

Additional Guidance Under Section 965; Guidance Under Sections 62, 962, and 6081 in Connection With Section 965; and Penalty Relief Under Sections 6654 and 6655 in Connection with Section 965 and Repeal of Section 958(b)(4)

Notice 2018-26

## SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) intend to issue regulations in connection with section 965 of the Internal Revenue Code (“Code”) as amended by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), which was enacted on December 22, 2017. For prior guidance issued under section 965, see Notice 2018-07, 2018-4 I.R.B. 317; Notice 2018-13, 2018-6 I.R.B. 341; and Rev. Proc. 2018-17, 2018-9 I.R.B. 384. In addition, this notice announces relief from estimated tax penalties in connection with the amendment of section 965 and the repeal of section 958(b)(4) by the Act.

Section 2 of this notice provides background on section 965 and other relevant provisions of the Code. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue in connection with section 965 and announces the IRS’s intent to modify certain form instructions as a result of section 965. Section 4 of this notice describes a modification that the Treasury Department and the IRS intend

to make with respect to regulations under section 965 that were described in section 3.04(a) of Notice 2018-13. Section 5 of this notice provides guidance under section 962 in connection with section 965. Section 6 of this notice provides guidance concerning the application of the estimated tax rules in sections 6654 and 6655 and a waiver from the penalty imposed under those sections with respect to estimated taxes in connection with section 965 and the repeal of section 958(b)(4). Section 7 of this notice describes the effective dates of the regulations and other guidance described in this notice, as well as a clarification to the effective date provided in section 6 of Notice 2018-13 for the rule described in section 5.01 of Notice 2018-13. Section 8 of this notice requests comments and provides contact information.

## SECTION 2. BACKGROUND

### *.01 Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income*

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation (“DFIC”) that begins before January 1, 2018 (such year of the DFIC, the “inclusion year”), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, a “measurement date,” and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the “section 965(a) earnings amount”). The section 965(a) earnings amount is not subject to the rules or limitations in section 952

and is not limited by the accumulated earnings and profits of the DFIC as of the close of the inclusion year.

*.02 Determination of United States Shareholder's Section 951(a)(1) Inclusion by Reason of Section 965*

Section 965(b)(1) provides that, if a taxpayer is a United States shareholder with respect to at least one DFIC and at least one E&P deficit foreign corporation, then the portion of the section 965(a) earnings amount which would otherwise be taken into account under section 951(a)(1) by a United States shareholder with respect to each DFIC is reduced by the amount of such United States shareholder's aggregate foreign E&P deficit that is allocated to such DFIC. The portion of the section 965(a) earnings amount that is taken into account under section 951(a)(1) by a United States shareholder, taking into account the reduction described in the preceding sentence, is referred to in this notice as the "section 965(a) inclusion amount."

*.03 Allocation of Aggregate Foreign E&P Deficit and Definition of E&P Deficit Foreign Corporation*

The aggregate foreign E&P deficit of any United States shareholder is allocated to each DFIC of the United States shareholder in an amount that bears the same proportion to such aggregate as (A) such United States shareholder's pro rata share of the section 965(a) earnings amount of each such DFIC bears to (B) the aggregate of such United States shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such United States shareholder. Section 965(b)(2). The term "aggregate foreign E&P deficit" means, with respect to any United States shareholder, the lesser of (I) the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder or (II) the

aggregate of such shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such shareholder. Section 965(b)(3)(A)(i).

The term "E&P deficit foreign corporation" means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if, as of November 2, 2017, (i) such specified foreign corporation has a deficit in post-1986 earnings and profits, (ii) such corporation was a specified foreign corporation, and (iii) such taxpayer was a United States shareholder of such corporation. Section 965(b)(3)(B). The term "specified E&P deficit" means, with respect to an E&P deficit foreign corporation, the amount of such corporation's deficit in post-1986 earnings and profits as of November 2, 2017. See section 965(b)(3)(C).

#### *.04 Application of the Participation Exemption*

Section 965(c)(1) provides that there shall be allowed as a deduction for the taxable year of a United States shareholder in which a section 965(a) inclusion amount is included in the gross income of such United States shareholder an amount equal to the sum of (A) the United States shareholder's 8 percent rate equivalent percentage (as defined in section 965(c)(2)(A)) of the excess (if any) of (i) the section 965(a) inclusion amount, over (ii) the amount of such United States shareholder's aggregate foreign cash position, plus (B) the United States shareholder's 15.5 percent rate equivalent percentage (as defined in section 965(c)(2)(B)) of so much of such United States shareholder's aggregate foreign cash position as does not exceed the section 965(a) inclusion amount. The deduction allowed to a United States shareholder under section 965(c) with respect to a section 965(a) inclusion amount of the United States shareholder is referred to in this notice as a "section 965(c) deduction."

Section 965(c)(3)(A) provides that the term “aggregate foreign cash position” means, with respect to any United States shareholder, the greater of (i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the last taxable year of such specified foreign corporation that begins before January 1, 2018 (“final cash measurement date”),<sup>1</sup> or (ii) one half of the sum of (I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation that ends before November 2, 2017 (the “second cash measurement date”), plus (II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation that precedes the taxable year referred to in subclause (I) (“first cash measurement date”). Each date referred to in the preceding sentence is referred to in this notice as a “cash measurement date.”

The cash position of any specified foreign corporation is the sum of (i) cash held by such corporation, (ii) the net accounts receivable of such corporation, and (iii) the fair market value of the following assets held by such corporation (each asset, a “cash equivalent asset”): (I) personal property which is of a type that is actively traded and for which there is an established financial market; (II) commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign

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<sup>1</sup> Notice 2018-07 and Notice 2018-13 referred to the year that includes the final cash measurement date as the “inclusion year” of such specified foreign corporation. However, only a DFIC can have an inclusion year, and therefore the final cash measurement date of a specified foreign corporation, which can be a DFIC, an E&P deficit foreign corporation, or neither, will not necessarily be the close of an inclusion year. The regulations described in Notice 2018-07 and Notice 2018-13 will describe the final cash measurement date consistently with section 965(c)(3)(A) and this notice. Any reference to an “inclusion year” for a specified foreign corporation that is not a DFIC will describe the last year of the specified foreign corporation that begins before January 1, 2018.

government; (III) any foreign currency; (IV) any obligation with a term of less than one year (“short-term obligation”); and (V) any asset which the Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B). Section 965(c)(3)(B). For purposes of determining the aggregate foreign cash position of a United States shareholder, the term “net accounts receivable” means, with respect to any specified foreign corporation, the excess (if any) of (i) such corporation’s accounts receivable, over (ii) such corporation’s accounts payable (determined consistent with the rules of section 461). Section 965(c)(3)(C).

Section 965(c)(3)(D) provides that net accounts receivable, actively traded property, and short-term obligations shall not be taken into account by a United States shareholder in determining its aggregate foreign cash position to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation.

Section 965(c)(3)(F) provides that if the Secretary determines that a principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under section 965(c), such transaction shall be disregarded for purposes of section 965(c).

#### *.05 Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income*

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign

corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1 (“effectively connected income”), or (B) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed income”). Section 965(d)(2).

Section 965(d)(3) provides that the term “post-1986 earnings and profits” means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by taking into account only periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (A) as of the measurement date that is applicable with respect to such foreign corporation, and (B) without diminution by reason of dividends distributed during the inclusion year other than dividends distributed to another specified foreign corporation.

#### *.06 Specified Foreign Corporation*

Section 965(e)(1) provides that the term “specified foreign corporation” means (A) any CFC and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder. For purposes of sections 951 and 961, a specified foreign corporation described in section 965(e)(1)(B) is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a) (and for purposes of determining a United States shareholder’s pro rata share of any amount with respect to a specified foreign corporation under section 965(f)). Section 965(e)(2). However, if a passive foreign investment company

(as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

*.07 Determination of Pro Rata Share*

Section 965(f)(1) provides that the determination of any United States shareholder's pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a CFC).

*.08 Election Under Section 965(h) Concerning Payment of Net Tax Liability Under Section 965*

Section 965(h)(1) provides that in the case of a United States shareholder of a DFIC, such United States shareholder may elect to pay the net tax liability under section 965 in eight installments. Section 965(h)(5) provides that any election under section 965(h)(1) must be made not later than the due date for the return of tax for the year of the United States shareholder in which or with which the inclusion year of the DFIC ends and must be made in such manner as the Secretary provides.

If an election is made under section 965(h)(1), the first installment must be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the year of the United States shareholder in which or with which the inclusion year of the DFIC ends, and each succeeding installment must be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the taxable year following the taxable year with respect to which the preceding installment was made. Section 965(h)(2).



Section 965(h)(6) defines the net tax liability under section 965 with respect to any United States shareholder as the excess (if any) of (i) such taxpayer's net income tax for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of section 965, over (ii) such taxpayer's net income tax for such taxable year determined (I) without regard to section 965, and (II) without regard to any income or deduction properly attributable to a dividend received by such United States shareholder from any DFIC. For this purpose, the term "net income tax" means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A.

*.09 Election Under Section 965(i) Concerning Payment of Net Tax Liability Under Section 965 by S Corporation Shareholder and Related Reporting Requirements*

Section 965(i)(1) provides that in the case of any S corporation that is a United States shareholder of a DFIC, each shareholder of such S corporation may elect to defer payment of such shareholder's net tax liability under section 965 with respect to such S corporation until the shareholder's taxable year which includes the triggering event with respect to such liability.

Under section 965(i)(1), any net tax liability, payment of which is deferred under section 965(i)(1), will be assessed on the return of tax as an addition to tax in the shareholder's taxable year which includes the triggering event with respect to such liability. As defined in section 965(i)(2), in the case of any shareholder's net tax liability under section 965 with respect to any S corporation, the triggering event with respect to such liability is whichever of the following occurs first: (i) such corporation ceases to be an S corporation (determined as of the first day of the first taxable year that such corporation is not an S corporation); (ii) a liquidation or sale of substantially all the

assets of such S corporation (including in a title 11 or similar case), a cessation of business by such S corporation, such S corporation ceases to exist, or any similar circumstance; or (iii) a transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise). In the case of a transfer of less than all of the taxpayer's shares of stock in the S corporation, such transfer shall only be a triggering event with respect to so much of the taxpayer's net tax liability under section 965 with respect to such S corporation as is properly allocable to such stock. Section 965(i)(2)(B).

Section 965(i)(3) defines a shareholder's net tax liability under section 965 with respect to any S corporation as the net tax liability under section 965 which would be determined under section 965(h)(6) if the only amounts taken into account under section 951(a)(1) by reason of section 965 by such shareholder were allocations from such S corporation.

*.10 Election Under Section 965(m) Concerning Inclusions of Amounts Under Section 965*

Under section 965(m)(1)(B), a real estate investment trust (REIT) may elect, in lieu of including any amount required to be taken into account under section 951(a)(1) by reason of section 965 in the taxable year in which it would otherwise be included in gross income (for purposes of the computation of REIT taxable income under section 857(b)), to include such amount in gross income in eight installments.

*.11 Election Under Section 965(n) Not to Apply Net Operating Loss Deduction*

Under section 965(n)(1), a United States shareholder of a DFIC may make an election pursuant to which the amount described in section 965(n)(2) shall not be taken into account (A) in determining the amount of the net operating loss deduction under

section 172 of such shareholder for such taxable year, or (B) in determining the amount of taxable income for such taxable year which may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172. The amount described in section 965(n)(2) is the sum of (A) the amount required to be taken into account under section 951(a)(1) by reason of section 965 (determined after the application of section 965(c)), plus (B) in the case of a domestic corporation which chooses to have the benefits of subpart A of part III of subchapter N for the taxable year, the taxes deemed to be paid by such corporation under subsections (a) and (b) of section 960 for such taxable year with respect to the amount described in section 965(n)(2)(A) which are treated as a dividends under section 78.

*.12 Regulations or Other Guidance Under Section 965*

Section 965(o) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 965, including regulations or other guidance to provide appropriate basis adjustments, and regulations or other guidance to prevent the avoidance of the purposes of section 965, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.

*.13 Definition of United States Shareholder*

For taxable years of foreign corporations beginning before January 1, 2018, under section 951(b), a United States shareholder is a United States person (within the meaning of section 957(c)) that owns within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the stock of a foreign corporation. Under section 957(c), a United States person generally

has the meaning assigned to it by section 7701(a)(30), which includes a domestic partnership or domestic trust. But see Notice 2010-41, 2010-22 I.R.B. 715 (announcing that the Treasury Department and the IRS intend to issue regulations treating certain domestic partnerships as foreign partnerships for purposes of identifying which United States shareholders are required to include amounts in gross income under section 951(a)). Moreover, an S corporation is treated as a partnership for purposes of sections 951 through 965. See section 1373(a).

*.14 Attribution Rules in Section 958(b) and Section 318(a)*

Section 958 provides rules for determining direct, indirect, and constructive stock ownership. Under section 958(a)(1), stock is considered owned by a person if it is owned directly or is owned indirectly through certain foreign entities under section 958(a)(2). Under section 958(b), section 318 applies, with certain modifications, to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), to treat the stock of a domestic corporation as owned by a United States shareholder of a CFC for purposes of section 956(c)(2), or to treat a foreign corporation as a CFC under section 957.

Section 318 provides rules that attribute the ownership of stock to certain family members, between certain entities and their owners, and to holders of options to acquire stock. Section 318(a)(1) provides rules attributing stock ownership among members of a family. Section 318(a)(2) provides rules attributing stock ownership “upward” from partnerships, estates, trusts, and corporations to partners, beneficiaries, owners, and shareholders. In addition, section 318(a)(3) provides specific rules that attribute the ownership of stock “downward” from partners, beneficiaries, owners, and

shareholders to partnerships, estates, trusts, and corporations. In particular, section 318(a)(3)(A) provides that stock owned, directly or indirectly, by or for a partner in a partnership or a beneficiary of an estate is considered as owned by the partnership or estate. This provision applies to all partners and beneficiaries without regard to the size of their interest in the partnership or estate. Section 318(a)(3)(B) similarly provides, subject to certain exceptions, that stock owned, directly or indirectly, by or for a beneficiary of a trust (or a person who is considered an owner of a trust) is considered owned by the trust. In comparison, section 318(a)(3)(C) provides that stock owned, directly or indirectly, by or for a shareholder in a corporation is considered owned by the corporation only if 50 percent or more in value of the stock in the corporation is owned, directly or indirectly, by such person.

Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, the Act repeals section 958(b)(4). As in effect prior to repeal, section 958(b)(4) provided that subparagraphs (A), (B), and (C) of section 318(a)(3) (providing for “downward” attribution) were not to be applied so as to consider a United States person as owning stock that is owned by a person who is not a United States person.

#### *.15 Estimated Taxes Under Sections 6654 and 6655*

Taxpayers who fail to make sufficient and timely payments of estimated taxes are liable for additions to tax under sections 6654(a), for individuals, and 6655(a), for corporations. Generally, the addition to tax is calculated by applying the underpayment

interest rate under section 6621 to the unpaid portion of any required installment for the period that portion goes unpaid.

#### *.16 Miscellaneous Itemized Deductions*

Under section 67(a), miscellaneous itemized deductions are allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income (the “2-percent floor”). As amended by the Act, section 67(g) provides that for taxable years beginning after December 31, 2017, and before January 1, 2026, no miscellaneous itemized deductions are allowable under section 67(a). In addition, under section 56(b)(1)(A)(i), an individual subject to the alternative minimum tax (“AMT”) in 2017 is not allowed a deduction for any miscellaneous itemized deduction. Under section 63(d), itemized deductions generally mean all allowable deductions except for the deductions allowable in arriving at adjusted gross income pursuant to section 62(a), the deduction provided by section 151, and the deduction provided in section 199A (added by the Act). Miscellaneous itemized deductions include all itemized deductions other than those listed in section 67(b), which does not reference the deduction under section 965(c).

#### *.17 Election Under Section 962 for Individual to be Subject to Tax at Corporate Rates*

As amended by the Act, section 962 provides that an individual who is a United States shareholder may elect to have the tax imposed under chapter 1 on amounts that are included in the individual’s gross income under section 951(a) be an amount equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. In addition, if such election is made, the amounts included in the individual’s gross income under section 951(a) are treated as if they were received by a domestic corporation for purposes of applying section 960 (relating to foreign tax

credits). See §1.962-1(a). However, the taxable income determined for purposes of applying section 11 is not reduced by any deduction of the United States shareholder. See §1.962-1(b)(1)(i). An election under section 962 does not affect tax imposed under other chapters, including under chapter 2A.

*.18 Extensions of Time for Filing Income Tax Returns and Paying Tax for Certain Citizens and Residents Abroad*

In relevant part, regulations under section 6081 provide an extension of time to the fifteenth day of the sixth month following the close of the taxable year for filing returns of income and for paying any tax shown on the return in the case of United States citizens or residents whose tax homes and abodes, in a real and substantial sense, are outside the United States and Puerto Rico, and United States citizens and residents in military or naval service on duty, including non-permanent or short term duty, outside the United States and Puerto Rico (“specified individuals”). See §1.6081-5(a)(5) and (6).

**SECTION 3. REGULATIONS TO BE ISSUED ADDRESSING THE APPLICATION OF SECTION 965**

*.01 Application of Section 318(a)(3)(A) to Treat a Foreign Corporation as a Specified Foreign Corporation*

As a result of the application of the constructive ownership rule in section 318(a)(3)(A) (providing for downward attribution of stock from a partner to a partnership), it may be difficult to determine if a foreign corporation is a specified foreign corporation under certain circumstances. Assume, for example, that a person, A, owns 100 percent of the stock of a domestic corporation, DC, and 1 percent of the interests in a partnership, PS. Assume further that a United States citizen, USI, owns 10 percent of the interests in PS and 10 percent by vote and value of the stock of a foreign

corporation, FC. The remaining 90 percent by vote and value of the stock of FC is owned by non-U.S. persons that are unrelated to A, USI, DC, and PS. Absent the application of sections 958(b), 318(a)(3)(A), and 318(a)(3)(C), FC would not be a specified foreign corporation, because FC is not a CFC and there would be no domestic corporation that is a United States shareholder of FC.

Under sections 958(b) and 318(a)(3)(A), PS would be treated as owning 100 percent of the stock of DC and 10 percent of the stock of FC. As a result, under sections 958(b), 318(a)(5)(A), and 318(a)(3)(C), DC would be treated as owning the stock of FC treated as owned by PS, and thus DC would be a United States shareholder with respect to FC, causing FC to be a specified foreign corporation within the meaning of section 965(e)(1)(B). USI is a United States shareholder with respect to FC and thus, absent an exception, would be required to include amounts in gross income under section 951(a)(1) by reason of section 965 with respect to FC. The results are the same whether A or PS or both are domestic or foreign persons.

The Treasury Department and the IRS have determined that it would pose compliance difficulties for taxpayers and administrative difficulties for the IRS to require a United States person to determine whether a foreign corporation with respect to which it is a United States shareholder is a specified foreign corporation if such foreign corporation may be a specified foreign corporation solely by reason of downward attribution under section 318(a)(3)(A) of stock from a partner to a partnership when such partner has only a de minimis interest in such partnership. Accordingly, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that, solely for purposes of determining whether a



foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B), stock owned, directly or indirectly, by or for a partner (tested partner) will not be considered as being owned by a partnership under sections 958(b) and 318(a)(3)(A) if such partner owns less than five percent of the interests in the partnership's capital and profits. For purposes of the preceding sentence, an interest in the partnership owned by another partner will be considered as being owned by the tested partner under the principles of sections 958(b) and 318, as modified by this notice, as if the interest in the partnership were stock.

Thus, for example, assume the same facts as in the example above, except that A is a corporation wholly owned by B, and B directly owns 4 percent of the interests in PS. For purposes of the rule in this section 3.01, applying the principles of sections 958(b) and 318, as modified by this notice, as if the interest in PS were stock, A is treated as owning the interests in PS owned by B (in addition to the 1 percent interest in PS that A owns directly), and thus A is not treated as owning less than five percent of the interests in PS's capital and profits. Accordingly, the rule in this section 3.01 does not apply, and PS is treated as owning A's stock in DC for purposes of determining whether FC is a specified foreign corporation within the meaning of section 965(e)(1)(B).

*.02 Determination of Cash Measurement Dates of a Specified Foreign Corporation with Respect to a United States Shareholder*

In certain cases, a specified foreign corporation may not be owned by a particular United States shareholder on all of the cash measurement dates, whether because the specified foreign corporation goes out of existence before the final cash measurement date or because its stock is acquired or disposed of between cash measurement dates.

The Treasury Department and the IRS understand that section 965(c)(3)(A)(i) could be interpreted to treat the close of the final taxable year of a specified foreign corporation that ceased to exist before November 2, 2017, as the final cash measurement date of such specified foreign corporation. Additionally, if a United States shareholder acquires or disposes of stock of a specified foreign corporation between cash measurement dates of the specified foreign corporation, questions have been raised as to whether the United States shareholder's pro rata share of the cash position of such specified foreign corporation as of an earlier or subsequent cash measurement date should be taken into account for purposes of determining the United States shareholder's aggregate foreign cash position.

The Treasury Department and the IRS intend to issue regulations providing that (i) the final cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any; (ii) the second cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any; (iii) the first cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any; and (iv) a United States shareholder takes into account its pro rata share of the cash position of a specified foreign corporation as of any cash measurement date of the specified foreign corporation on which such United States shareholder is a United States shareholder of such specified foreign corporation, regardless of whether such United States shareholder is a United States

shareholder of such specified foreign corporation as of any other cash measurement date, including the final cash measurement date of such specified foreign corporation. For purposes of applying this paragraph, a 52-53-week taxable year is deemed to begin on the first day of the calendar month nearest to the first day of the 52-53-week taxable year, and is deemed to end or close on the last day of the calendar month nearest to the last day of the 52-53-week taxable year, as the case may be. See §1.441-2(c).

Example. (i) Facts. Except as otherwise provided, for all relevant periods, USP, a domestic corporation, has owned directly at least 10 percent of the stock of CFC1, CFC2, CFC3, and CFC4, each a foreign corporation. CFC1 and CFC2 have calendar year U.S. taxable years. CFC3 and CFC4 have U.S. taxable years that end on November 30. No entity has a short taxable year, except as a result of the transactions described below.

(a) USP transferred all of its stock of CFC2 to an unrelated person on June 30, 2016, at which point USP ceased to be a United States shareholder with respect to CFC2.

(b) CFC4 dissolved on December 30, 2010, and, as a result, its final taxable year ended on December 30, 2010.

(ii) Analysis. Each of CFC1, CFC2, CFC3, and CFC4 is a specified foreign corporation. Taking into account the regulations described in this section 3.02, the cash measurement dates of the specified foreign corporations to be taken into account by USP in determining its aggregate foreign cash position are summarized in the following table:

|      | Cash Measurement Dates |                   |                   |
|------|------------------------|-------------------|-------------------|
|      | Final                  | Second            | First             |
| CFC1 | December 31, 2017      | December 31, 2016 | December 31, 2015 |
| CFC2 | N/A                    | N/A               | December 31, 2015 |
| CFC3 | November 30, 2018      | November 30, 2016 | November 30, 2015 |
| CFC4 | N/A                    | N/A               | N/A               |

*.03 Treatment of Certain Accrued Foreign Income Taxes for Purposes of Determining Post-1986 Earnings and Profits*

Post-1986 earnings and profits are defined, in relevant part, as the earnings and profits of a specified foreign corporation determined as of each of the two measurement

dates described in section 965(a) and “computed in accordance with sections 964(a) and 986.” Section 965(d)(3). In general, section 964(a) provides that, under regulations prescribed by the Secretary, the earnings and profits of any foreign corporation, and the deficit in earnings and profits of any foreign corporation, for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations. As described in section 3.02 of Notice 2018-13, for purposes of measuring the post-1986 earnings and profits of a specified foreign corporation as of a measurement date, the extent to which an item of income, deduction, gain, or loss is taken into account as of such measurement date must be determined under principles generally applicable to the calculation of the earnings and profits of a domestic corporation. Section 3.02(a) of Notice 2018-13 provided a limited exception to this general rule in order to reduce taxpayer compliance burdens. Section 3.02(a) of Notice 2018-07 also announced the intention to issue regulations that may provide exceptions to this general rule in limited cases that are contemplated by section 965 or the legislative history to the Act, such as to address double counting or double non-counting.

The Treasury Department and the IRS have determined that an additional limited exception to the general rule is appropriate for certain foreign income taxes that accrue between measurement dates. Accordingly, the Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a specified foreign corporation’s post-1986 earnings and profits as of the measurement date on November 2, 2017, any foreign income tax (as defined in section 901(m)(5)) that accrues (i) within the specified foreign corporation’s U.S. taxable year that includes

November 2, 2017, and (ii) after November 2, 2017, but on or before December 31, 2017, will be allocated between the respective portions of the foreign tax base on which the accrued foreign taxes are determined that are attributable to the part of the U.S. taxable year ending on November 2, 2017, and the part of the U.S. taxable year beginning after November 2, 2017.

The Treasury Department and the IRS have determined that it is appropriate to limit the scope of the regulations to foreign income taxes that accrue on or before December 31, 2017, in order to allow for the section 965(a) earnings amounts of each specified foreign corporation to be determined as of the final measurement date, December 31, 2017.

The regulations announced in this section 3.03 are relevant solely for purposes of determining a specified foreign corporation's post-1986 earnings and profits (including a deficit) within the meaning of section 965(d)(3). Therefore, the regulations to be issued will not affect, for example, the computation of credits for taxes deemed paid under sections 902 and 960.

#### *.04 Prevention of the Reduction of the Section 965 Tax Liability of a United States Shareholder*

##### *(a) Anti-Avoidance Rule*

##### *(i) Transactions Undertaken with a Principal Purpose of Reducing Section 965 Tax Liability*

The Treasury Department and the IRS intend to issue regulations under sections 965(c)(3)(F) and 965(o) providing that a transaction will be disregarded for purposes of determining a United States shareholder's section 965 tax liability if each of the following conditions is satisfied: (i) such transaction occurs, in whole or in part, on or after November 2, 2017 (the "specified date"); (ii) such transaction is undertaken with a

principal purpose of reducing the section 965 tax liability of such United States shareholder; and (iii) such transaction would, without regard to this sentence, reduce the section 965 tax liability of such United States shareholder (the “anti-avoidance rule”).

For purposes of this section 3.04(a) and section 3.04(b) of this notice, a transaction (or change in method of accounting or election described in section 3.04(b) of this notice) reduces the section 965 tax liability of a United States shareholder if such transaction (i) reduces a section 965(a) inclusion amount of such United States shareholder with respect to any specified foreign corporation, (ii) reduces the aggregate foreign cash position of such United States shareholder, or (iii) increases the amount of foreign income taxes of any specified foreign corporation deemed paid by such United States shareholder under section 960 as a result of an inclusion under section 951(a) by reason of section 965. Also for purposes of this section 3.04(a) and section 3.04(b) of this notice, in the case of a United States shareholder that is a domestic pass-through entity, a domestic pass-through owner of such domestic pass-through entity is also treated as a United States shareholder. For the definition of domestic pass-through entity and domestic pass-through owner, see section 3.05(b) of this notice.

Under section 3.04(a)(ii) through (iv) of this notice, certain transactions are presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. The presumption described in the preceding sentence may be rebutted only if facts and circumstances clearly establish that the transaction was not undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. The

regulations will provide that a taxpayer that takes the position that the presumption is rebutted must attach a statement to its income tax return for its taxable year in which or with which the relevant taxable year of the relevant specified foreign corporation ends disclosing that it has rebutted the presumption. In the case of a transaction described in section 3.04(a)(ii) and (iii), if the presumption does not apply because such transaction occurs in the ordinary course of business, whether such transaction was undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder must be determined under all the facts and circumstances. Under section 3.04(a)(ii) through (iv) of this notice, certain transactions are also treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. Further, under section 3.04(a)(ii), certain distributions are treated per se as not being undertaken with a principal purpose of reducing the section 965 tax liability of such United States shareholder and therefore are not subject to the anti-avoidance rule.

For purposes of the rules described in section 3.04(a)(ii) through (iv) of this notice, a person is treated as related to a United States shareholder if (i) the person bears a relationship to the United States shareholder described in section 267(b) or section 707(b) and (ii) the relationship described in clause (i) of this sentence is satisfied either immediately before or immediately after the transaction. Furthermore, for purposes of the rules described in section 3.04(a)(ii) and (iv) of this notice, the term “transfer” includes any disposition, exchange, contribution, distribution, issuance, redemption, recapitalization, or loan, and includes an indirect transfer (for example, a transfer of an interest in a partnership is a transfer of the assets of such partnership).

No inference is intended as to the treatment, under general tax law, of transactions that occurred before the specified date. The IRS may, where appropriate, challenge such transactions under the Code, regulations, or judicial doctrines such as the step transaction doctrine or the economic substance doctrine.

*(ii) Application of the Anti-Avoidance Rule to Cash Reduction Transactions*

For purposes of applying the anti-avoidance rule, a cash reduction transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “cash reduction transaction” means (i) a transfer of cash, accounts receivable, or cash equivalent assets by a specified foreign corporation to a United States shareholder of such specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation, or (ii) an assumption by a specified foreign corporation of an accounts payable of a United States shareholder of such specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation, if such transfer or assumption would, without regard to the anti-avoidance rule, reduce the aggregate foreign cash position of such United States shareholder. The presumption described in this paragraph does not apply to a cash reduction transaction that occurs in the ordinary course of business.

Notwithstanding the presumption described in the preceding paragraph, except in the case of a specified distribution, a cash reduction transaction that is a distribution by a specified foreign corporation to a United States shareholder of such specified foreign corporation will be treated per se as not being undertaken with a principal purpose of reducing the section 965 tax liability of such United States shareholder for purposes of the anti-avoidance rule. A specified distribution will be treated per se as being



undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. For purposes of this section 3.04(a)(ii), the term “specified distribution” means a cash reduction transaction that is a distribution by a specified foreign corporation of a United States shareholder if (i) at the time of the distribution, there was a plan or intention for the distributee to transfer, directly or indirectly, cash, accounts receivable, or cash equivalent assets to any specified foreign corporation of such United States shareholder, or (ii) the distribution is a non pro rata distribution to a foreign person that is related to such United States shareholder. For purpose of clause (i) of the preceding sentence, an indirect transfer includes, for example, a transfer of cash to a partnership if a specified foreign corporation of such United States shareholder is a partner.

*(iii) Application of the Anti-Avoidance Rule to E&P Reduction Transactions*

For purposes of applying the anti-avoidance rule, an E&P reduction transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “E&P reduction transaction” means a transaction between a specified foreign corporation and any of (i) a United States shareholder of such specified foreign corporation, (ii) another specified foreign corporation of a United States shareholder of such specified foreign corporation, or (iii) any person related to a United States shareholder of such specified foreign corporation, if such transaction would, without regard to the anti-avoidance rule, reduce the accumulated post-1986 deferred foreign income or the post-1986 undistributed earnings (as defined in section 902(c)(1) as in effect before the date of the enactment of the Act) of such specified foreign corporation or another specified foreign corporation of any United States shareholder of such specified foreign corporation. The

presumption described in this paragraph does not apply to an E&P reduction transaction that occurs in the ordinary course of business.

Notwithstanding the presumption described in the preceding paragraph, a specified transaction will be treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. For purposes of the preceding sentence, the term “specified transaction” means an E&P reduction transaction that involves one or more of the following: (i) a complete liquidation of a specified foreign corporation to which section 331 applies; (ii) a sale or other disposition of stock by a specified foreign corporation, or (iii) a distribution by a specified foreign corporation that reduces the earnings and profits of such specified foreign corporation pursuant to section 312(a)(3).

*(iv) Application of the Anti-Avoidance Rule to Pro Rata Share Transactions*

For purposes of applying the anti-avoidance rule, a pro rata share transaction is presumed to be undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder. For this purpose, the term “pro rata share transaction” means a transfer of the stock of a specified foreign corporation to a United States shareholder of the specified foreign corporation or a person related to a United States shareholder of such specified foreign corporation if such transfer would, without regard to the anti-avoidance rule, (i) reduce such United States shareholder’s pro rata share of the section 965(a) earnings amount of such specified foreign corporation if it is a DFIC; (ii) increase such United States shareholder’s pro rata share of the specified E&P deficit of such specified foreign corporation if it is an E&P deficit foreign corporation; or (iii) reduce such United States shareholder’s pro rata share of the cash position of such specified foreign corporation.

Notwithstanding the presumption described in the preceding paragraph, an internal group transaction will be treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of a United States shareholder for purposes of the anti-avoidance rule. For purposes of the preceding sentence, the term “internal group transaction” means a pro rata share transaction if, immediately before or after the transfer, the transferor of the stock of the specified foreign corporation and the transferee of such stock are members of an affiliated group in which the United States shareholder is a member. For this purpose, the term “affiliated group” has the meaning set forth in section 1504(a), determined without regard to paragraphs (1) through (8) of section 1504(b), and the term “members of an affiliated group” means entities included in the same affiliated group. For purposes of identifying an affiliated group and the members of such group, (i) each partner in a partnership, as determined without regard to clause (ii) of this sentence, is treated as holding its proportionate share of the stock held by the partnership, as determined under the rules and principles of sections 701 through 777, and (ii) if one or more members of an affiliated group own, in the aggregate, at least 80 percent of the interests in a partnership’s capital or profits, the partnership will be treated as a corporation that is a member of the affiliated group.

Example. (i) Facts. FP, a foreign corporation, owns all of the stock of USP, a domestic corporation. USP owns all of the stock of FS, a foreign corporation. USP has held the stock of FS for more than one year. USP has a calendar year taxable year; FS’s taxable year ends November 30. On January 2, 2018, USP transfers all of the stock of FS to FP in exchange for cash. On January 3, 2018, FS makes a distribution with respect to the stock transferred to FP. USP treats the transaction as a taxable sale of the FS stock and claims a dividends received deduction under section 245A with respect to its deemed dividend under section 1248(j) as a result of the sale. FS has post-1986 earnings and profits as of December 31, 2017, and no previously taxed income or effectively connected income for any previous taxable year.

(ii) Analysis. The transfer of the stock of FS is a pro rata share transaction because such transfer is to a person related to USP, and the transfer would, without regard to the anti-avoidance rule, reduce USP's pro rata share of FS's section 965(a) earnings amount. Because USP and FP are also members of an affiliated group within the meaning of this section 3.04(a)(iv), the transfer of the stock of FS is also an internal group transaction and is treated per se as being undertaken with a principal purpose of reducing the section 965 tax liability of USP. Accordingly, the transfer will be disregarded for purposes of determining USP's section 965 tax liability with the result that, among other things, USP's pro rata share of FS's section 965(a) earnings amount is determined as if USP owned (within the meaning of section 958(a)) 100 percent of the stock of FS on the last day of FS's inclusion year and no other person received a distribution with respect to such stock during such year. See section 951(a)(2)(A) and (B).

(b) Disregard of Certain Changes in Method of Accounting and Entity Classification Elections

The Treasury Department and the IRS also intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that any change in method of accounting made for a taxable year of a specified foreign corporation that ends in 2017 or 2018 will be disregarded for purposes of determining the section 965 tax liability of a United States shareholder if such change in method of accounting would otherwise reduce the section 965 tax liability of such United States shareholder. The rule described in this section 3.04(b) will apply whether or not such change in method of accounting was made in accordance with the procedures described in Rev. Proc. 2015-13, 2015-5 I.R.B. 419 (or successor), and whether or not such change in method of accounting was properly made. These regulations will not apply to a change in method of accounting for which the original and/or duplicate copy of any Form 3115, Application for Change in Accounting Method, requesting the change was filed before the specified date, November 2, 2017.

The regulations will also provide that any entity classification election under §301.7701-3 that is filed on or after the specified date will be disregarded for purposes

of determining the section 965 tax liability of such United States shareholder if such entity classification election would otherwise reduce the section 965 tax liability of any United States shareholder. An entity classification election filed on or after the specified date will be subject to these regulations even if such entity classification election was effective on a date before the specified date.

The regulations described in this section 3.04(b) will apply regardless of whether such change in method of accounting or change of entity classification election is made with a principal purpose of reducing the section 965 tax liability of a United States shareholder.

*.05 Rules Related to Elections, Reporting, and Payment*

(a) Documentation of Cash Position

Section 965(c)(3)(D) provides that net accounts receivable, actively traded property, and short-term obligations shall not be taken into account by a United States shareholder in determining its aggregate foreign cash position to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation. The IRS intends to issue forms, publications, regulations, or other guidance that will specify the documentation that a United States shareholder must maintain or provide, and the time and manner for providing any such documentation, in order to make the required demonstration to the Secretary.

(b) United States Persons Eligible to Make Elections Under Section 965 in the Case of a United States Shareholder that is a Domestic Pass-Through Entity

Section 965 increases the amount included in the gross income of a United States shareholder under section 951(a)(1) only if such United States shareholder owns

(within the meaning of section 958(a)) stock in one or more specified foreign corporations. See section 951(a)(2)(A). For purposes of this notice, the term “section 958(a) stock” means, with respect to a United States shareholder of a DFIC, the stock of the DFIC owned by the United States shareholder within the meaning of section 958(a).

The Treasury Department and IRS have determined that if a domestic pass-through entity is a United States shareholder of a DFIC and owns section 958(a) stock in such DFIC, the section 965(a) inclusion amount with respect to such section 958(a) stock and the section 965(c) deduction with respect to such amount should be determined at the level of the domestic pass-through entity. However, the domestic pass-through owners of the domestic pass-through entity are subject to federal income tax on their share of the section 965(a) inclusion amount with respect to the section 958(a) stock of the domestic pass-through entity. Accordingly, in the case of a domestic pass-through entity that is a United States shareholder, the regulations will provide that each domestic pass-through owner takes into account its share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of the domestic pass-through entity and the section 965(c) deduction with respect to such amount, regardless of whether such domestic pass-through owner is also a United States shareholder with respect to such DFIC. In this case, the section 965(a) inclusion amount and the related section 965(c) deduction must be allocated in the same proportion. For example, if a domestic pass-through owner is allocated 50 percent of the section 965(a) inclusion amount with respect to section 958(a) stock of a domestic pass-through entity, such domestic pass-through owner must be allocated 50 percent of the related section 965(c)

deduction. If the domestic pass-through owner is also a United States shareholder with respect to such DFIC that owns section 958(a) stock of such DFIC, regulations will provide that the section 965(a) inclusion amount with respect to such section 958(a) stock of such domestic pass-through owner and the section 965(c) deduction with respect to such amount are determined separately from its share of the section 965(a) inclusion amount and section 965(c) deduction of the domestic pass-through entity.

For purposes of this notice, the term “domestic pass-through entity” means a pass-through entity that is a United States person (as defined in section 7701(a)(30)). Also for purposes of this notice, a “pass-through entity” means a partnership, S corporation, or any other person to the extent that the income or deductions of such person are included in the income of one or more direct or indirect owners or beneficiaries of the person. Accordingly, if, for example, a domestic trust is subject to federal income tax on a portion of its section 965(a) inclusion amount and its domestic pass-through owners are subject to tax on the remaining portion, the domestic trust is treated as a domestic pass-through entity with respect to such remaining portion. Also for purposes of this notice, the term “domestic pass-through owner” means a United States person that is a partner, shareholder, beneficiary, grantor, or owner, as the case may be, in a domestic pass-through entity, except that, in the case of tiered pass-through entities, the term does not include a partner, shareholder, beneficiary, or owner that is itself a domestic pass-through entity. In the case of tiered pass-through entities, a reference in this notice to a domestic pass-through owner includes a United States person that is an indirect partner, shareholder, beneficiary, or owner through one or more other pass-through entities, and a reference to a domestic pass-through owner’s

share of the section 965(a) inclusion amount and section 965(c) deduction of a domestic pass-through entity includes such domestic pass-through owner's share of the section 965(a) inclusion amount and section 965(c) deduction of a domestic pass-through entity owned indirectly by such domestic pass-through owner through one or more other pass-through entities.

The elections under section 965(h), (m), and (n) ("specified elections") are described in section 965 as available to a United States shareholder of a DFIC. However, because a domestic pass-through owner includes in income a share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of a domestic pass-through entity, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of regulatory authority under section 965(o), allowing such domestic pass-through owner to make a specified election that applies to its share of the section 965(a) inclusion amount with respect to section 958(a) stock of a DFIC of the domestic pass-through entity. Such a domestic pass-through owner will be permitted to make a specified election regardless of whether the domestic pass-through owner is itself a United States shareholder of the DFIC. If a domestic pass-through owner makes a specified election for its taxable year, such election will be applicable to all section 965(a) inclusion amounts included in the gross income of such domestic pass-through owner for such taxable year (other than amounts with respect to which elections under section 965(i) are effective), whether included directly by reason of owning section 958(a) stock in a DFIC or indirectly by reason of being a domestic pass-through owner.



If an S corporation is, directly or indirectly, a partner, beneficiary, or owner of a domestic pass-through entity and takes into account a share of the section 965(a) inclusion amount of a domestic pass-through entity with respect to a DFIC, and the S corporation is a United States shareholder of the DFIC, the regulations will provide that shareholders of the S corporation will be permitted to make an election under section 965(i) to defer the shareholder's net tax liability under section 965 with respect to the S corporation. However, in such a case, if the S corporation is not itself a United States shareholder of a DFIC, the net tax liability under section 965 of a shareholder with respect to the S corporation for purposes of the election under section 965(i) will not include the shareholder's share of the domestic pass-through entity's section 965(a) inclusion amount with respect to the DFIC or section 965(c) deduction with respect to such amount.

(c) Determination of Amount of Net Tax Liability Under Section 965 for Purposes of Section 965(h)

As discussed in section 3.05(b) of this notice, if a domestic pass-through entity is a United States shareholder that has a section 965(a) inclusion amount with respect to section 958(a) stock in a DFIC, a United States person that is a domestic pass-through owner, directly or indirectly, in such domestic pass-through entity is subject to net income tax on its share of the section 965(a) inclusion amount. Accordingly, the Treasury Department and the IRS intend to issue regulations providing that for purposes of determining the net tax liability under section 965 of a domestic pass-through owner, the domestic pass-through owner will be treated as a United States shareholder. See, however, section 5 of this notice, which provides that a domestic

pass-through owner that is not itself a United States shareholder is not permitted to make an election under section 962.

Furthermore, the regulations will provide that, in the case of a taxpayer that has made one or more elections under section 965(i) for a taxable year, the taxpayer's net tax liability under section 965 for purposes of section 965(h) is the taxpayer's net tax liability under section 965 as determined under section 965(h)(6) (taking into account the rules in this section 3.05(c)) reduced by the aggregate amount of the taxpayer's net tax liabilities under section 965 as determined under section 965(i)(3) (taking into account the rule provided in section 3.05(b) of this notice) with respect to which elections under section 965(i) are effective.

(d) Application of Section 965(n) to Losses Arising in the Year in Which the Inclusion Year of a DFIC Ends

A United States shareholder of a DFIC may elect the application of section 965(n) for the taxable year of the United States shareholder in which, or with which, the inclusion year of the DFIC ends. If such an election is made, the United States shareholder does not take into account the amount described in section 965(n)(2) in determining the amount of the net operating loss deduction under section 172 of such shareholder for such taxable year or in determining the amount of taxable income for such taxable year which may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172.

Questions have arisen regarding the scope of the election under section 965(n) due to the use of the term "deduction" in section 965(n)(1)(A). A net operating loss "deduction" for a taxable year generally refers to the amount of a net operating loss carried to such taxable year from a prior or subsequent year rather than the net

operating loss arising from such year. Compare section 172(a) and (c). However, interpreting “deduction” in section 965(n)(1)(A) to refer to carryovers or carrybacks (and not to the net operating loss for the taxable year) would cause that paragraph to be duplicative of section 965(n)(1)(B), which already provides that amounts described in section 965(n)(2) are disregarded for purposes of applying net operating loss carryovers or carrybacks to such taxable year under section 172. The Treasury Department and the IRS have determined that section 965(n)(1)(A) was intended to apply to a different set of losses than those to which section 965(n)(1)(B) applies. Therefore, the Treasury Department and the IRS intend to issue regulations providing that, if an election under section 965(n) is made with respect to a taxable year in which or with which the inclusion year of a DFIC ends, the amount of a net operating loss for such taxable year will be determined without taking into account as gross income the amount described in section 965(n)(2). The regulations will also clarify that an election made under section 965(n) will be treated as made with respect to both the amount of a net operating loss for such taxable year and the net operating loss carryovers or carrybacks for such taxable year.

(e) Filing and Payment Due Date for Specified Individuals

A specified individual (as defined in section 2.18 of this notice) who does not make the election under section 965(h)(1) or (i)(1) is considered to have timely filed such person’s return and paid the net tax liability under section 965 if the filing and payment are made on or before the fifteenth day of the sixth month following the close of the taxable year, and the specified individual attaches a statement to the return showing that the person for whom the return is made is a person described in §1.6081-5(a). See §1.6081-5(a)(5)-(6), and (b). For a specified individual who makes the

election under section 965(h)(1), section 965(h)(2) provides that the installments must be paid on the due dates for the relevant returns (determined without regard to any extension of time for filing the return).

The question has arisen whether the disregarding of extensions of time to file in section 965(h)(2) applies to negate the extension of time to pay that is otherwise available under §1.6081-5 for a specified individual that does not make the election under section 965(h)(1). The Treasury Department and the IRS intend to issue regulations providing that, if a specified individual receives an extension of time to file and pay under §1.6081-5(a)(5) or (6), then the individual's due date for an installment payment under section 965(h) is also the fifteenth day of the sixth month following the close of a taxable year.

*.06 Treatment of Section 965(c) Deduction for Purposes of Sections 62(a) and 63(d)*

Questions have arisen as to whether the section 965(c) deduction is a miscellaneous itemized deduction as defined in section 67(b). The Treasury Department and the IRS have determined that an individual's section 965(c) deduction was not intended to be subject to the 2-percent floor under section 67 or the deduction disallowance under the AMT, or, in the case of a taxable year beginning after December 31, 2017, the deduction disallowance under section 67 as modified by the Act. Therefore, the Treasury Department and the IRS intend to issue regulations, pursuant to the grant of authority under section 965(o), providing that a section 965(c) deduction will not be treated as an itemized deduction, including for purposes of sections 56 and 67.

#### SECTION 4. MODIFICATION OF RULE DESCRIBED IN SECTION 3.04(a) OF NOTICE 2018-13

Section 3.04(a) of Notice 2018-13 announced that the Treasury Department and the IRS intend to issue regulations providing that, for purposes of calculating the net accounts receivable of a specified foreign corporation, the term “accounts receivable” means receivables described in section 1221(a)(4), and the term “accounts payable” means payables arising from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers. The Treasury Department and the IRS have determined that it is appropriate to exclude any receivable or payable with an initial term of one year or more for purposes of calculating a specified foreign corporation’s net accounts receivable. Cf. section 965(c)(3)(B)(iii)(IV) (short-term obligations). Accordingly, the Treasury Department and the IRS intend to issue regulations providing that the terms “accounts receivable” and “accounts payable” will include only receivables or payables with a term of less than one year.

#### SECTION 5. REGULATIONS TO BE ISSUED ADDRESSING ELECTIONS UNDER SECTION 962

As discussed in section 3.05(b) of this notice, if a domestic pass-through entity is a United States shareholder that has a section 965(a) inclusion amount with respect to section 958(a) stock in a DFIC, a domestic pass-through owner of such entity is subject to net income tax on its share of the section 965(a) inclusion amount. The Treasury Department and the IRS intend to issue regulations clarifying that a domestic pass-through owner who is an individual (including, as provided in §1.962-2(a), a trust or estate) and a United States shareholder with respect to a DFIC may make an election under section 962 with respect to the individual’s share of the section 965(a) inclusion

amount of a domestic pass-through entity with respect to such DFIC. However, an individual who is not a United States shareholder of a DFIC is not permitted to make an election under section 962 with respect to the individual's share of a section 965(a) inclusion amount of a domestic pass-through entity with respect to such DFIC notwithstanding the rules in section 3.05(b) and (c) of this notice. See section 962(b). The regulations will clarify that the same principles apply to inclusions under section 951(a) other than by reason of section 965.

If an individual elects to have the provisions of section 962 apply for a taxable year, the tax imposed on amounts included in the individual's gross income under section 951(a) (directly by reason of owning section 958(a) stock or indirectly by reason of being a domestic pass-through owner), including by reason of section 965, is an amount equal to the tax that would be imposed under section 11 if the amounts were received by a domestic corporation. In addition, §1.962-1(b)(1)(i) provides that a deduction of a United States shareholder does not reduce the amount included in gross income under section 951(a) for purposes of computing the amount of tax that would be imposed under section 11.

The Treasury Department and the IRS have determined that in the case of a taxpayer making an election under section 962, Congress intended for the section 965(c) deduction (which is generally available to United States shareholders of DFICs, including individuals) to be allowed with respect to the tax imposed under section 11 rather than under section 1. See H.R. Rep. No. 115-466, at 620 (2017) (Conf. Rep.). Pursuant to the grant of authority under section 965(o), the Treasury Department and the IRS intend to modify §1.962-1(b)(1)(i) to provide that, in computing the amount of

tax due as a result of a section 962 election, the section 965(c) deduction may be taken into account. Specifically, the regulations will provide that “taxable income” as used in section 11 shall be reduced by the section 965(c) deduction. These regulations will not apply to any other deductions, and therefore existing §1.962-1(b)(1)(i) will continue to provide that “taxable income” as used in section 11 shall not be reduced by any other deductions. Any section 965(c) deduction allowed in determining “taxable income” as used in section 11 for purposes of computing the tax due as a result of a section 962 election will not also be allowed for purposes of determining an individual’s actual taxable income.

Example. (i) Facts. USI, a United States citizen, owns 10% of the capital and profits of USPRS, a domestic partnership that has a calendar year taxable year, the remainder of which is owned by foreign persons unrelated to USI or USPRS. USPRS owns all of the stock of FS, a foreign corporation that is a CFC with a calendar year U.S. taxable year. USPRS has a section 965(a) inclusion amount with respect to FS of \$1,000 and is allowed a section 965(c) deduction of \$700. FS has no post-1986 foreign income taxes (as defined in section 902(c)(1) as in effect before the date of the enactment of the Act). USI makes a valid election under section 962 for 2017.

(ii) Analysis. USI’s “taxable income” described in §1.962-1(b)(1)(i) equals \$100 (USI’s distributive share of USPRS’s section 965(a) inclusion amount) minus \$70 (USI’s distributive share of USPRS’s allowable section 965(c) deduction), or \$30. No other deductions are allowed in determining this amount. USI’s tax on such amount will be equal to the tax imposed under section 11 as if \$30 were received by a domestic corporation. USI cannot deduct \$70 for purposes of determining USI’s taxable income that is subject to tax under section 1.

## SECTION 6. PENALTY RELIEF UNDER SECTIONS 6654 AND 6655 IN CONNECTION WITH THE AMENDMENT OF SECTION 965 AND THE REPEAL OF SECTION 958(B)(4)

### *.01 Penalty Waiver with Respect to Section 965*

A United States shareholder that has a net tax liability under section 965 generally includes the amount of the net tax liability on its return for the year in which or with which the inclusion year of the DFIC ends.

Section 965(h)(1) provides that a United States shareholder of a DFIC may elect to pay the net tax liability under section 965 in eight annual installments, the first of which is due on the due date (without regard to any extension of time to file) of the return for the shareholder's taxable year in which or with which the inclusion year of the DFIC ends. Each successive installment is due on the due date (without regard to any extension of time to file) of the return for the taxable year following the taxable year the prior installment was made. Section 965(h)(2). The timely payment of an installment does not incur underpayment interest. See H.R. Rep. No. 115-466, at 611 (2017) (Conf. Rep.). Section 965(h), therefore, demonstrates Congress's intent to permit a taxpayer to pay its net tax liability under section 965 without incurring additional liability, including additions to tax. Consistent with this intent, and in the interest of sound tax administration, the IRS will waive underpayment penalties under sections 6654 and 6655 with respect to a taxpayer's net tax liability under section 965 for those taxpayers that make an election under section 965(h). In addition, the IRS will waive underpayment penalties under sections 6654 and 6655 with respect to a taxpayer's net tax liability under section 965 for those taxpayers who do not elect to pay their net tax liability under section 965 in installments. Accordingly, a taxpayer's required installments of estimated tax need not include amounts attributable to its net tax liability under section 965 to prevent the imposition of penalties under sections 6654(a) and 6655(a). If a taxpayer fails to timely pay its net tax liability under section 965 when due, other sections of the Code may apply; for example, additions to tax could result under section 6651, and installment payments could be accelerated under section 965(h)(3).



The instructions to estimated tax forms will be modified, as necessary, to clarify that no underpayment penalty will be imposed under section 6654 or section 6655 with respect to a taxpayer's net tax liability under section 965 and that the taxpayer may exclude such amounts when calculating the amount of its required installment.

*.02 Penalty Waiver for 2017 with Respect to Amendments to Sections 965 and 958(b) by the Act*

In addition, because the amendment to section 965 and the repeal of section 958(b)(4) could also affect tax liability (other than by way of the imposition of the net tax liability under section 965) for periods that end before or shortly after the enactment of the Act, the IRS has determined that additional penalty relief is appropriate. Therefore, the IRS has determined that if the amendment to section 965 or the amendment to section 958(b) by the Act causes an underpayment related to a required installment of estimated tax due on or before January 15, 2018, the estimated tax penalty under section 6654 or section 6655 will not apply to that underpayment.

## SECTION 7. EFFECTIVE DATES

Section 965 is effective for the last taxable years of foreign corporations that begin before January 1, 2018, and with respect to United States shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end. The Treasury Department and the IRS intend to provide that the regulations and instructions described in sections 3, 4, 5, and 6 of this notice are effective beginning for the first taxable year of a foreign corporation (and with respect to United States shareholders, the taxable years in which or with which such taxable years of the foreign corporations end) to which section 965 applies. Before the issuance of the regulations

and instructions described in this notice, taxpayers may rely on the rules described in sections 3, 4, 5, and 6 of this notice.

This notice also clarifies one of the effective dates described in section 6 of Notice 2018-13, which provided that taxpayers could rely on the rules described in section 5.01 of Notice 2018-13 with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance. Taxpayers may rely on section 5.01 of Notice 2018-13 with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance (the application of which will be prospective).

#### SECTION 8. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. The Treasury Department and the IRS expect to issue additional guidance under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR-4579, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to [Notice.comments@irsounsel.treas.gov](mailto:Notice.comments@irsounsel.treas.gov). Comments will be available for public inspection and copying.

The principal author of this notice is Ms. Perkins of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Perkins at (202) 317-6934 (not a toll free call).