International Tax Watch

Treasury Issues Code Sec. 901(m) Regulations

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I. Introduction

Section 901(m) of the Code[1] was added in 2010 as part of a broader crack-down on what Congress perceived as taxpayer abuse of the foreign tax credit provisions. Specifically, taxpayers had engaged in a number of different transactions to "hype" the rate of foreign tax paid. This is made possible due to the fact that the amount of creditable tax paid to a foreign government is determined under foreign law. At the same time, the "base" upon which those taxes are imposed (*i.e.,* earnings and profits or "E&P") is determined under U.S. law. This disconnect allowed taxpayers to take advantage of differences between the manner in which U.S. earnings are computed to make it appear that a given amount of foreign tax represented a 45-percent effective rate when, under foreign law, it was really a 10-percent or 30-percent rate.

One common example involved a U.S.-based multinational ("USCO") that acquired the shares of a foreign target corporation (FT) and made a section 338(g) election for the target. FT's historic E & P disappear (as do its foreign tax pools), its assets are stepped up to fair market value for U.S. (but not foreign) purposes and its resulting E & P are lower (on a go-forward basis) than they would have been had no election been made. Given that no adjustment is made for foreign tax purposes, however, the same amount of foreign tax continues to be paid. Hence, FT's creditable tax pool is "hyped."

Section 901(m) attacks this problem, by converting a portion of FT's creditable tax pool into a noncreditable expenditure. Section 901(m) refers to this noncreditable expenditure as the "Disqualified Portion" of otherwise creditable taxes paid by FT. The Disqualified Portion can still be deducted.[2] It just cannot be credited. Thus, those credits are not valueless, but Section 901(m) reduces their value by an amount equal to one minus the U.S. tax rate.[3]

Section 901(m)(3)(A) defines the "Disqualified Portion" as a percentage computed as follows:

$$\text{Disqualified Portion} = \frac{\text{aggregate basis differences allocable to the taxable year with respect to all relevant foreign assets}}{\text{the foreign tax bases upon which the creditable tax is imposed}}$$

This fraction relies heavily on other definitions. First, section 901(m)(4) defines the term "Relevant Foreign Asset" or "RFA" as any asset that: (i) was acquired in a "Covered

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Asset Acquisition" or "CAA" as determined under U.S. law and (ii) generates income, deduction, gain or loss, attributable to the foreign tax base upon which the creditable tax is imposed. For this purpose, a CAA is defined to include section 338 transactions, acquisitions of partnerships where a section 754 election is made, transactions treated as acquisitions of stock for foreign purposes but assets for U.S. tax purposes and other transactions identified in future guidance.[4] Section 901(m)(3)(C) defines the term "Basis Difference" as the difference (positive or negative) between the U.S. tax basis of a Relevant Foreign Asset immediately before a CAA and the U.S. tax basis immediately after a CAA. To determine what portion of a Basis Difference is allocable to the applicable tax year, section 901(m)(3)(B) simply states that the taxpayer is supposed to use the applicable cost recovery method under the Code.

Example. On January 1, 2018, USCO acquires FT for $100 and makes a section 338(g) election for FT. FT has two assets on its balance sheet and no liabilities. The first asset is a machine. Immediately prior to the effective date of the 338(g) election, the machine had a U.S. tax basis of $20. The second asset is goodwill. Immediately prior to the effective date of the section 338(g) election, the goodwill had a basis of zero. USCO files a Form 8883 allocating the $100 purchase price to the assets and allocates $20 to the machine and $80 to the goodwill. FT is only subject to one type of tax that is creditable—*i.e.,* the French income tax. For U.S. (not French) purposes, FT amortizes the machine on a straight line basis over five years. FT amortizes its goodwill over a 15-year period.

In the language of the statute, USCO's acquisition of, and election for, FT is a CAA. Both assets are RFAs. The only Basis Difference relates to the goodwill. The Basis Difference equals 80 and the applicable cost recovery period is 15 years or $5.33 per year.

In very simple cases, it is relatively straightforward to understand what Congress intended and how the rules ought to apply. Real life is much more complicated, however, and presented a lot of difficult questions about how section 901(m) should operate.[5] The statute, for example, does not provide guidance regarding multiple CAAs or what happens when a single asset impacts the computation of more than one creditable tax under foreign law. One feature of the statute that makes it more complex than other tax provisions is its reliance on foreign law conclusions to function. Congress has increasingly relied on foreign tax law conclusions to determine U.S. tax outcomes as Congress seeks to prevent arbitrage between U.S. and foreign tax laws.[6]

Prior to December 7, 2016, the only guidance the U.S. Treasury and Internal Revenue Service (collectively, "IRS") put out was Notices 2014-44[7] and 2014-45.[8] These notices sought to prevent taxpayers from deliberately triggering two CAAs in rapid succession and, thus, argue that section 901(m) did not apply because there was no Basis Difference immediately before and immediately after the second CAA.

On December 7, 2016, however, the IRS released T.D. 9800, which sets forth more holistic guidance with respect to section 901(m). T.D. 9800 contains temporary regulations (hereinafter, the "Temporary Regulations"). The IRS simultaneously issued proposed regulations (hereinafter, "Proposed Regulations").[9]

At a high level, the government clearly put a tremendous amount of consideration into the regulations. Overall, the government tried to hew close to the statutory language while also making the regulations administrable. With respect to administration, the government carefully delineates when it is referring to U.S. tax law and when it is referring to foreign tax law.[10] As noted above, Congress (and Treasury) has increasingly sought to look to foreign tax law first in order to reach a conclusion under U.S. law to combat arbitrage.[11] The problem is that in real world situations, it is not always as clear as it should be when a determination is to be made under U.S. tax law principles or foreign tax law principles. Yet, in the case of the section 901(m) regulations, the government appears to have gone the extra mile in delineating when U.S. law, foreign law or both should govern.

There are a number of features of the rules that taxpayers will appreciate. They include, for example, the exclusion of "withholding taxes" from the definition of foreign income taxes. Thus, withholding taxes will not be subject to denial under these rules, even if incurred by an entity that owns assets with a basis difference. Taxpayers will also like the fact that the regulations provide an election to use an asset's foreign basis immediately before a CAA, instead of U.S. basis, to determine the Basis Difference associated with the asset. In addition, the regulations clarify that an asset does not become an RFA simply because it has a basis that was determined by reference to an RFA.[12] Taxpayers will further appreciate the fact that the section 901(m) regulations do contain a *de minimis* exception. Yet, as noted below, certain anti-abuse rules may limit the utility of the *de minimis* exception in practice.

The purpose of this column is to provide an overview of the section 901(m) regulations, but we avoid commenting on the specific portions of those rules that relate to

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subchapter K and partnerships. We will attempt to address the interaction with subchapter K in a subsequent column.

The column proceeds in seven parts. First, we explain what a CAA is under the regulations. Second, we discuss RFAs. Third, we discuss how Basis Differences are computed under the regulations. Fourth, we discuss how Basis Differences are taken into account. Fifth, we discuss the successor rules for transfers of RFAs with unallocated Basis Differences. Sixth, we discuss how to compute the disqualified tax amount (akin to the statute's Disqualified Portion). Lastly, we offer some concluding thoughts.

Given that the Temporary Regulations are effective now, whereas the Proposed Regulations are only effective on a prospective basis (but may be applied by taxpayers retroactively), we attempt throughout the column to distinguish between the guidance provided by the two sets of regulations to the extent that it does not significantly impair readability. Also, all references to "CFC," "CFC1" or CFC2" are references to an entity that is considered a "controlled foreign corporation" within the meaning of section 957 of the Code.

II. Covered Asset Acquisitions

The regulations provide that the following transactions are considered CAAs:

(1) a qualified stock purchase to which section 338(a) applies (*i.e.,* because an election is made on Form 8023)[13];

(2) any transaction that is treated as an acquisition of assets for U.S. income tax purposes and as an acquisition of stock of a corporation (or the transaction is disregarded) for foreign income tax purposes[14];

(3) any acquisition of an interest in a partnership that has an election in effect under section 754 (*a.k.a.* "Section 743(b) CAA")[15];

(4) any transaction (or series of transactions occurring pursuant to a plan) to the extent it is treated as an acquisition of assets for U.S. tax purposes and an acquisition of a "fiscally transparent entity" for foreign purposes[16];

Example.[17] FPS is an entity formed under Country F law that is considered a partnership for U.S. and Country F purposes. FPS is owned 50/50 by each of FC1 and FC2. USP, a domestic corporation, owns all of the stock of DE, a disregarded entity. USP and DE each purchase 50 percent of FPS from FC1 and FC2. The transaction is a CAA because the acquisition is considered an asset acquisition for U.S. purposes and an acquisition of a "fiscally transparent entity" under Country F law.

(5) any transactions (or series of transactions occurring pursuant to a plan) to the extent it is treated as a partnership distribution where the U.S. tax basis consequences are determined under section 732(b) or (d) or which causes the basis of assets to be adjusted under section 734(b), but only if the adjustment results in a basis increase in one or more assets distributed without a corresponding increase in the foreign basis of such assets[18]; and

Example. USCO is a domestic corporation that owns all of the stock of CFC1. CFC1 owns an equity interest in FPS, a foreign partnership formed under the law of Country F. FPS distributes Asset A to CFC1 in a liquidating distribution. As a result, CFC1 takes Asset A with a basis equal to CFC1's basis in the partnership (not FPS's basis in Asset A). The adjustment results in a step-up in basis. Unless Country F provides an asset basis adjustment akin to section 732(b), the transaction is a CAA.

(6) any transaction (or series of transactions occurring pursuant to a plan) to the extent it is treated as an acquisition of assets for purposes of U.S. and foreign tax, provided the transaction results in an increase in the U.S. basis without a corresponding increase in the foreign basis of one or more assets.[19]

Example.[20] USP, a domestic corporation, wholly owns CFC1, a foreign corporation. CFC1 wholly owns CFC2. CFC1 and CFC2 are both organized in Country F. CFC1 transfers Asset A to CFC2 in a transaction that is described in section 351 with boot. As such, CFC1 recognizes gain on the transfer, and CFC2's U.S. tax basis is increased by the amount of CFC1's gain. No similar basis increase arises under Country F law. Even though the transaction is an asset acquisition for U.S. and Country F purposes, the transaction is a CAA.

The regulations provide that, for transactions occurring during the period from January 1, 2011, to immediately before July 21, 2014, the statute alone defines a CAA. For transactions occurring on or after July 21, 2014, the first three categories of transactions constitute CAAs. The fourth, fifth and sixth categories of CAA are included in the Proposed Regulations and so do not apply until the Proposed Regulations are published in final form.

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Example.[21] U.S. Seller is a domestic corporation that owns all of the outstanding shares of CFC1. CFC1 owns all of the outstanding shares of CFC2 and all of the equity interests in a disregarded entity (DE1). DE1 owns all of the outstanding equity interests in another disregarded entity (DE2). U.S. Seller sells all of the outstanding shares of CFC1 to a domestic corporation (U.S. Buyer). U.S. Buyer elects to make a section 338(g) election for CFC1 and CFC2.

The section 901(m) regulations treat the above referenced transaction as four separate CAAs—one for the assets of each of CFC1, CFC2, DE1 and DE2. In addition, the regulations contain a number of definitions that drive the application of the remainder of the regulations. Specifically, the term "Section 901(m) Payor" refers to a person eligible to claim the U.S. foreign tax credit, regardless whether the person actually does claim the credit.[22] Importantly, this is a U.S. tax law concept. In the foregoing example, CFC1 and CFC2 would each be Section 901(m) Payors, even if U.S. Buyer chooses not to claim a foreign tax credit. The regulations define "RFA Owner (U.S.)" as the person who is considered to own an RFA for U.S. federal income tax purposes.[23] The regulations define "RFA Owner (foreign)" as the person (which would include a disregarded entity) that is considered to own an RFA for foreign law purposes.[24] In this case, there are only two RFA Owners (U.S.)—they are CFC1 and CFC2. CFC1 is considered the RFA Owner (U.S.) of all assets it holds directly and all assets held by DE1 and DE2. CFC2 is considered to own all of the assets it owns directly. Each of CFC1, DE1, DE2 and CFC2 can be considered an RFA Owner (foreign) of the assets they own directly. Thus, although CFC1 owns all of the DE1 and DE2 assets for U.S. purposes, it would not be considered the RFA Owner (foreign) of the assets held by DE1 and DE2. The regulations also contain an important definition for "Foreign Payor."[25] The Foreign Payor looks to foreign law to identify which entity (even a disregarded entity) the tax at issue is imposed on. A single entity (even a disregarded entity) can be a Foreign Payor with respect to more than one tax. Thus, in the foregoing example, assuming every entity is organized under the laws of France and they do not do business anywhere else, there would be four (4) Foreign Payors. If DE1 happens to also do business in Italy, then DE1 may be a Foreign Payor for French income tax and Italian income tax.

The preamble to the Proposed Regulations contains a more intricate example to demonstrate that the RFA Owner (U.S.) may not necessarily be the Section 901(m) Payor:

Example.[26] USCO1 and USCO2 are domestic corporations. They each own 50 percent of an FPS that is fiscally transparent under U.S. and foreign law. FPS, in turn, owns an entity that is disregarded for U.S. tax purposes ("DE"). DE is subject to a foreign income tax. USCO1 and USCO2 are each Section 901(m) Payors. DE is a Foreign Payor and the RFA Owner (foreign). FPS is the RFA Owner (U.S.).

This nomenclature may be tedious, but it is very important because it enables the rest of the regulations to deal with the myriad different fact patterns that may arise in practice. The definitions are also required to more specifically delineate when a given rule is referring to U.S. tax law or foreign tax law.

III. Relevant Foreign Assets

The Temporary Regulations define an RFA in the same manner as the statute, without elaboration.[27] The Proposed Regulations (which are prospective in effect) refine the definition to clarify that an asset is only an RFA, with respect to an item of foreign income, if income, deduction, gain or loss attributable to the asset is taken into account (or would be taken into account) in measuring foreign income.[28] Moreover, to prevent abuse, the Proposed Regulations provide that an asset will become an RFA with respect to another type of foreign income if the taxpayer engages in transactions with a principal purpose of avoiding section 901(m).[29] A principal purpose will be deemed to arise if the asset becomes relevant to the determination of a new type of foreign income within one year of the CAA. Importantly, the presumption is *not* rebuttable.

Example.[30] USP1 and USP2 are unrelated domestic corporations. USP1 wholly owns USSub, a domestic corporation. On January 1 of Year 1, USP2 acquires all of the stock of USSub from USP1 in a qualified stock purchase and an election is made under section 338(g). None of USSub's assets are relevant for purposes of determining foreign income immediately after the CAA. USSub subsequently transfers its assets to a foreign corporation in Country X in a section 351 transaction that does not generate gain or loss for U.S. federal income tax purposes.[31] Although the acquisition of USSub is a CAA, none of the assets are RFAs because none of the assets are relevant for purposes of determining foreign income. The subsequent transfer to the foreign subsidiary makes the assets "relevant" for determining foreign income, but the transfer is not a CAA. The Proposed Regulations provide that because the subsequent transfer is done with a principal purpose of avoiding section 901(m), the Asset

becomes a relevant foreign asset, or RFA, with respect to Country X foreign income and income taxes.

That does not mean that the taxpayer cannot plan, however. Specifically, an asset is only an RFA to the extent it is relevant for purposes of determining foreign income upon which a creditable foreign income tax is based. Thus, an asset with a significant Basis Difference may be an RFA with respect to a relatively small amount of foreign income and foreign income tax, while at the same time the amortization of that asset hypes other high-tax activities.

Example. USCO, a domestic corporation, owns all of the outstanding shares of CFC organized under the laws of The Netherlands. CFC owns and operates a single member disregarded entity ("DE1") organized under the laws of Germany. Assume that, every year, DE1 generates 100 of pre-tax income and 30 of creditable German income taxes. None of DE1's assets have undergone a CAA and none possess a Basis Difference. CFC acquires all of the equity interests in another disregarded entity formed under the laws of Ireland ("DE2") for 300. Assume DE2's only asset is intellectual property that was self-developed, has a $0 basis under U.S. tax law (and Irish tax law), has not yet been commercialized and so does not generate any taxable income under the laws of Ireland. The intellectual property is amortizable over a 15-year period. The intellectual property should be considered an RFA with respect to any Irish income generated by, and any Irish income taxes that are incurred by, DE2. So long as no Irish income or taxes are generated, however, CFC will have E & P every year of 50 (100 – 30 – 20) thereby "hyping" CFC's tax rate from 30 percent to 37.5 percent.

The foregoing example should not be subject to the anti-abuse rule, even though it results in hyping the German credits.[32]

Moreover, there may be other ways to "cleanse" the RFA taint from an asset. For example, if DE2 had accumulated carryforward losses under Irish tax law, DE2 could contribute the intellectual property to an Irish (or non-Irish) subsidiary in a transaction that is considered taxable under Irish law. If it is considered taxable under Irish law, the transfer would be considered a "Disposition" (see below) and reduce (potentially to zero) the Basis Difference associated with the asset. The asset may continue to be an RFA under the anti-abuse rule, but if there is no Basis Difference, no creditable taxes would be denied.

IV. Determining Basis Differences

The Temporary Regulations clarify that a Basis Difference has to be computed for each type foreign income with respect to which an RFA is relevant. Thus, a single asset could (conceivably) be an RFA for more than one type of foreign income.[33]

Consistent with the statute, the Temporary Regulations provide a general rule for determining Basis Differences by measuring the difference between the U.S. tax basis in an asset subject to a CAA immediately before and immediately after the CAA.[34] A number of commentators raised the issue that, quite often, it would simply not be possible to ascertain the U.S. tax basis for the assets of a foreign target immediately before the CAA. This is especially true when the assets at issue are acquired from a non-U.S. seller that is not otherwise required to comply with U.S. tax requirements.[35] For that reason, the Proposed Regulations offer the taxpayer an election to use the foreign asset basis in an asset immediately after the CAA in place of (and substitution for) the U.S. tax basis of the asset immediately prior to the CAA.[36] Although the Proposed Regulations have prospective effect, the taxpayer does have the option to apply the regulations currently so long as the taxpayer and all related persons apply all of the Proposed Regulations.[37] The foreign basis election can be made separately for different groups of RFAs.

Example.[38] U.S. Seller is a domestic corporation that owns all of the outstanding shares of CFC1. CFC1 owns all of the outstanding shares of CFC2 and all of the equity interests in a disregarded entity (DE1). DE1 owns all of the outstanding equity interests in another disregarded entity (DE2). U.S. Seller sells all of the outstanding shares of CFC1 to a domestic corporation (U.S. Buyer). U.S. Buyer elects to make a section 338(g) election for CFC1 and CFC2.

In the foregoing example, CFC1 can make a foreign basis election for the RFAs that are relevant in determining its own income under foreign law; the RFAs that are relevant for computing DE1's income under foreign law and/or the RFAs that are relevant for computing DE2's income under foreign law. To prevent taxpayers from whipsawing the government, however, the Proposed Regulations provide that the election is irrevocable and, if not made timely, is not subject to relief under Reg. §301.9100-1 (so-called 9100 Relief).[39]

In order to provide some limited relief to taxpayers who have relatively small Basis Differences and, thus, are unlikely to have engaged in a CAA in order to hype their

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foreign tax credit pools, the Proposed Regulations provide a *de minimis* exception.[40] The *de minimis* exception is satisfied if either of two (2) tests are met. The first test is the Cumulative Basis Difference Exemption ("Cumulative Exemption").[41] The second test is the RFA Class Exemption ("Class Exemption").[42]

The Cumulative Exemption is met if the Basis Difference with respect to a given RFA and foreign income tax is not taken into account if the sum of all basis differences with respect to a single CAA and a single RFA Owner (U.S.) is less than the greater of two amounts. The first amount is a fixed number—$10 million. The second amount is 10 percent of the total U.S. basis of all the RFAs immediately after the CAA.[43]

The RFA Class Exemption is met if the RFA is part of a class of RFAs and the absolute value of the sum of the Basis Differences (including negative Basis Differences) with respect to a single CAA and a single RFA Owner for all of the RFAs within that class is less than the greater of two amounts. The first amount is $2 million. The second amount is 10 percent of the total U.S. basis of all the RFAs in that class of RFAs immediately after the CAA.[44] For this purpose, the "classes" of RFAs are the "classes" of assets defined in the section 338 regulations, regardless whether the CAA happens to result from a section 338 election or not.[45]

The foregoing *de minimis* rules would be a lot more helpful if it were not for the exceptions. Specifically, the Proposed Regulations provide that the foregoing amounts are reduced in the event the CAA occurs between a transferor and transferee that are related persons.[46] Moreover, the Proposed Regulations provide an exception that potentially swallows the rule for "Aggregated CAA Transactions." Aggregated CAA Transactions are defined to mean a series of CAA transactions that are undertaken pursuant to the same plan.[47] In that case, the Proposed Regulations provide that all of the RFAs of all of the RFA Owners (U.S.) that participate in the Aggregate CAA have to add up their Basis Differences in determining whether the exception applies. Thus, if 20 foreign subsidiaries acquire 20 other foreign subsidiary target entities and make section 338(g) elections for them, each with a Basis Difference of $1 million, the Aggregate CAA transaction will not satisfy the *de minimis* exception even though each individual acquisition likely could have qualified.

Nevertheless, taxpayers will want to consider whether the RFA Class Exemption can be used to lessen section 901(m) compliance when performing their purchase price allocations on Forms 8594 or 8883 or pursuant to section 755. Specifically, even with the Aggregated CAA Transaction rules, it is still possible under the RFA Class Exemption to push the vast majority of the Basis Difference to specific asset classes (*i.e.,* goodwill) in specific jurisdictions and away from other classes (*i.e.,* for inventory and equipment). This then potentially reduces the compliance burdens associated with relatively small basis differences (equal to 10 percent or less of the post-CAA basis) for equipment or inventory under section 901(m).

V. Taking Basis Differences into Account

Once the taxpayer has identified that it has a CAA, and determined it has one or more RFAs with a Basis Difference, it has to determine how to take that Basis Difference into account each year in computing its direct credit under section 901 or its indirect foreign tax credit pools under section 902.

The Temporary Regulations state the general rule. Specifically, the Basis Difference (not the entire U.S. tax basis in the RFA) is addressed using the applicable cost recovery method.[48] The Proposed Regulations recognize that a single asset may be subject to multiple recovery methods, however. In that case, the regulations instruct that only the method that is used to recover the Basis Difference is used.[49]

If there is a "Disposition" of an RFA, the Temporary and Proposed Regulations address how the remaining Basis Differences are taken into account as the "Disposition Amount." For this purpose, the term "Disposition" means a sale, abandonment or mark-to-market event *either* for U.S. or foreign tax law purposes.[50]

> **Example.**[51] USCO acquires all of the stock of a foreign corporation (CFC1) from an unrelated party and makes a section 338(g) election for CFC1. CFC1 is organized under the laws of Country F. CFC1 has a single asset, Asset A. Two days after the acquisition, CFC1 contributes Asset A to a lower-tier subsidiary, CFC2, in exchange for shares of CFC2 in a transaction described in section 351 of the Code. No gain or loss is recognized under U.S. tax law. Moreover, Country F treats the contribution as a tax-deferred transaction such that no gain or loss is recognized under foreign law. Because no gain or loss is recognized under U.S. or Country F law, the section 351 transfer is not considered a "Disposition" of Asset A.

The rules for allocating the Disposition Amount apply differently depending on whether or not the disposition is one where all realized gain (or loss) with respect to the

asset is recognized for both U.S. *and* foreign tax purposes.[52] Before proceeding, the following terms have to be defined and understood (*see* Table 1):

TABLE 1.

Term	Definition
Foreign Disposition Gain	the amount of gain realized and recognized upon a disposition with respect to an RFA under foreign law, even if recognition is deferred under a provision akin to Code Sec. 267(f) or Reg. §1.1502-13 of U.S. law.[1]
Foreign Disposition Loss	the amount of loss realized and recognized upon a disposition with respect to an RFA under foreign law, even if recognition is deferred under a provision akin to Code Sec. 267(f) or Reg. §1.1502-13 of U.S. law.[2]
U.S. Disposition Gain	the amount of gain realized and recognized for U.S. income tax purposes on a disposition of an RFA, even if recognition is deferred under Code Sec. 267(f) or Reg. §1.1502-13 of U.S. law.[3]
U.S. Disposition Loss	the amount of loss recognized for U.S. income tax purposes on a disposition of an RFA, even if recognition is deferred under Code Sec. 267(f) or Reg. §1.1502-13 of U.S. law.[4]

ENDNOTES

1 Reg. §1.901(m)-1T(a)(18).
2 Reg. §1.901(m)-1T(a)(19).
3 Reg. §1.901(m)-1T(a)(43).
4 Reg. §1.901(m)-1T(a)(44).

If the Disposition results in full gain (or loss) recognition under U.S. *and* foreign law (*i.e.,* no portion of the gain is deferred or is not recognized under U.S. or foreign law), then the entire unallocated Basis Difference is considered the Disposition Amount.[53] That amount is then allocated to the RFA Owner (U.S.) in the tax year in which the disposition arises.[54]

> **Example.**[55] On January 1, 2018, USP acquires all of the stock of CFC1 and makes a section 338(g) election for CFC1. CFC1 is organized under the laws of Country F. CFC1 owns a single asset, Asset A. Asset A gives rise to income or deductions that are relevant for Country F income tax purposes. CFC1 is the RFA Owner (U.S.) with respect to Asset A. It is also the Foreign Payor with respect to any Country F income taxes. CFC1 is also the Section 901(m) Payor with respect to the income taxes for which CFC1 is a Foreign Payor. Immediately before the effective date of the election, CFC1 had a U.S. tax basis of 10 and a foreign tax basis of 40 in Asset A. Immediately after the election, CFC1 had a U.S. tax basis of 100 and a foreign tax basis of 40. The Basis Difference in this case is 90. The basis recovery period under U.S. law is five years. Therefore, 18 (90/5) of the Basis Difference would normally be allocated to each year. There are no cost recovery deductions under Country F law. On July 1, 2019, CFC1 transfers Asset A to a third party in a transaction in which all realized gain is recognized for both U.S. and Country F income tax purposes. As a result, CFC1 recognizes U.S. Disposition Gain of 50.[56] CFC1 recognizes Foreign Disposition Gain of 80.[57] The section 338(g) election for CFC1 represents a CAA of Asset A. The subsequent transaction in 2019 is a disposition of Asset A in which all gain is recognized under U.S. and foreign law. In 2019, CFC1 has another nine of Basis Difference allocable to it (18 annual allocation × 6/12) plus the Disposition Amount. The Disposition Amount in this case is the entire amount of unallocated Basis Difference, or 63 (90 total Basis Difference – 18 – 9).

If, instead, the Disposition does not result in full gain (or loss) recognition under U.S. and foreign law, more complex rules apply.

The rationale for these more complex rules is that the regulation drafters did not want a Section 901(m) Payor to be able to accelerate the recovery of unallocated Basis Differences unless (and only to the extent that) the event at issue results in a decrease in the unallocated Basis Differences.[58] To make this determination, the regulations force the taxpayer to ask whether the Basis Difference is positive or negative. Then, the taxpayer has to ask what gain (or loss) was recognized with respect to the RFA under U.S. and foreign law.

If the Basis Difference is positive, then the Disposition Amount equals the *lesser* of: (i) any Foreign Disposition Gain plus any U.S. Disposition Loss (expressed as a positive number) or (ii) the unallocated Basis Difference.[59] If the Basis Difference is negative, then the Disposition Amount equals the *greater* of: (i) any U.S. Disposition Gain (expressed as a negative amount) plus any Foreign Disposition Loss or (ii) the unallocated Basis Difference.[60]

The Proposed Regulations provide special rules that apply when: (i) the RFA Owner (U.S.) is fiscally transparent for U.S. tax purposes[61]; (ii) the disposition occurs after CAAs resulting from partnership basis step ups under section 743[62]; (iii) mid-year transactions (*i.e.,* when a disregarded entity undergoes a change of its ownership)[63]; and (iv) where the RFA Owner (U.S.) is a reverse hybrid.[64] We do not address these special rules in this column.

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Example.[65] Assume the same facts as in the prior example, except that on July 1, 2019, CFC1 transfers Asset A to CFC2 in exchange for CFC2 shares that are worth 100. CFC2 is also organized under the laws of Country F. Assume that CFC1 does not recognize any of its gain or loss with respect to Asset A. Yet, for Country F purposes, CFC1 recognizes Foreign Disposition Gain of 60 (100 value minus 40). Immediately after the transfer, Asset A has a U.S. tax basis of 70 (which is carryover basis) and a foreign tax basis of 100 (a market value cost basis). In 2019, CFC1 has a cost recovery amount of 9, just like in the prior example. This represents half year of recovery of a 90 Basis Difference that is to be recovered over a five-year period. In addition, however, CFC1's transfer of Asset A represents a "disposition" of that asset. As such, CFC1 must determine the Disposition Amount. Given that the disposition does not trigger recognition of all of the gain in Asset A for U.S. and foreign law purposes, CFC1 has to ascertain whether the Basis Difference is positive or negative. In this case, the Basis Difference is positive. As such, the Disposition Amount equals the lesser of Foreign Disposition Gain plus U.S. Disposition Loss (expressed as a positive number) or the unallocated Basis Difference. In this case, the Foreign Disposition Gain is 60. The U.S. Disposition Loss is 0. The unallocated Basis Difference is 63. Thus, the Disposition Amount is 60 and the total Basis Difference allocated to 2019 is 69 (60 + 9).

Astute readers will notice that the entire Basis Difference has not been addressed in this example. Instead, of the original 90 of Basis Difference, only 87 has been accounted for (18 of recovery in 2018 + 69 recovery in 2019). This leaves 3 remaining. This remaining amount—the unallocated Basis Difference—does not just disappear. It is, instead, addressed under the successor rules discussed below.

VI. The Successor Rules—or—How to Deal with Unallocated Basis Differences After an RFA Has Been Transferred

As we illustrated in the prior section, it is possible for a Section 901(m) Payor to transfer an RFA to a different Section 901(m) Payor before all of the Basis Difference associated with the RFA has been taken into account. Specifically, a "Disposition" only arises if an RFA is transferred in a transaction that triggers gain recognition under U.S. or foreign law. Moreover, *even if* the transfer triggers gain recognition, the Disposition does not automatically result in immediate recovery of all unallocated Basis Differences.

Absent special rules, taxpayers could avoid recovering the entire Basis Difference and thereby thwart the Congressional rationale for enacting section 901(m). To prevent this result, the regulations contain a set of rules (the "Successor Rules").[66]

The general rule is that section 901(m) continues to apply to an RFA after certain types of transactions ("Successor Transactions") and until all of the Basis Difference associated with the RFA is recovered.[67] For this purpose, the term Successor Transaction refers to any transfer of an RFA after a CAA if the RFA has unallocated Basis Difference after the transfer.[68] Importantly, a "transfer" is not a "disposition." It is any transaction considered a "transfer" for U.S. tax purposes.[69]

It is possible that the subsequent transfer can be a CAA. If it is, the new CAA does not "cleanse" the unallocated Basis Difference associated with the RFA. Instead, the taxpayer has to continue to keep track of the unallocated Basis Difference associated with the first CAA and any new Basis Difference created in connection with any subsequent CAA.[70]

Example.[71] USCO is a domestic corporation that owns all of the stock of CFC, a Country A corporation. On January 1, 2018, CFC acquires all of the stock of FT, a foreign corporation formed under the laws of Country A, and makes a section 338(g) election with respect to FT. FT owns a single parcel of land, which is not depreciable for U.S. or Country A purposes. The land had a U.S. tax basis before the acquisition of 100 and a U.S. tax basis immediately after the acquisition of 300. The section 338(g) election is a CAA, the land is an RFA and the Basis Difference with respect to the RFA is 200. Assume that, on February 1, 2018, FT elects to be treated as a disregarded entity. As such, FT is deemed to liquidate under section 332 of the Code, but there is no transaction for Country A purposes. This deemed liquidation is another CAA. The Basis Difference, however, is zero. Yet, it is not a Disposition. Hence, the recovery of the unallocated Basis Difference from the first CAA is not accelerated. The fact that the Basis Difference associated with the second CAA is zero does not "cleanse" the Basis Difference from the first CAA. Moreover, the deemed liquidation is considered a "transfer" of the land from FT to CFC for U.S. tax purposes. Given that there is unallocated Basis Difference of 200 at the time of the "transfer" the deemed liquidation is considered a Successor Transaction. Hence, section 901(m) continues to apply in CFC's hands.

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One important point the regulations do not cover is currency. Specifically, the regulations simply "assume" that the Basis Difference will remain the same, but in many cases the Basis Difference will have to be translated from one functional currency environment to another. For example, assume FT in the foregoing example used the British pound and CFC used the Euro as its functional currency. The 200 Basis Difference would have been determined in pounds. Going forward it would presumably have to be determined in Euros.[72] Thus, the Basis Difference will need to be translated from pounds to Euros, but the regulations do not provide how that is to occur.[73]

The Proposed Regulations (which have a prospective effective date) provide that if a foreign basis election (to determine Basis Difference) is made with respect to a foreign income tax after a subsequent CAA, any unallocated basis difference with respect to one or more prior CAAs is not taken into account.[74] Instead, the Proposed Regulations state that the only Basis Difference taken into account is the difference associated with that subsequent CAA. Presumably, the government's rationale for providing this rule is that the government assumes a taxpayer would not make a foreign basis election unless the foreign basis was closer to the new U.S. tax basis than the historic U.S. tax basis.

VII. Disqualified Tax Amount

The entire preceding discussion was simply a preamble to the main event—which is to determine the amount of otherwise creditable taxes that cannot be claimed as a credit—*a.k.a.*, the Disqualified Tax Amount. This is what the statute refers to as the Disqualified Portion.

Somewhat surprisingly, the entire regulation that addresses the computation of the Disqualified Tax Amount was only issued in proposed form. Nevertheless, one pro-taxpayer development is that the Temporary Regulations defined the term "foreign income tax" to mean any tax that is creditable under section 901 or 903 (governing "in lieu of" taxes) but excluding "withholding taxes" described in section 901(k)(1)(B).[75] The logic here is presumably that taxpayers are not likely engaging in CAA transactions in the hope of "hyping" withholding taxes associated with interest income, rental income or dividend income they receive from other jurisdictions. Moreover, withholding taxes do not typically bear any relationship to the amount of tax basis a taxpayer has in a particular asset. Hence, there is no need to prevent the taxpayer from claiming those taxes as a credit.

The regulation begins by stating that a Section 901(m) Payor only calculates a Disqualified Tax Amount if the Section 901(m) Payor has an "Aggregate Basis Difference."[76] This then begs the question as to what an Aggregate Basis Difference is. The regulations define an Aggregate Basis Difference as the sum of *all* of a Section 901(m) Payor's allocated Basis Differences for a given year with respect to a *single* foreign income tax and *single* Foreign Payor organized by foreign tax credit basket.[77]

Example.[78] USCO, a domestic corporation, acquired all of the stock of CFC1 on January 1, 2018. CFC1 owns all of the stock of CFC2. CFC1 owns all of the stock of DE1, a disregarded entity, which in turn owns all of the outstanding equity interests in DE2, also a disregarded entity. CFC1, CFC2, DE1 and DE2 are all formed under the laws of Country F. Country F imposes a single tax that is a creditable income tax. The section 338 election triggers four separate CAAs. CFC1 and CFC2 are each Section 901(m) Payors. Yet, CFC1, CFC2, DE1 and DE2 are each Foreign Payors. Given that CFC1 is the RFA Owner (U.S.) of its assets and DE1 and DE2's assets, CFC1 has to compute three different Aggregate Basis Differences. It has to compute one for its own assets, one for DE1's assets and a third for DE2's assets. CFC2 also has to compute an Aggregate Basis Difference for its assets.

If CFC1 happened to also conduct business through a branch in Country G, which caused CFC1 to incur Country G income tax, CFC1 would have to compute a fourth Aggregate Basis Difference with respect to that Country G foreign income tax. This is because Aggregate Basis Differences are determined by Foreign Payor *and* by foreign income tax such that one Foreign Payor who is subject to multiple foreign income tax levies will have to compute multiple Aggregate Basis Differences.

The regulations provide that if foreign law imposes a foreign income tax on the combined income of two or more Foreign Payors, all Foreign Payors whose items of income, deduction, gain or loss are included in the U.S. taxable income or earnings and profits of a Section 901(m) Payor are treated as a single Foreign Payor.[79]

Example.[80] The facts are the same as in the preceding example, except that Country F imposes its income tax on the combined income of CFC1, CFC2, DE1 and DE2. In this case, there are two Foreign Payors. CFC1, CFC2, DE1 and DE2 are combined and treated as one Foreign Payor. They compute one Aggregate Basis Difference. CFC2 is a separate Foreign Payor and, hence, has to compute its own Aggregate Basis Difference.

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TABLE 2.

(A) = (Foreign Income Tax Amount + FCCT) X $\dfrac{\text{Lesser of Aggregate Basis Difference or Allocable Foreign Income}}{\text{Allocable Foreign Income}}$

(B) = the amount of FCCT that is a Disqualified Tax Amount of the Section 901(m) Payor with respect to another foreign income tax.

where:	*Allocable Foreign Income*	is the entire Foreign Income Tax Amount ***unless*** the Foreign Income Tax Amount is imposed on more than one Section 901(m) Payor, in which case this amount equals the portion of the Foreign Income Tax Amount allocated to that Section 901(m) Payor as provided in the section 901(m) regulations.[1]
	FCCT	means, with respect to a given Foreign Income Tax Amount, the amount of tax claimed as a credit against this amount (i.e., where Country A imposes an income tax of $30 but allows a credit for Country B taxes of $10, the Country A tax would be the Foreign Income Tax Amount whereas the Country B taxes would represent the FCCT).
	Foreign Income Tax Amount	means, with respect to a given foreign income tax, the amount of tax actually shown on a foreign tax return.

ENDNOTES

1 The Proposed Regulations address three (3) different scenarios where a Foreign Income Tax Amount needs to be allocated amongst more than one Section 901(m) Payor. Specifically, Prop. Reg. §1.901(m)-3(b)(2)(iii)(C)(1) addresses the allocation of income between two different points of time, such as when a section 338(g) election is made or a disregarded entity is transferred from one person to another person. Prop. Reg. §1.901(m)-3(b)(2)(iii)(C)(2) addresses situations involving partnerships and special allocations to ensure that income is matched with the associated foreign tax. Finally, Prop. Reg. §1.901(m)-3(b)(2)(iii)(C)(3) addresses situations where the creditable tax is imposed on the combined income of multiple Section 901(m) Payors.

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A Section 901(m) Payor's Disqualified Tax Amount equals the lesser of the foreign income tax paid or accrued by the Section 901(m) Payor or the Tentative Disqualified Tax Amount.[81] The Tentative Disqualified Tax Amount equals the amount described in Proposed Reg. §1.901(m)-3(b)(ii)(A) ("(A)") reduced by the amount described in Proposed Reg. §1.901(m)-3(b)(ii)(B) ("(B)") (see Table 2).[82]

The foregoing calculation is tedious but is made simpler if: (i) there is no foreign income tax that is creditable against another foreign income tax such that the FCCT variable can be excluded; and (ii) the tax at issue is not imposed on more than one Foreign Payor, in which case Allocable Foreign Income is identical to the foreign income upon which the tax is imposed. Moreover, the rationale for limiting the numerator in the fraction used to compute (A) is to ensure that the Disqualified Tax Amount is never higher than 100 percent of the creditable foreign taxes at issue. We illustrate the application of the calculation in the following example:

Example.[83] USCO is a domestic corporation that acquires all of the outstanding equity interests of a disregarded entity ("DE1") in a transaction treated as a stock purchase under the laws Country F and as an asset purchase for U.S. tax purposes. DE1 is formed under the laws of Country F but also operates a branch in Country G that imposes income tax on DE1's operations. Country F and G both impose a 30-percent income tax, but Country F provides a foreign tax credit for taxes paid to other jurisdictions. USCO is the Section 901(m) Payor and the RFA Owner (U.S.) of DE1's RFAs. DE1 is the Foreign Payor of the Country F and Country G income taxes. The assets that DE1 held immediately prior to the acquisition are referred to as the "Pre-Transaction Assets." Immediately after the acquisition, DE1 acquires additional assets ("Post-Transaction Assets"). Assume that, in the year following the acquisition, DE1 generates 100 of income attributable to DE1's Post-Transaction Assets and 100 of income attributable to its Pre-Transaction Assets. Under Country G law, DE1 has generated 100 of pre-tax income subject to 30 of income tax. Under Country F law, the entire 200 of pre-tax income is subject to a tentative tax of 60, but Country F permits a credit of 30 for the Country G taxes that are paid, netting a 30 Country F tax liability. Assume that USCO has a 100 Aggregate Basis Difference with respect to DE1's Country F tax levy and a 100 Aggregate Basis Difference with respect to DE1's Country G tax levy. USCO has to compute its Disqualified Tax Amount with respect to each of the Country F levy and the Country G levy.

Given that the Country G levy is creditable against the Country F levy, it is best to start with the Country G levy. The Disqualified Tax Amount computation with respect to the Country G levy starts by taking the lesser of the amount of the credit ($30) or the Tentative Disqualified Tax Amount. The Tentative Disqualified Tax Amount equals (A) minus (B) which are calculated below (see Table 3):

TABLE 3.

$$(A) = (\$30 + \$0) \times \frac{\text{Lesser of: } \$100^{1} \text{ or } \$100^{2}}{\$100 \text{ Allocable Foreign Income}}$$

minus

(B) = $0, because no tax is claimed as a credit against the Country G levy.

equals

Disqualified Tax Amount = $30

ENDNOTES

1 This is the Aggregate Basis Difference.
2 This is the Allocable Foreign Income.

Next, USCO has to determine the Disqualified Tax Amount associated with its Country F levy. Again, the amount starts by taking the lesser of the amount of the credit ($30) or the Tentative Disqualified Tax Amount with respect to this levy. The Disqualified Tax Amount equals (A) minus (B) which are calculated below (see Table 4):

TABLE 4.

$$(A) = (\$30 + \$30) \times \frac{\text{Lesser of } \$100 \text{ or } \$100}{\$200}$$

minus

(B) = $30, because the Country G levy is claimed as a credit against the Country F levy.

equals

Disqualified Tax Amount = $0

The Proposed Regulations provide a special rule whereby the Disqualified Tax Amount is zero if either of three situations arise.[84] First, the Section 901(m)'s Aggregate Basis Difference for the tax year is a negative amount.[85] Second, the Foreign Payor has no income (or has a loss) measured under foreign law for its foreign tax year.[86] Third, the Foreign Income Tax Amount that is paid or accrued by, or considered paid or accrued by, the Section 901(m) Payor for the U.S. tax year is zero.[87]

Yet, even if the Disqualified Tax Amount is zero for a given year, that does not mean that the Section 901(m) Payor gets a free pass with respect to the Aggregate Basis Difference for that year. Instead, the Proposed Regulations include a concept known as the Aggregate Basis Difference Carryover or "ABD Carryover."[88] The concept behind having carryover provisions is that an Aggregate Basis Difference allocable to a given year may simply go unused. Thus, absent special rules, it would simply disappear. Instead, the Proposed Regulations provide that it continues to carry forward like other attributes (*i.e.,* an E & P deficit or a foreign tax credit pool).[89]

The amount of a Section 901(m) Payor's ABD Carryover generated from a given tax year equals the Aggregate Basis Difference for that year if the Disqualified Tax Amount for that year is zero.[90] If the Disqualified Tax Amount is larger than zero, then the ABD Carryover will be determined as follows. If the Section 901(m) Payor's Aggregate Basis Difference for the U.S. tax year exceeds its Allocable Foreign Income, the excess gives rise to an ABD Carryover from that year.[91] If the Tentative Disqualified Tax Amount exceeds the Disqualified Tax Amount, the ABD Carryover is determined under the following formula (see Table 5):

TABLE 5.

$$\text{ABD Carryover} = (\text{Tentative Disqualified Tax Amount} - \text{Disqualified Tax Amount}) \times \frac{\text{Allocable Foreign Income}}{\text{Foreign Income Tax Amount} + \text{FCCT}}$$

Importantly, the relevant tax year is the U.S. tax year, not the foreign tax year.

Example.[92] USCO, a domestic corporation, owns all of the stock of CFC1. CFC1 acquires all of the equity interests of a disregarded entity, DE1, on July 1, 2018, in a transaction that is considered a CAA. CFC1 and DE1 are both formed under the laws of Country F. CFC1 has a calendar year for U.S. tax

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purposes, but DE1 has a June 30 fiscal year end for Country F purposes. DE1 owns a single asset (Asset A) that generates income that is subject to Country F income tax. The Basis Difference with respect to Asset A for a full U.S. tax year is 18, and for a half year would be 9. In this case, CFC1 is the Section 901(m) Payor and the RFA Owner (U.S.) with respect to Asset A. DE1 is the Foreign Payor of any Country F income tax. Given that CFC1 does not own any assets, CFC1 only has to perform one Aggregate Basis Difference calculation per year for DE1's payment of Country F income tax. In 2018, the first tax year ending after the CAA, CFC's Aggregate Basis Difference is 9. Yet, because DE1's foreign tax year does not end on December 31, 2018, its Country F income tax will not accrue on December 31, 2018. Instead, it will accrue the following year. Thus, for 2018, the Foreign Income Tax Amount is zero. Because the Foreign Income Tax Amount is zero, the Disqualified Tax Amount is also zero. Because the Disqualified Tax Amount is zero, the ABD Carryover equals the entire Aggregate Basis Difference attributable to 2018, which is 9. This amount is carried forward. Hence, in the following year, CFC1 will have an Aggregate Basis Difference of 27 (*i.e.*, 18 of Basis Difference allocable to that year + the 9 of ABD Carryover from the prior year).

The Proposed Regulations also contain rules for how the ABD Carryover moves from entity to entity, pursuant to tax-free reorganizations and other transactions, which we do not elaborate on here.[93]

VIII. Conclusion

The Treasury and the IRS should be commended for drafting a very thoughtful set of regulations on an exceedingly complex topic. In particular, the government appears to have given a lot of thought to what aspects of section 901(m) should be governed by U.S. law and which aspects of section 901(m) should be governed by foreign law. Having said that, taxpayers will likely be nonplussed with the *de minimis* exception, since very few large taxpayers will be able to avail themselves of that exception. Hence, taxpayers should assume that the vast majority of multi-jurisdictional deals involving CAAs will still be subject to section 901(m) unless the *de minimis* rules are excpanded before the Proposed Regulations are finalized.

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ENDNOTES

1 Unless otherwise noted, all Code, section and Treas. Reg. § references are to the United States Internal Revenue Code of 1986, as amended, or treasury regulations issued pursuant thereto.
2 Code Sec. 901(m)(6).
3 Instead of claiming a credit of $100 for foreign income taxes of $100, thereby reducing U.S. tax liability by $100, the taxpayer now deducts those $100 of taxes, which only provides a U.S. tax reduction of $35—a 65-percent reduction.
4 Code Sec. 901(m)(2).
5 *See, e.g.*, John D. McDonald, Stewart R. Lipeles & Juliana Assis, *Section 901(m) Meets the Real World*, 89 TAXES 5 (November 2011).
6 *See, e.g.*, Erika W. Nijenhuis & John D. McDonald, *Foreign Tax Law: Its Relevance in Resolving U.S. Tax Law Disputes*, 91 TAXES 39 (April 2013).
7 Notice 2014-44, 2014-32 IRB 270 (July 21, 2014).
8 Notice 2014-45, 2014-34 IRB 388 (July 29, 2014).
9 81 FR 88,563 (Dec. 7, 2016).
10 Although it did not address a number of currency issues. For example, it did not address how one computes the Disposition Amount triggered when the currency used to compute earnings and profits is not the same currency that is used to compute gain on the foreign tax return. Normally, they will be the same, but sometimes the foreign jurisdiction will demand that the tax return (and income shown on the return) be calculated under the national currency while the U.S. GAAP books and records and U.S. Form 5471 are computed in U.S. dollars or Euros.
11 Examples include Code Sec. 894 (where U.S. treaty benefits are contingent on the timing and character of income recognized under foreign income tax law), Code Sec. 1503(d) (governing dual consolidated losses) and Code Sec. 909 (governing foreign tax credit splitting events).
12 T.D. 9800 (Dec. 7, 2016) ("Notice 2014-44 stated that the Treasury Department and the IRS are continuing to study whether and to what extent section 901(m) should apply to an asset received in exchange for an RFA in a transaction which the U.S. basis of the asset is determined by reference to the U.S. basis of the transferred RFA. The Treasury Department and the IRS have determined that an asset should not become an RFA solely because the U.S. basis of that asset is determined by reference to the U.S. basis of an RFA for which the asset is exchanged in a successor transaction. Accordingly, for example, if, in a successor transaction, an RFA owner transfers an RFA to a corporation in a transfer to which section 351 applies, the stock of the transferee corporation received is not an RFA even though the U.S. basis of the stock is determined under section 358 by reference to the U.S. basis of the RFA transferred.").
13 Reg. §1.901(m)-2T(b)(1).
14 Reg. §1.901(m)-2T(b)(2).
15 Reg. §1.901(m)-2T(b)(3).
16 Proposed Reg. §1.901(m)-2(b)(4).
17 This is taken from Proposed Reg. §1.901(m)-2(e) Example 1.
18 Proposed Reg. §1.901(m)-2(b)(5).
19 Proposed Reg. §1.901(m)-2(b)(6).
20 Proposed Reg. §1.901(m)-2(e) Example 2.
21 This example is modified from Proposed Reg. §1.901(m)-3(b)(3) Example 1.
22 Proposed Reg. §1.901(m)-1(a)(35). The regulations provide that each member of a consolidated group is considered a separate Section 901(m) Payor but individuals filing a joint return are considered a single Section 901(m) Payor.
23 Proposed Reg. §1.901(m)-1(a)(31).
24 Proposed Reg. §1.901(m)-1(a)(32).
25 Proposed Reg. §1.901(m)-1(a)(23).
26 81 FR 88,563 (Dec. 7, 2016).
27 Reg. §1.901(m)-2T(c)(1).
28 Proposed Reg. §1.901(m)-2(c)(2).
29 Proposed Reg. §1.901(m)-2(c)(3).
30 This example is taken from Proposed Reg. §1.901(m)-2(e) Example 3.
31 The example in the regulations presumably does not refer to foreign law (which would normally also be relevant in determining whether a "disposition" of an RFA occurred) because the asset is assumed to not yet be relevant under any foreign income tax law.

[32] Instead, to be subject to the anti-abuse rule, DE2 would have to transfer the intellectual property to DE1 in a transaction that does not constitute a "Disposition" (see below) such that the remaining Basis Difference is not accelerated.
[33] Reg. §1.901(m)-4T(a).
[34] Reg. §1.901(m)-4T(b).
[35] *See, e.g.*, Joshua Kaplan, Jeffrey Farrell & Caren Shein, *Uncovering the Covered Asset Acquisition Rules*, 62 Tax Executive 277 (October 2010) (arguing that if a foreign corporation has never computed its tax attributes under U.S. tax principals, it may be both complex, expensive and time consuming to reconstruct the foreign corporation's U.S. tax basis for each RFA immediately before the CAA); Patrick Jackman & Philip Tretiak, *Cross-Border Acquisitions Get More Expensive: New Legislation Would Limit FTCs in "Covered Asset Acquisitions,"* 36 Int'l Tax J. 5 (September 2010) (referencing the difficulty that a purchaser would face when attempting to apply U.S. tax principals to a foreign target that has likely never made such calculations before); James Tobin, *Covered Asset Acquisitions Uncovered*, Tax Management International Journal (July 2011) (indicating that before an acquisition occurs, a purchaser would be required to conduct a full historical E & P study of the foreign target to determine the U.S. tax basis of all of its assets).
[36] Proposed Reg. §1.901(m)-4(c).
[37] Proposed Reg. §1.901(m)-4(g)(3).
[38] This example is modified from Proposed Reg. §1.901(m)-3(b)(3) Example 1.
[39] Proposed Reg. §1.901(m)-4(c)(7).
[40] Proposed Reg. §1.901(m)-7.
[41] Proposed Reg. §1.901(m)-7(b)(2).
[42] Proposed Reg. §1.901(m)-7(b)(3).
[43] Proposed Reg. §1.901(m)-7(b)(2).
[44] Proposed Reg. §1.901(m)-7(b)(3).
[45] Proposed Reg. §1.901(m)-7(b)(3)(ii).
[46] Proposed Reg. §1.901(m)-7(c)(1).
[47] Proposed Reg. §1.901(m)-1(a)(3).
[48] Reg. §1.901(m)-5T(b)(2)(i).
[49] Proposed Reg. §1.901(m)-5(b)(2)(ii).
[50] Reg. §1.901(m)-1T(a)(10).
[51] This example is modified from Proposed Reg. §1.901(m)-5(h) Example 3.
[52] Reg. §1.901(m)-5T(c)(2).
[53] Reg. §1.901(m)-5T(c)(2)(i).
[54] Proposed Reg. §1.901(m)-5(c)(1).
[55] Proposed Reg. §1.901(m)-5(h) Example 1.
[56] This equals 120 of proceeds minus 70 basis. The 70 basis equals the 100 starting basis minus 30 depreciation (1.5 years of depreciation = 20 + 10).
[57] This equals the 120 disposition.
[58] T.D. 9800 (Dec. 7, 2016) ("To the extent that the disparity in the U.S. basis and the foreign basis is decreased as a result of the disposition, however, a portion of the unallocated basis difference … should be taken into account.").
[59] Reg. §1.901(m)-5T(c)(2)(ii)(A).
[60] Reg. §1.901(m)-5T(c)(2)(ii)(B).
[61] Proposed Reg. §1.901(m)-5(d).
[62] Proposed Reg. §1.901(m)-5(e).
[63] Proposed Reg. §1.901(m)-5(f).
[64] Proposed Reg. §1.901(m)-5(g).
[65] Proposed Reg. §1.901(m)-5(h) Example 2.
[66] Reg. §1.901(m)-6T and Proposed Reg. §1.901(m)-6.
[67] Reg. §1.901(m)-6T(b)(1).
[68] Reg. §1.901(m)-6T(b)(2).
[69] The regulations do not specify whether the movement from one qualified business unit (QBU) of a single taxpayer to another QBU of that same taxpayer, although disregarded for other purposes, would be considered a "transfer" given that it does have significance under section 987 of the Code.
[70] Reg. §1.901(m)-6T(b)(4)(i).
[71] Reg. §1.901(m)-6T(b)(5) Example.
[72] We assume the mere holding of land would not constitute a qualified business unit within the meaning of section 987 of the Code.
[73] This issue (*i.e.*, the translation of tax basis in tax-free transfers) is not governed by the section 987 regulations where neither the transferor nor transferee is a Section 987 QBU as defined in the section 987 regulations. The options would appear to be either the spot exchange rate on the date the deemed liquidation occurs or the historic pound to Euro exchange rate on the date the asset was originally acquired by FT. *See, e.g.*, CCA 200303021 (Oct. 1, 2001) (historical exchange rate used to translate exchanging shareholder's basis in an inbound "B" reorganization).
[74] Proposed Reg. §1.901(m)-6(b)(4)(ii).
[75] Reg. §1.901(m)-1T(a)(40).
[76] Proposed Reg. §1.901(m)-3.
[77] Proposed Reg. §1.901(m)-1(a)(1).
[78] This example is taken from Proposed Reg. §1.901(m)-3(b)(3) Example 1.
[79] Proposed Reg. §1.901(m)-1(a)(1).
[80] Proposed Reg. §1.901(m)-3(b)(3) Example 1.
[81] Proposed Reg. §1.901(m)-3(b)(2).
[82] Proposed Reg. §1.901(m)-3(b)(2)(ii).
[83] This example is modified from Proposed Reg. §1.901(m)-3(b)(3) Example 3.
[84] Proposed Reg. §1.901(m)-3(b)(2)(iv).
[85] Proposed Reg. §1.901(m)-3(b)(2)(iv)(A). This could happen if, for example, some of the RFAs have positive Basis Differences whereas others have negative Basis Differences.
[86] Proposed Reg. §1.901(m)-3(b)(2)(iv)(B).
[87] Proposed Reg. §1.901(m)-3(b)(2)(iv)(C).
[88] Proposed Reg. §1.901(m)-1(a)(2).
[89] For rules governing "how" the ABD Carryover is carried forward see Proposed Reg. §1.901(m)-6(c).
[90] Proposed Reg. §1.901(m)-3(c)(2)(i).
[91] Proposed Reg. §1.901(m)-3(c)(2)(ii)(A).
[92] Proposed Reg. §1.901(m)-3(c)(3) Example.
[93] Proposed Reg. §1.901(m)-6(c).

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