application of section 1248 for purposes of section 1411.

* * * * *

■ **Par. 10.** Section 1.1411–10 is amended by:

■ 1. Revising the heading of paragraph (c)(3);

■ 2. In paragraph (c)(3), removing the language ''With respect to stock of a CFC'' and adding in its place ''With respect to stock of a foreign corporation that is a CFC (or that was a CFC at any time during the 5-year period ending on the date of sale or exchange)'';

■ 3. Revising paragraph (c)(3)(i) and the introductory text of paragraph (c)(3)(ii);

■ 4. Adding paragraph (d)(5); and

■ 5. Adding a sentence to the end of paragraph (i).

The revisions and additions read as follows:

§ 1.1411–10 Controlled foreign corporations and passive foreign investment companies.

* * * * *

(c) * * *

(3) *Application of sections 1248 and 367(b).* * * *

(i) In determining the amount of gain recognized on the sale or exchange of stock of a foreign corporation under section 1248(a) or the amount of gain realized on the exchange of stock of a foreign corporation under § 1.367(b)–4 or 1.367(b)–5, basis is determined in accordance with the provisions of paragraph (d) of this section; and

(ii) Section 1248(a), and § 1.367(b)–2(c)(1) and (d)(2)(ii) apply without regard to the exclusions for certain

earnings and profits under section 1248(d)(1) and (d)(6), except that those exclusions will apply with respect to the earnings and profits of a foreign corporation that are attributable to:

* * * * *

(d) * * *

(5) *Basis adjustments under section 367(b).* With respect to stock of a foreign corporation that is exchanged in a transaction subject to section 367(b), the portion of the basis increase provided by § 1.367(b)–2(e)(3)(ii) by reason of paragraph (c)(3)(ii) of this section is made solely for purposes of section 1411.

* * * * *

(i) * * * Paragraph (c)(3) of this section, to the extent it references regulations issued under section 367(b), and paragraph (d)(5) of this section, apply to transactions completed on or after October 5, 2023 and to any transactions treated as completed before October 5, 2023 as a result of an entity classification election made under § 301.7701–3 of this chapter that is filed on or after October 5, 2023.

Douglas W. O'Donnell,

Deputy Commissioner for Services and Enforcement.

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RIN 0651–AD68

Rules Governing Pre-Issuance Internal Circulation and Review of Decisions Within the Patent Trial and Appeal Board

AGENCY: United States Patent and Trademark Office, Department of Commerce.

ACTION: Notice of proposed rulemaking.

SUMMARY: The United States Patent and Trademark Office (''USPTO'' or ''Office'') proposes regulations to govern the pre-issuance circulation and review of decisions within the Patent Trial and Appeal Board (''PTAB'' or ''Board''). The Office proposes these provisions to refine the current interim process in light of stakeholder feedback received in response to a Request for Comments (RFC). This proposed rule promotes the efficient delivery of reliable intellectual property rights by promoting consistent, clear, and open decision-making processes at the PTAB.

DATES: Comments must be received by December 5, 2023 to ensure consideration.

ADDRESSES: Comments must be submitted through the Federal eRulemaking Portal at *www.regulations.gov.* To submit comments via the portal, one should enter docket number PTO–P–2023–0012 on the homepage and select ''search.'' The site will provide search results listing all documents associated with this docket. Commenters can find a reference to this notice and select the ''comment'' icon, complete the required fields, and enter or attach their comments. Attachments to electronic comments will be accepted in Adobe® portable document format (PDF) or Microsoft Word® format. Because comments will be made available for public inspection, information that the submitter does not desire to make public, such as an address or phone number, should not be included in the comments.

Visit the Federal eRulemaking Portal for additional instructions on providing comments via the portal. If electronic submission of, or access to, comments is not feasible due to a lack of access to a computer and/or the internet, please contact the USPTO using the contact information below for special instructions.

FOR FURTHER INFORMATION CONTACT: Melissa A. Haapala, Vice Chief Administrative Patent Judge, or Stacy B. Margolies, Lead Administrative Patent Judge, 571–272–9797.

SUPPLEMENTARY INFORMATION:

Executive Summary

Purpose: This proposed rule would codify processes and standards to govern the internal pre-issuance circulation and review of decisions within the PTAB.

Since May of 2022, the USPTO has been using an interim process for PTAB decision circulation and internal PTAB review to promote consistent, clear, and open decision-making processes at the USPTO. The processes were put in place to support a consistent and clear approach to substantive areas of patent law and PTAB-specific procedures, while maintaining open decision-making processes. The USPTO subsequently issued an RFC seeking public input on these processes. After reviewing feedback received from the public in response to the RFC, the USPTO now seeks to formalize its processes for circulation and review of decisions within the PTAB through notice-and-comment rulemaking.

This proposed rule provides that the USPTO Director, Deputy Director, and Commissioners for Patents and Trademarks are not involved, directly or indirectly, in the decision making of panels of the PTAB prior to issuance of a decision by the panel. In addition, no employee of the Office external to the Board, nor any member of PTAB management, is involved, directly or indirectly, in panel decision-making unless a panel member has requested their input. The adoption of any feedback received by the panel is entirely optional and solely within the discretion of the panel.

This proposed rule also sets forth that, if the Office establishes procedures governing the internal circulation and review of decisions prior to issuance to one or more designated members of the Board, no management judge shall participate in any such review, either directly or indirectly. The adoption of any feedback received pursuant to such review is entirely optional and solely within the discretion of the panel.

Finally, this proposed rule provides that decisions of the Board are expected to comport with applicable statutes, regulations, binding case law, and written agency or Board policy or guidance, and that there is no unwritten agency or Board policy or guidance that is binding on any panel of the Board.

Background

On September 16, 2011, the America Invents Act (AIA) was enacted into law (Pub. L. 112–29, 125 Stat. 284 (2011)). The AIA established the PTAB, which is made up of administrative patent judges (APJs) and four statutory members, namely the USPTO Director, the USPTO Deputy Director, the USPTO Commissioner for Patents, and the USPTO Commissioner for Trademarks. 35 U.S.C. 6(a). The PTAB hears and decides ex parte appeals of adverse decisions by examiners in applications for patents; appeals of adverse decisions by examiners in reexamination proceedings; and proceedings under the AIA, including inter partes reviews, post grant reviews, covered business method (CBM) patent reviews,[1] and derivation proceedings, in panels of at least three members. 35 U.S.C. 6(b), (c). Under the statute, the Director designates the members of each panel. 35 U.S.C. 6(c). The Director has delegated that authority to the Chief

[1] Under section 18 of the AIA, the transitional program for post-grant review of CBM patents sunset on September 16, 2020. AIA 18(a). Although the program has sunset, existing CBM proceedings, based on petitions filed before September 16, 2020, remain pending on appeal at the Federal Circuit Court of Appeals.