Coordination of Extraordinary Disposition and Disqualified Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 245A and 951A of the Internal Revenue Code (the “Code”) that coordinate the extraordinary disposition rule under section 245A of the Code with the disqualified basis and disqualified payment rules under section 951A of the Code. This document also contains final regulations under section 6038 of the Code regarding information reporting to facilitate administration of the final regulations. The final regulations affect corporations that are subject to the extraordinary disposition rule and the disqualified basis rule or the disqualified payment rule. This document finalizes proposed regulations published on August 27, 2020.
DATES:

Effective date: These regulations are effective on January 12, 2021.¹

Applicability dates: For dates of applicability, see §§ 1.245A-11 and 1.6038-2(m)(5).

FOR FURTHER INFORMATION CONTACT: Logan M. Kincheloe, (202) 317-6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 27, 2020, the Department of the Treasury (“Treasury Department”) and the IRS published proposed regulations (REG-124737-19) under sections 245A, 951A, and 6038 in the Federal Register (85 FR 53098) (the “proposed regulations”). The Treasury Department and the IRS received one written comment with respect to the proposed regulations; however, the comment was not substantively related to, and did not suggest any revisions to, the proposed regulations. Therefore, this preamble does not address the comment. The written comment is available at www.regulations.gov or upon request. A public hearing on the proposed regulations was not held because there were no requests to speak.

This document contains amendments to 26 CFR part 1 under sections 245A, 951A, and 6038 (the “final regulations”). Any term used but not defined in this preamble has the meaning given to it in the final regulations or the preamble to the proposed regulations.

¹ The effective date of these regulations is delayed to provide for the orderly amendment of §1.951A-2 by TD 9922, 85 FR 71998, published on November 12, 2020, and with a delayed effective date of January 11, 2021. The changes to §1.951A-2 made in these regulations are to the regulation text as amended by TD 9922.
I. Overview

The extraordinary disposition rule and the disqualified basis rule generally address certain transactions, involving related controlled foreign corporations ("CFCs") of a section 245A shareholder, that were not subject to current U.S. tax solely by reason of having occurred during the disqualified period. In general, as to the section 245A shareholder, the extraordinary disposition rule ensures that earnings and profits generated by such a transaction are subject to U.S. tax when distributed as a dividend, and the disqualified basis rule ensures that basis generated by the transaction does not offset or reduce income that would otherwise be subject to U.S. tax at the section 245A shareholder-level under section 951(a)(1)(A) or 951A(a), or at the CFC-level under section 882(a) (that is, as income effectively connected with the conduct of a trade or business in the United States). See §§1.245A-5 and 1.951A-2(c)(5).

Absent a coordination mechanism, the extraordinary disposition rule and the disqualified basis rule could give rise to excess taxation as to a section 245A shareholder, because the earnings and profits to which the extraordinary disposition rule applies ("extraordinary disposition E&P"), and the basis to which the disqualified basis rule applies ("disqualified basis"), are generally a function of a single amount of gain. The proposed regulations coordinate the extraordinary disposition rule and the disqualified basis rule through two operative rules: the DQB reduction rule, which reduces disqualified basis in certain cases, and the EDA reduction rule, which reduces an extraordinary disposition account in certain cases. See proposed §§1.245A-7 and 1.245A-8. These operative rules also apply to coordinate the extraordinary disposition
rule and the disqualified payment rule, which addresses transactions similar to those to which the disqualified basis rule applies.

This rulemaking finalizes the proposed regulations, with one revision, as discussed in part II of this Explanation of Revisions.

II. The DQB Reduction Rule – Treatment of Prior Extraordinary Disposition Amounts

Under the proposed regulations, the DQB reduction rule generally applies when, as to a section 245A shareholder, extraordinary disposition E&P become subject to U.S. tax by reason of the application of the extraordinary disposition rule to a distribution of the extraordinary disposition E&P. See proposed §§1.245A-7(b) and 1.245A-8(b). In general, the DQB reduction rule provides that basis attributable to gain to which the extraordinary disposition E&P are also attributable is no longer disqualified basis. Id.

The preamble to the proposed regulations noted that the Treasury Department and the IRS were studying whether the DQB reduction rule should also apply by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(1)(i) through (iv). The preamble requested comments on this matter, but none were received. Such a prior extraordinary disposition amount generally represents extraordinary disposition E&P that have become subject to U.S. tax as to a section 245A shareholder other than by direct application of the extraordinary disposition rule – for example, extraordinary disposition E&P that give rise to an income inclusion to the section 245A shareholder by reason of sections 951(a)(1)(B) and 956(a). Under the extraordinary disposition rule, the application of the other provision to the extraordinary disposition E&P results in a reduction to the application of the extraordinary disposition rule, because otherwise the earnings and profits (or an amount of other earnings and
profits) could be taxed as to the section 245A shareholder both by reason of the other provision and the extraordinary disposition rule. See §1.245A-5(c)(3)(i)(D). This reduction to the application of the extraordinary disposition rule will generally result in an extraordinary disposition being subject to a single level of U.S. tax.

The Treasury Department and the IRS have determined that the DQB reduction rule should also apply by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(1)(j) through (iv), and therefore the final regulations provide a rule to this effect. See §§1.245A-7(b)(3) and 1.245A-8(b)(6). Absent such an approach, gain to which extraordinary disposition E&P and disqualified basis are attributable could in effect be taxed both by reason of the disqualified basis rule and a provision other than the extraordinary disposition rule.

Applicability Dates

The final regulations apply to taxable years of foreign corporations beginning on or after [INSERT DATE PUBLISHED IN FEDERAL REGISTER], and to taxable years of section 245A shareholders in which or with which such taxable years of foreign corporations end. See §1.245A-11(a). In addition, taxpayers may choose to apply the final regulations to taxable years beginning before [INSERT DATE PUBLISHED IN FEDERAL REGISTER], subject to certain limitations. See §1.245A-11(b).

Special Analyses

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

I. Paperwork Reduction Act ("PRA")
The collections of information in the final regulations are in §1.6038-2(f)(17) and (18). Under the PRA (44 U.S.C. 3501 et seq.), an agency may not conduct or sponsor and a person is not required to respond to a collection of information unless it displays a valid OMB control number.

The collection of information in §1.6038-2(f)(17) is mandatory for every U.S. shareholder of a CFC that holds an item of property that has disqualified basis within the meaning of §1.951A-3(h)(2) during an annual accounting period and files Form 5471 for that period (OMB control number 1545-0123). The collection of information in §1.6038-2(f)(17) is satisfied by providing information about the items of property with disqualified basis held by the CFC during the CFC’s accounting period as Form 5471 and its instructions may prescribe. For purposes of the PRA, the reporting burden associated with §1.6038-2(f)(17) will be reflected in the applicable PRA submission associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with §1.6038-2(f)(17) is 7,500-8,500, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

<table>
<thead>
<tr>
<th>New</th>
<th>Revision of existing form</th>
<th>Number of respondents (estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule to Form 5471</td>
<td>✓</td>
<td>7,500-8,500</td>
</tr>
</tbody>
</table>

The collection of information in §1.6038-2(f)(18) is mandatory for every U.S. shareholder of a CFC that applies the rules of §§1.245A-6 through 1.245A-11 during an annual accounting period and files Form 5471 for that period (OMB control number
The collection of information in §1.6038-2(f)(18) is satisfied by providing information about the reduction to an extraordinary disposition account made pursuant to §1.245A-7(b) or §1.245A-8(b) and reductions to an item of specified property’s disqualified basis pursuant to §1.245A-7(c) or §1.245A-8(c) during the corporation’s accounting period as Form 5471 and its instructions may prescribe. For purposes of the PRA, the reporting burden associated with §1.6038-2(f)(18) will be reflected in the applicable PRA submission associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with §1.6038-2(f)(18) is 7,500-8,500, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

<table>
<thead>
<tr>
<th>New</th>
<th>Revision of existing form</th>
<th>Number of respondents (estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule to Form 5471</td>
<td>✓</td>
<td>7,500-8,500</td>
</tr>
</tbody>
</table>

The current status of the PRA submissions related to the new revised Form 5471 as a result of the information collections in the final regulations is provided in the accompanying table. The reporting burdens associated with the information collections in § 1.6038-2(f)(17) and (18) are included in the aggregated burden estimates for OMB control number 1545-0123, which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017). The overall burden estimates provided in 1545-0123 are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden.
of the tax forms that will be revised as a result of the information collections in the final regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and the IRS urge readers to recognize that these numbers are duplicates of estimates provided for informational purposes in other proposed and final regulatory actions and to guard against over-counting the burden that international tax provisions imposed before the Act.

No burden estimates specific to the final regulations are currently available. The Treasury Department and the IRS have not identified any burden estimates, including those for new information collections, related to the requirements under the final regulations. Proposed revisions to these forms that reflect the information collections contained in these final regulations will be made available for public comment at www.irs.gov/draftforms and will not be finalized until after approved by OMB under the PRA.

<table>
<thead>
<tr>
<th>Information Collection</th>
<th>Type of Filer</th>
<th>OMB Number(s)</th>
<th>Status</th>
</tr>
</thead>
</table>

II. Regulatory Flexibility Act

It is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). The small entities that are subject to §1.245A–5 are small entities that are U.S. shareholders of certain foreign corporations
that are otherwise eligible for the section 245A deduction on distributions from the foreign corporation. The small entities that are subject to §1.951A-2(c)(5) are U.S. shareholders of certain foreign corporations that are subject to tax under section 951 with respect to subpart F income of those foreign corporations or section 951A with respect to tested income of those foreign corporations.

The taxpayers potentially affected by these final regulations are U.S. shareholders of at least two related foreign corporations, one that has an extraordinary disposition account and the other that has assets with disqualified basis corresponding to the extraordinary disposition account. This means that the foreign corporation with the extraordinary disposition account has or had a fiscal year and engaged in a disposition of property (i) during the period between January 1, 2018, and the end of the transferor foreign corporation’s last taxable year beginning before 2018; (ii) outside the ordinary course of the foreign corporation’s activities; and (iii) generally, while the corporation was a CFC.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged in these particular transactions are not readily available. Based on tabulations of the 2014 Statistics of Income Study file the Treasury Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. Previous estimates suggest that approximately half of domestic corporations with CFCs have less than $25 million in gross receipts. However, the number of potentially affected taxpayers is smaller than the number of domestic corporations with at least one fiscal year CFC because a domestic corporation will not
be affected unless its fiscal year CFC engages in a non-routine sale with a related party that creates an extraordinary disposition account and disqualified basis, and the domestic corporation must then incur the type of cost (limitation of the section 245A deduction or allocation of deductions or losses to residual CFC gross income and reduction in untaxed earnings) that causes these final regulations to apply. There are several industries that may be identified as small even though their annual receipts are above $25 million or because they have fewer employees than the SBA Size Standard for that industry. The Treasury Department and the IRS do not have more precise data indicating the number of small entities that will be potentially affected by the regulations. The rule may affect a substantial number of small entities, but data are not readily available to assess how many entities will be affected. Nevertheless, for the reasons described below, the Treasury Department and the IRS have determined that the regulations will not have a significant economic impact on small entities.

The Treasury Department and the IRS have concluded that there is no significant economic impact on such entities as a result of the final regulations. To make this determination, the Treasury Department and the IRS calculated the ratio of estimated global intangible lowed-taxed income (“GILTI”) and subpart F income tax attributable to these businesses to aggregate total sales data. Bureau of Economic Analysis data on the activities of multinational enterprises report total sales of all foreign affiliates of U.S. parents of $7,183 billion in 2017 (accessed at this web address in December, 2018: https://apps.bea.gov/iTable/iTable.cfm?ReqID=2&step=1). Projections for GILTI and Subpart F tax revenues average $20 billion per year over the ten-year budget window (see Joint Committee on Taxation, Estimated Budget Effects of the Conference
Agreement for H.R. 1, The “Tax Cuts and Jobs Act, JCX-67-17, December 18, 2017), resulting in a less than 1 percent share of GILTI and Subpart F tax in total sales of U.S.-parented affiliates. Compliance costs for these regulations will be a small fraction of the revenue amounts. Thus, any tax regulation that affects the proceeds from GILTI and subpart F income would have an economic impact of less than 3 to 5 percent of “receipts” (as that term is defined in 13 CFR 121.104, the provision for calculating small business receipts, to mean sales and any other measure of gross income), an economic impact that the Treasury Department and IRS regard as the threshold for significant under the Regulatory Flexibility Act. This calculated percentage is furthermore an upper bound on the true expected effect of the final regulations because not all the GILTI and subpart F income estimated to be attributable to small entities will be affected by the final regulations. For example, GILTI and subpart F income that is not attributable to a CFC that holds property with disqualified basis (or property that would otherwise have disqualified basis in the absence of these regulations) is not affected by these final regulations. Consequently, the Treasury Department and the IRS have determined that these final regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, the proposed regulations (REG-124737-19) preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses, and no comments were received.

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

IV. Executive Order 13132: Federalism

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

Drafting Information

The principal author of the final regulations is Logan M. Kincheloe, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:
PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order for §§ 1.245A-6 through 1.245A-11 to read in part as follows:

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

Sections 1.245A-6 through 1.245A-11 also issued under 26 U.S.C. 245A(g), 882(c)(1)(A), 951A, 954(b)(5), 954(c)(6), and 965(o).

* * * * *

Par. 2. Section 1.245A-5 is amended by:

1. In the first sentence of paragraph (c)(3)(i)(A), adding immediately after the language “by the prior extraordinary disposition amount” the language “and as provided in §1.245A-7 or §1.245A-8.”

2. Revising paragraph (j)(8)(ii).

The revision reads as follows:

§1.245A-5 Limitation of section 245A deduction and section 954(c)(6) exception.

* * * * *

(j) * * *

(8) * * *

(ii) Analysis. Because the royalty prepayment was carried out with a principal purpose of avoiding the purposes of this section, appropriate adjustments are required to be made under the anti-abuse rule in paragraph (h) of this section. CFC1 is a CFC that has a November 30 taxable year, so under paragraph (c)(3)(iii) of this section, CFC1 has a disqualified period beginning on January 1, 2018, and ending on November 30, 2018. In addition, even though the intangible property licensed by CFC1 to CFC2 is specified property, CFC2’s prepayment of the royalty would not be treated as a disposition of the specified property by CFC1 and, therefore, would not constitute an extraordinary disposition (and thus would not give rise to extraordinary disposition E&P), absent the application of the anti-abuse rule of paragraph (h) of this section. Pursuant to paragraph (h) of this section, the earnings and profits of CFC1 generated as a result of the $100x of prepaid royalty are treated as extraordinary disposition E&P for
purposes of this section and, therefore, US1 has an extraordinary disposition account with respect to CFC1 of $100x. In addition, the prepaid royalty gives rise to a disqualified payment (as defined in §1.951A-2(c)(6)(ii)(A)) of $100x. As a result, §1.245A-7(b) or §1.245A-8(b), as applicable, applies to reduce the disqualified payment in the same manner as if the disqualified payment were disqualified basis, and §1.245A-7(c) or §1.245A-8(c), as applicable, applies to reduce the extraordinary disposition account in the same manner as if the deductions directly or indirectly related to the disqualified payment were deductions attributable to disqualified basis of an item of specified property that corresponds to the extraordinary disposition account.

* * * *

Par. 3. Sections 1.245A-6 through 1.245A-11 are added to read as follows:

Sec.

* * * *

1.245A-6 Coordination of extraordinary disposition and disqualified basis rules.
1.245A-7 Coordination rules for simple cases.
1.245A-8 Coordination rules for complex cases.
1.245A-9 Other rules and definitions.
1.245A-10 Examples.
1.245A-11 Applicability dates.

* * * *

§1.245A-6 Coordination of extraordinary disposition and disqualified basis rules.

(a) **Scope.** This section and §§1.245A-7 through 1.245A-11 coordinate the application of the extraordinary disposition rules of §1.245A-5(c) and (d) and the disqualified basis rule of §1.951A-2(c)(5). Section 1.245A-7 provides coordination rules for simple cases, and §1.245A-8 provides coordination rules for complex cases. Section 1.245A-9 provides definitions and other rules, including rules of general applicability for purposes of this section and §§1.245A-7 through 1.245A-11. Section 1.245A-10 provides examples illustrating the application of this section and §§1.245A-7 through 1.245A-9. Section 1.245A-11 provides applicability dates.
(b) **Conditions to apply coordination rules for simple cases.** For a taxable year of a section 245A shareholder for which the conditions described in paragraphs (b)(1) and (2) of this section are satisfied, the section 245A shareholder may apply the coordination rules of §1.245A-7 (rules for simple cases) to an extraordinary disposition account of the section 245A shareholder with respect to an SFC and disqualified basis of an item of specified property that corresponds to the extraordinary disposition account (as determined pursuant to §1.245A-9(b)(1)). If the conditions are not satisfied, then the coordination rules of §1.245A-8 (rules for complex cases) apply beginning with the first day of the first taxable year of the section 245A shareholder for which the conditions are not satisfied and all taxable years thereafter. If the conditions are satisfied for a taxable year of the section 245A shareholder but the section 245A shareholder chooses not to apply the coordination rules of §1.245A-7 for that taxable year, then the coordination rules of §1.245A-8 apply to that taxable year (though, for a subsequent taxable year, the section 245A shareholder may apply the coordination rules of §1.245A-7, provided that the conditions described in paragraphs (b)(1) and (2) of this section are satisfied for such subsequent taxable year and have been satisfied for all earlier taxable years). For purposes of applying paragraphs (b)(1) and (2) of this section, a reference to a section 245A shareholder, an SFC, or a CFC does not include a successor of the section 245A shareholder, the SFC, or the CFC, respectively.

(1) **Requirements related to the SFC.** The condition of this paragraph (b)(1) is satisfied for a taxable year of the section 245A shareholder if the following requirements are satisfied:
(i) On January 1, 2018, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(ii) On each day of the taxable year of the section 245A shareholder, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(iii) On no day during the taxable year of the section 245A shareholder was the SFC a distributing or controlled corporation in a transaction described in a section 355, or did the SFC acquire the assets of a corporation as to which there is an extraordinary disposition account pursuant to a transaction described in section 381 (that is, taking into account the requirements of this paragraph (b)(1) and paragraph (b)(2) of this section, the section 245A shareholder's extraordinary disposition account with respect to the SFC has not been adjusted pursuant to the rules of §1.245A-5(c)(4)).

(2) Requirements related to an item of specified property that corresponds to an extraordinary disposition account and a CFC holding the item. The condition of this paragraph (b)(2) is satisfied for a taxable year of a section 245A shareholder if the following requirements are satisfied:

(i) For each item of specified property with disqualified basis that corresponds to the extraordinary disposition account, the item of specified property is held by a CFC immediately after the extraordinary disposition of the item of specified property.

(ii) For each CFC described in paragraph (b)(2)(i) of this section--

(A) All of the stock (by vote and value) of the CFC is owned (within the meaning of section 958(a)) by the section 245A shareholder and any domestic affiliates of the
section 245A shareholder immediately after the extraordinary disposition described in paragraph (b)(2)(i) of this section;

(B) For each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, there is no extraordinary disposition account with respect to the CFC, and the sum of the balance of the hybrid deduction accounts (as described in §1.245A(e)-1(d)(1)) with respect to shares of stock of the CFC is zero (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year); and

(C) On each day of each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, and on each day of each taxable year of the CFC that begins with or within the taxable year of the section 245A shareholder--

(1) The CFC holds the item of specified property described in paragraph (b)(1)(i) of this section;

(2) The section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a)) all of the stock (by vote and value) of the CFC;

(3) The CFC does not hold any item of specified property with disqualified basis other than an item of specified property that corresponds to the extraordinary disposition account;

(4) The CFC does not own an interest in a partnership, trust, or estate (directly or indirectly through one or more other partnerships, trusts, or estates) that holds an item of specified property with disqualified basis; and
(5) The CFC is not engaged in the conduct of a trade or business in the United States and therefore does not have ECTI, and the CFC does not have any deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5).

§1.245A-7 Coordination rules for simple cases.

(a) Scope. This section applies for a taxable year of a section 245A shareholder for which the conditions of §1.245A-6(b)(1) and (2) are satisfied and for which the section 245A shareholder chooses to apply this section (in lieu of §1.245A-8).

(b) Reduction of disqualified basis by reason of an extraordinary disposition amount or tiered extraordinary disposition amount--(1) In general. If, for a taxable year of a section 245A shareholder, an extraordinary disposition account of the section 245A shareholder gives rise to one or more extraordinary disposition amounts or tiered extraordinary disposition amounts, then, with respect to an item of specified property that corresponds to the extraordinary disposition account, the disqualified basis of the item of specified property is, solely for purposes of §1.951A-2(c)(5), reduced (but not below zero) by an amount (determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of--

(i) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account.
(2) **Timing rules regarding disqualified basis.** See §1.245A-9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(3) **Special rule regarding prior extraordinary disposition amounts.** For purposes of paragraph (b)(1) of this section, to the extent that an extraordinary disposition account of a section 245A shareholder is reduced under §1.245A-5(c)(3)(i)(A) by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(1)(i) through (iv), the extraordinary disposition account is considered to give rise to an extraordinary disposition amount or tiered extraordinary disposition amount (and the amount by which the account is reduced is treated as an extraordinary disposition amount or tiered extraordinary disposition amount).

(c) **Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis—(1) In general.** If, for a taxable year of a CFC, the CFC holds one or more items of specified property that correspond to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, then the extraordinary disposition account is reduced (but not below zero) by the lesser of the amounts described in paragraphs (c)(1)(i) and (ii) of this section (each determined in the functional currency of the CFC).

(i) The excess (if any) of the adjusted earnings of the CFC for the taxable year of the CFC, over the sum of the previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year).
(ii) The balance of the section 245A shareholder’s RGI account with respect to the CFC (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(ii) of this section for the taxable year).

(2) Timing of reduction to extraordinary disposition account. See §1.245A-9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) Adjusted earnings. The term adjusted earnings means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC’s taxable year (taking into account all distributions during the taxable year), and with the adjustments described in paragraphs (c)(3)(i) through (iii) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that is or was allocated and apportioned to residual CFC gross income of the CFC solely by reason of §1.951A-2(c)(5)(i).

(ii) The earnings and profits are decreased by the amount by which an RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(ii) of this section for a prior taxable year of the CFC.

(iii) The earnings and profits are determined without regard to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(4) RGI account. For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder’s RGI account with respect to the CFC:
(i) The balance of the RGI account is increased by the sum of the amounts of
deductions and losses of the CFC that, but for §1.951A-2(c)(5)(i), would have
decreased one or more categories of the CFC’s positive subpart F income or the CFC’s
tested income, or increased or given rise to a tested loss or one or more qualified
deficits of the CFC.

(ii) The balance of the RGI account is decreased to the extent that, by reason of
the application of paragraph (c)(1) of this section with respect to the taxable year of the
CFC, there is a reduction to the extraordinary disposition account of the section 245A
shareholder.

§1.245A-8 Coordination rules for complex cases.

(a) **Scope.** This section applies beginning with the first day of the first taxable
year of a section 245A shareholder for which §1.245A-7 does not apply and for all
taxable years thereafter, or for a taxable year of a section 245A shareholder for which
the section 245A shareholder chooses not to apply §1.245A-7.

(b) **Reduction of disqualified basis by reason of an extraordinary disposition
amount or tiered extraordinary disposition amount**—(1) **In general.** If, for a taxable year
of a section 245A shareholder, an extraordinary disposition account of the section 245A
shareholder gives rise to one or more extraordinary disposition amounts or tiered
extraordinary disposition amounts, then, with respect to an item of specified property
that corresponds to the extraordinary disposition account and for which the ownership
requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the
section 245A shareholder, solely for purposes of §1.951A-2(c)(5), the disqualified basis
of the item of specified property is reduced (but not below zero) by an amount
(determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of--

(i) The excess (if any) of--

(A) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; over

(B) The basis benefit account with respect to the extraordinary disposition account (determined as of the end of the taxable year of the section 245A shareholder, and without regard to the application of paragraph (b)(4)(i)(B) of this section for the taxable year); and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder.

(2) Timing rules regarding disqualified basis. See §1.245A-9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(3) Ownership requirement with respect to an item of specified property--(i) In general. For a taxable year of a section 245A shareholder, the ownership requirement of this paragraph (b)(3)(i) is satisfied with respect to an item of specified property if, on at least one day that falls within the taxable year, the item of specified property is held by--

(A) The section 245A shareholder;
(B) A person (other than the section 245A shareholder) that, on at least one day that falls within the section 245A shareholder's taxable year, is a related party with respect to the section 245A shareholder (such a person, a qualified related party with respect to the section 245A shareholder for the taxable year of the section 245A shareholder); or

(C) A specified entity at least 10 percent of the interests of which are, on at least one day that falls within the section 245A shareholder's taxable year, owned directly or indirectly through one or more other specified entities by the section 245A shareholder or a qualified related party.

(ii) Rules for determining an interest in a specified entity. For purposes of paragraph (b)(3)(i)(C) of this section, the phrase “at least 10 percent of the interests” means--

(A) If the specified entity is a foreign corporation, at least 10 percent of the stock (by vote or value) of the foreign corporation;

(B) If the specified entity is a partnership, at least 10 percent of the interests in the capital or profits of the partnership; or

(C) If the specified entity is not a foreign corporation or a partnership, at least 10 percent of the value of the interests in the specified entity.

(4) Basis benefit account--(i) General rules. The term basis benefit account means, with respect to an extraordinary disposition account of a section 245A shareholder, an account of the section 245A shareholder (the initial balance of which is zero), adjusted pursuant to the rules of paragraphs (b)(4)(i)(A) and (B) of this section on the last day of each taxable year of the section 245A shareholder. The basis benefit
account must be maintained in the same functional currency as the extraordinary disposition account.

(A) The balance of the basis benefit account is increased to the extent that a basis benefit amount with respect to an item of specified property that corresponds to the section 245A shareholder’s extraordinary disposition account is assigned to the taxable year of the section 245A shareholder. However, if the extraordinary disposition ownership percentage applicable to the section 245A shareholder’s extraordinary disposition account is less than 100 percent, then, the basis benefit account is instead increased by the amount equal to the basis benefit amount multiplied by the extraordinary disposition ownership percentage.

(B) The balance of the basis benefit account is decreased to the extent that, for a taxable year that includes the date on which the section 245A shareholder’s taxable year ends, disqualified basis of an item of specified property would have been reduced pursuant to paragraph (b)(1) of this section but for an amount in the basis benefit account.

(ii) Rules for determining a basis benefit amount--(A) In general. The term basis benefit amount means, with respect to an item of specified property that has disqualified basis, the portion of disqualified basis that, for a taxable year, is directly (or indirectly through one or more specified entities that are not corporations) taken into account for U.S. tax purposes by a U.S. tax resident, a CFC described in §1.267A-5(a)(17), or a specified foreign person and--
(1) Reduces the amount of the U.S. tax resident’s taxable income, one or more categories of the CFC’s positive subpart F income, the CFC’s tested income, or the specified foreign person’s ECTI, as applicable; or

(2) Prevents a decrease or offset of the amount of the CFC’s tested loss or qualified deficits.

(B) Rules for determining whether disqualified basis of an item of specified property is taken into account. For purposes of paragraph (b)(4)(ii)(A) of this section, disqualified basis of an item of specified property is taken into account for U.S. tax purposes without regard to whether the disqualified basis is reduced or eliminated under §1.951A-3(h)(2)(ii)(B)(1).

(C) Timing rules when disqualified basis gives rise to a deferred or disallowed loss. To the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is deferred, then the determination of whether the item of deduction or loss gives rise to a basis benefit amount under paragraph (b)(4)(ii)(A) of this section is made when the item of deduction or loss is no longer deferred. In addition, to the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is disallowed under section 267(a)(1), then a basis benefit amount is treated as occurring in the taxable year when and to the extent that gain is reduced pursuant to section 267(d), and provided that the gain is described in paragraph (b)(4)(ii)(A) of this section.

(iii) Rules for assigning a basis benefit amount to a taxable year of a section 245A shareholder.--(A) In general. For purposes of applying paragraph (b)(4)(i)(A) of this section with respect to a section 245A shareholder, a basis benefit amount with
respect to an item of specified property is assigned to a taxable year of the section 245A shareholder if--

(1) With respect to the item of specified property, the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder; and

(2) The basis benefit amount occurs during the taxable year of the section 245A shareholder, or a taxable year of a U.S. tax resident (other than the section 245A shareholder), a CFC described in §1.267A-5(a)(17), or a specified foreign person, as applicable, that--

(i) Ends with or within the taxable year of the section 245A shareholder; or

(ii) Begins with or within the taxable year of the section 245A shareholder, but only in a case in which but for this paragraph (b)(4)(iii)(A)(2)(ii) the basis benefit amount would not be assigned to a taxable year of the section 245A shareholder.

(B) Anti-duplication rule. For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Thus, for example, if the entire amount of disqualified basis of an item of specified property gives rise to a basis benefit amount for a particular taxable year of a CFC and is assigned to a taxable year of a section 245A shareholder but, pursuant to §1.951A-3(h)(2)(ii)(B)(1)(ii), the disqualified basis is not reduced or eliminated in such taxable year of the CFC
(because, for example, the buyer is a CFC that is a related party) and, as a result, the disqualified basis thereafter gives rise to an additional basis benefit amount, then no portion of the additional basis benefit amount is assigned to a taxable year of any section 245A shareholder.

(iv) Successor rules for basis benefit accounts. To the extent that an extraordinary disposition account of a section 245A shareholder is adjusted pursuant to §1.245A-5(c)(4), a basis benefit account with respect to the extraordinary disposition account is adjusted in a similar manner.

(5) Special rules regarding duplicate DQB of an item of exchanged basis property--(i) Adjustments to certain rules in applying paragraph (b)(1) of this section. For purposes of paragraph (b)(1) of this section for a taxable year of a section 245A shareholder, the following rules apply with respect to duplicate DQB of an item of exchanged basis property:

(A) Duplicate DQB of the item of exchanged basis property with respect to an item of specified property to which the item of exchanged property relates is not taken into account for purposes of paragraph (b)(1) of this section if the disqualified basis of the item of specified property is taken into account for purposes of paragraph (b)(1) of this section. Thus, for example, if for a taxable year of a section 245A shareholder the ownership requirement of paragraph (b)(3) of this section is satisfied with respect to an item of specified property and an item of exchanged basis property that relates to the item of specified property, all of the disqualified basis of which is duplicate DQB with respect to the item of specified property, then only the disqualified basis of the item of
specified property is taken into account for purposes of, and is subject to reduction
under, paragraph (b)(1) of this section.

(B) If, pursuant to paragraph (b)(5)(i)(A) of this section, duplicate DQB of an item
of exchanged basis property with respect to an item of specified property is not taken
into account for purposes of paragraph (b)(1) of this section, then, solely for purposes of
§1.951A-2(c)(5), the duplicate DQB of the item of exchanged basis property is reduced
(in the same manner as it would be if the disqualified basis were taken into account for
purposes of paragraph (b)(1) of this section) by the product of the amounts described in
paragraphs (b)(5)(i)(B)(1) and (2) of this section.

(1) The reduction, under paragraph (b)(1) of this section for the taxable year of
the section 245A shareholder, to the disqualified basis of the item of specified property
to which the item of exchanged basis property relates.

(2) A fraction, the numerator of which is the duplicate DQB of the item of
exchanged basis property with respect to the item of specified property, and the
denominator of which is the sum of the amounts of duplicate DQB with respect to the
item of specified property of each item of exchanged basis property that relates to the
item of specified property and for which the ownership requirement of paragraph
(b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder.
For purposes of determining this fraction, duplicate DQB of an item of exchanged basis
property is determined pursuant to the rules of paragraph (b)(2)(i) of this section (by
replacing the term “paragraph (b)(1)” in that paragraph with the term “paragraph
(b)(5)(i)(B)”). In addition, duplicate DQB of an item of exchanged basis property is
excluded from the denominator of the fraction to the extent the duplicate DQB is
attributable to duplicate DQB of another item of exchanged basis property that is included in the denominator of the fraction.

(ii) Adjustments to certain rules in applying paragraph (b)(4) of this section. For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter duplicate DQB attributable to such disqualified basis of the item of specified property gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Similarly, for purposes of paragraph (b)(4)(i)(A) of this section, to the extent that duplicate DQB attributable to disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis of the item of specified property (or duplicate DQB attributable to such disqualified basis of the item of specified property) gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder.

(6) Special rule regarding prior extraordinary disposition amounts. For purposes of paragraph (b)(1) of this section, to the extent that an extraordinary disposition account of a section 245A shareholder is reduced under §1.245A-5(c)(3)(i)(A) by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(1)(i) through (iv), the extraordinary disposition account is considered to give rise to an extraordinary disposition amount or tiered extraordinary disposition amount (and the
amount by which the account is reduced is treated as an extraordinary disposition amount or tiered extraordinary disposition amount).

(c) Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis—(1) In general.

For a taxable year of a CFC, if there is an RGI account with respect to the CFC that relates to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, and the section 245A shareholder satisfies the ownership requirement of paragraph (c)(5) of this section for the taxable year of the CFC, then, subject to the limitations in paragraphs (c)(6) and (7) of this section, the extraordinary disposition account is reduced (but not below zero) by the lesser of the following amounts (each determined in the functional currency of the CFC)—

(i) The excess (if any) of—

(A) The product of—

(1) The adjusted earnings of the CFC for the taxable year of the CFC; and

(2) The percentage of stock of the CFC (by value) that, in aggregate, is owned directly or indirectly through one or more specified entities by the section 245A shareholder and any domestic affiliates on the last day of the taxable year of the CFC; over

(B) The sum of—

(1) The sum of the balance of the section 245A shareholder’s and any domestic affiliates’ previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year);
(2) The sum of the balance of the hybrid deduction accounts (as described in §1.245A(e)-1(d)(1)) with respect to shares of stock of the CFC that the section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a), and determined by treating a domestic partnership as foreign) as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year; and

(3) The sum of the balance of the section 245A shareholder’s and any domestic affiliates’ extraordinary disposition accounts with respect to the CFC (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year). However, if the section 245A shareholder or a domestic affiliate has an RGI account with respect to the CFC that relates to an extraordinary disposition account with respect to the CFC, then only the excess, if any, of the balance of the extraordinary disposition account over the balance of the RGI account that relates to the extraordinary disposition account (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year) is taken into account for purposes of this paragraph (c)(1)(i)(B)(3). In addition, for purposes of this paragraph (c)(1)(i)(B)(3), an extraordinary disposition account that but for paragraph (e)(1) of this section would be with respect to the CFC for purposes of this section is treated as an extraordinary disposition account with respect to the CFC and thus is taken into account for purposes of this paragraph (c)(1)(i)(B)(3).

(ii) The balance of the RGI account with respect to the CFC that relates to the section 245A shareholder’s extraordinary disposition account with respect to the SFC
(determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year).

(2) **Timing of reduction to extraordinary disposition account.** See §1.245A-9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) **Adjusted earnings.** The term **adjusted earnings** means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC’s taxable year (taking into account all distributions during the taxable year, and not taking into account any deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5)) and with the adjustments described in paragraphs (c)(3)(i) through (iv) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that--

(A) Is or was attributable to disqualified basis of an item of specified property, but only to the extent that gain recognized on the extraordinary disposition of the item of specified property was included in the initial balance of an extraordinary disposition account;

(B) Is or was allocated and apportioned to residual CFC gross income of the CFC (or a predecessor) solely by reason of §1.951A-2(c)(5)(i); and

(C) Does not or has not given rise to or increased a deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5), determined as of the end of the taxable year of the CFC.

(ii) The earnings and profits are decreased by the amount by which any RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(i)(B) of this section for a prior taxable year of the CFC.
(iii) The earnings and profits are determined without regard to earnings attributable to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(iv) The earnings and profits are decreased by the amount of any deduction or loss that, but for paragraph (c)(3)(i)(C) of this section, would be described in paragraph (c)(3)(i) of this section.

(4) RGI account--(i) In general. For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder's RGI account that is with respect to the CFC and that relates to an extraordinary disposition account of the section 245A shareholder with respect to an SFC:

(A) The balance of the RGI account is increased by the product of the amounts described in paragraphs (c)(4)(i)(A)(1) and (2) of this section for a taxable year of the CFC.

(1) The sum of the amounts of deductions and losses of the CFC that--

(i) Are attributable to disqualified basis of one or more items of specified property that correspond to the extraordinary disposition account; and

(ii) But for §1.951A-2(c)(5)(i), would have decreased one or more categories of the CFC’s positive subpart F income, the CFC’s tested income, or the CFC’s ECTI, or increased or given rise to a tested loss or one or more qualified deficits of the CFC.

(2) The lesser of--

(i) A fraction (expressed as a percentage), the numerator of which is the sum of the portions of the CFC’s subpart F income and tested income or tested loss (expressed as a positive number) taken into account under sections 951(a)(1)(A) and 951A(a) (as
determined under the rules of §§1.951-1(b) and (e) and 1.951A-1(d)) by the section
245A shareholder and any domestic affiliates of the section 245A shareholder and the
section 245A shareholder’s and any domestic affiliates’ pro rata shares of the CFC’s
qualified deficits (expressed as a positive number), and the denominator of which is the
sum of the CFC’s subpart F income, tested income or tested loss (expressed as a
positive number), and qualified deficits (expressed as a positive number), but for
purposes of this paragraph (c)(4)(i)(A)(2)(i) treating ECTI (expressed as a positive
number) as if it were subpart F income; and

(ii) The extraordinary disposition ownership percentage applicable as to the
section 245A shareholder’s extraordinary disposition account.

(B) The balance of the RGI account is decreased to the extent that, by reason of
the application of paragraph (c)(1) of this section with respect to the taxable year of the
CFC, there is a reduction to the extraordinary disposition account of the section 245A
shareholder.

(ii) Successor rules for RGI accounts. To the extent that an extraordinary
disposition account of a section 245A shareholder is adjusted pursuant to §1.245A-
5(c)(4), an RGI account of a CFC with respect to the extraordinary disposition account
is adjusted in a similar manner.

(5) Ownership requirement with respect to a CFC. For a taxable year of a CFC,
a section 245A shareholder satisfies the ownership requirement of this paragraph (c)(5)
if, on the last day of the CFC’s taxable year, the section 245A shareholder or a domestic
affiliate is a United States shareholder with respect to the CFC.
(6) **Allocation of reductions among multiple extraordinary disposition accounts.**

This paragraph (c)(6) applies if, by reason of the application of paragraph (c)(1) of this section with respect to a taxable year of a CFC (and but for the application of this paragraph (c)(6) and paragraph (c)(7) of this section), the sum of the reductions under paragraph (c)(1) of this section to two or more extraordinary disposition accounts of a section 245A shareholder or a domestic affiliate of the section 245A shareholder would exceed the amount described in paragraph (c)(1)(i)(A) of this section (the amount of such excess, the *excess amount*). When this paragraph (c)(6) applies, the reduction to each extraordinary disposition account described in the previous sentence is equal to the reduction that would occur but for this paragraph (c)(6) and paragraph (c)(7) of this section, less the product of the excess amount and a fraction, the numerator of which is the balance of the extraordinary disposition account, and the denominator of which is the sum of the balances of all of the extraordinary dispositions accounts described in the previous sentence. For purposes of determining this fraction, the balance of an extraordinary disposition account is determined as of the end of the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, that includes the date on which the CFC’s taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, and adjustments to the extraordinary disposition account for prior extraordinary disposition amounts).

(7) **Extraordinary disposition account not reduced below balance of basis benefit account.** An extraordinary disposition account of a section 245A shareholder cannot be reduced pursuant to paragraph (c)(1) of this section below the balance of the basis
benefit account with respect to the extraordinary disposition account (determined when a reduction to the extraordinary disposition account would occur under paragraph (c)(1) of this section).

(d) Special rules for determining when specified property corresponds to an extraordinary disposition account--(1) Substituted property--(i) Treatment as specified property that corresponds to an extraordinary disposition account. For purposes of this section, an item of substituted property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of substituted property relates, as described in paragraph (d)(1)(ii) of this section) corresponds. In addition, in a case in which an item of substituted property relates to an item of specified property that corresponds to a particular extraordinary disposition account and an item of specified property that corresponds to another extraordinary disposition account (such that, pursuant to this paragraph (d)(1)(i), the item of substituted property is treated as corresponding to multiple extraordinary disposition accounts), only the disqualified basis of the item of substituted property attributable to the first item of specified property is taken into account for purposes of applying this section as to the first extraordinary disposition account, and, similarly, only the disqualified basis of the item of substituted property attributable to the second item of specified property is taken into account for purposes of applying this section as to the second extraordinary disposition account.

(ii) Definition of substituted property. The term substituted property means an item of property the disqualified basis of which is, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(i) or (iii), increased by reason of a reduction under §1.951A-3(h)(2)(ii)(B)(1) in disqualified
basis of an item of specified property. An item of substituted property relates to an item of specified property if the disqualified basis of the item of substituted property was increased by reason of a reduction in disqualified basis of the item of specified property.

(2) **Exchanged basis property**--(i) **Treatment as specified property that corresponds to an extraordinary disposition account for certain purposes.** For purposes of this section, an item of exchanged basis property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of exchanged basis property relates) corresponds.

(ii) **Definition of exchanged basis property.** The term exchanged basis property means an item of property the disqualified basis of which, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), includes disqualified basis of an item of specified property. An item of exchanged basis property relates to an item of specified property if the disqualified basis of the item of exchanged basis property includes disqualified basis of the item of specified property.

(iii) **Definition of duplicate DQB**--(A) **In general.** The term duplicate DQB means, with respect to an item of exchanged basis property and the item of specified property to which the exchanged basis property relates, the disqualified basis of the item of exchanged basis property that includes or is attributable to disqualified basis of the item of specified property.

(B) **Certain nonrecognition transfers involving stock or a partnership interest.** To the extent that an item of exchanged basis property that is stock or an interest in a partnership (lower-tier item) includes disqualified basis of an item of specified property
to which the lower-tier item relates (contributed item), and another item of exchanged basis property that is stock or a partnership interest (upper-tier item) includes disqualified basis of the lower-tier item that is attributable to disqualified basis of the contributed item, the disqualified basis of the upper-tier item is attributable to disqualified basis of the contributed item and the upper-tier item is an item of exchanged basis property that relates to the contributed item. The principles of the preceding sentence apply each time disqualified basis of an item of exchanged basis property that is stock or an interest in a partnership is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.

(C) Multiple nonrecognition transfers of an item of specified property. To the extent that multiple items of exchanged basis property that are stock or interests in a partnership include disqualified basis of the same item of specified property (contributed item) to which the items of exchanged basis property relate, and the issuer of one of the items of exchanged basis property (upper-tier successor item) receives the other item of exchanged basis property (lower-tier successor item) in exchange for the contributed property, the disqualified basis of the upper-tier successor item is attributable to disqualified basis of the lower-tier successor item and the upper-tier successor item is an item of exchanged basis property that relates to the lower-tier successor item. The principles of the preceding sentence apply each time disqualified basis of an item of specified property to which an item of exchanged basis property that is stock or an interest in partnership relates is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.
(e) Special rules when extraordinary disposition accounts are adjusted pursuant to §1.245A-5(c)(4)--(1) Extraordinary disposition account with respect to multiple SFCs. This paragraph (e)(1) applies if, pursuant to §1.245A-5(c)(4)(ii) or (iii) (the transaction or transactions by reason of which §1.245A-5(c)(4)(ii) or (iii) applies, the adjustment transaction), an extraordinary disposition account of a section 245A shareholder with respect to an SFC (such extraordinary disposition account, the transferor ED account; and such SFC, the transferor SFC) gives rise to an increase in the balance of an extraordinary disposition account with respect to another SFC (such extraordinary disposition account, the transferee ED account; such SFC, the transferee SFC; and such increase, the adjustment amount). When this paragraph (e)(1) applies, the following rules apply for purposes of this section:

(i) A ratable portion of the transferee ED account is treated as retaining its status as an extraordinary disposition account with respect to the transferor SFC and is not treated as an extraordinary disposition account with respect to the transferee SFC (the transferee ED account to such extent, the deemed transferor ED account), based on the adjustment amount relative to the balance of the transferee ED account (without regard to this paragraph (e)(1)) immediately after the adjustment transaction. Thus, for example, whether or not the transferor SFC is in existence immediately after the transaction, the items of specified property that correspond to the deemed transferor ED account are the same as the items of specified property that correspond to the transferor ED account. As an additional example, whether or not the transferor SFC is in existence immediately after the transaction the extraordinary disposition ownership percentage with respect to the deemed transferor ED account is the same as the
extraordinary disposition ownership percentage with respect to the transferor ED account (except to the extent the extraordinary disposition ownership percentage is adjusted pursuant to the rules of paragraph (e)(2) of this section).

(ii) In the case of an amount (such as an extraordinary disposition amount or tiered extraordinary disposition amount) determined by reference to the transferee ED account (without regard to this paragraph (e)(1)), the portion of the amount that is considered attributable to the deemed transferor ED account (and not the transferee ED account) is equal to the product of such amount and a fraction, the numerator of which is the balance of the deemed transferor ED account, and the denominator of which is the balance of the transferee ED account (determined without regard to this paragraph (e)(1)). Thus, for example, if after an adjustment transaction the transferee ED account (without regard to this paragraph (e)(1)) gives rise to an extraordinary disposition amount, and if the fraction (expressed as a percentage) is 40, then, for purposes of this section, 40 percent of the extraordinary disposition amount is treated as attributable to the deemed transferor ED account and the remaining 60 percent of the extraordinary disposition amount is attributable to the transferee ED account, and the balance of each of the deemed transferor ED account and the transferee ED account is correspondingly reduced.

(2) Extraordinary disposition accounts with respect to a single SFC. If an extraordinary disposition account of a section 245A shareholder with respect to an SFC is reduced by reason of §1.245A-5(c)(4), then, except as provided in paragraph (e)(1) of this section, for purposes of this section, the extraordinary disposition ownership percentage as to the extraordinary disposition account (as well as the extraordinary

40
disposition ownership percentage as to any extraordinary disposition account with respect to the SFC that is increased by reason of the reduction) is adjusted in a similar manner.

§1.245A-9 Other rules and definitions.

(a) In general. This section provides rules of general applicability for purposes of §§1.245A-6 through 1.245A-10, a transition rule to revoke an election to eliminate disqualified basis, and definitions.

(b) Rules of general applicability—(1) Correspondence. An item of specified property corresponds to a section 245A shareholder’s extraordinary disposition account if gain was recognized on the extraordinary disposition of the item and the gain was taken into account in determining the initial balance of the account. See §1.245A-8(d) for additional rules regarding when an item of property is treated as corresponding to an extraordinary disposition account in certain complex cases.

(2) Timing rules related to disqualified basis for purposes of applying §§1.245A-7(b) and 1.245A-8(b)—(i) Determination of disqualified basis. For purposes of determining the fraction described in §1.245A-7(b)(1)(ii) or §1.245A-8(b)(1)(ii) when applying §1.245A-7(b)(1) or §1.245A-8(b)(1)(ii), respectively, for a taxable year of a section 245A shareholder, disqualified basis of an item of specified property is determined as of the beginning of the taxable year of the CFC that holds the item of specified property (in a case in which §1.245A-7(b) applies) or the specified property owner (in a case in which §1.245A-8(b) applies), in either case, that includes the date on which the section 245A shareholder’s taxable year ends (and without regard to any reductions to the disqualified basis of the item of specified property pursuant to
§1.245A-7(b)(1) or §1.245A-8(b)(1) for such taxable year of the CFC or the specified property owner, as applicable). However, if disqualified basis of the item of specified property arose as a result of an extraordinary disposition that occurred after the beginning of the taxable year of the CFC or the specified property owner described in the preceding sentence, then the disqualified basis of the item of specified property is determined as of the date on which the extraordinary disposition occurred (and without regard to any reductions to the disqualified basis of the item of specified property pursuant to paragraph (b)(1) of this section for such taxable year of the CFC or the specified property owner).

(ii) Reduction to disqualified basis of an item of specified property. The reduction to disqualified basis of an item of specified property pursuant to §1.245A-7(b)(1) or §1.245A-8(b)(1) occurs on the date described in paragraph (b)(2)(i) of this section.

(iii) Definition of specified property owner. For purposes of applying §1.245A-8(b)(1) and paragraphs (b)(2)(i) and (ii) of this section for a taxable year of a section 245A shareholder, the term specified property owner means, with respect to an item of specified property, the person that, on at least one day of the taxable year of the person that includes the date on which the section 245A shareholder’s taxable year ends, held the item of specified property. However, if, but for this sentence, there would be more than one specified property owner with respect to the item of specified property, then the specified property owner is the person that held the item of specified property on the earliest date that falls within the section 245A shareholder’s taxable year.

(3) Timing rules for reducing an extraordinary disposition account under §§1.245A-7(c) and 1.245A-8(c). For purposes of §1.245A-7(c)(1) or §1.245A-8(c)(1), as
applicable, with respect to a taxable year of a CFC, the reduction to an extraordinary disposition account pursuant to §1.245A-7(c)(1) or §1.245A-8(c)(1) occurs as of the end of the taxable year of the section 245A shareholder that includes the date on which the CFC’s taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary amounts, adjustments to the extraordinary disposition account for prior extraordinary disposition amounts, and the application of §1.245A-7(b) or §1.245A-8(b), as applicable, each for the taxable year of the section 245A shareholder).

(4) **Currency translation.** For purposes of applying §§1.245A-7(b) and 1.245A-8(b), the disqualified basis of (and, if applicable, a basis benefit amount with respect to) an item of specified property that corresponds to an extraordinary disposition account are translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, using the spot rate on the date the extraordinary disposition occurred. A reduction in disqualified basis of an item of specified property determined under §1.245A-7(b)(1) or §1.245A-8(b)(1) is translated (if necessary) into the functional currency in which the disqualified basis of the item of specified property is maintained, and a reduction in an extraordinary disposition account determined under §1.245A-7(c) or §1.245A-8(c) section is translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, in each case using the spot rate described in the preceding sentence.

(5) **Anti-avoidance rule.** Appropriate adjustments are made pursuant to this paragraph (b)(5), including adjustments that would disregard a transaction or arrangement in whole or in part, to any amounts determined under (or subject to
application of) this section if a transaction or arrangement is engaged in with a principal purpose of avoiding the purposes of §§1.245A-6 through 1.245A-10.

(c) Transition rule to revoke election to eliminate disqualified basis--(1) In general. This paragraph (c)(1) applies to an election that is filed, pursuant to §1.951A-3(h)(2)(ii)(B)(3), to eliminate the disqualified basis of an item of specified property. An election to which this paragraph (c)(1) applies may be revoked if, on or before [DATE 90 DAYS AFTER A TREASURY DECISION ADOPTING THESE RULES AS FINAL REGULATIONS IS PUBLISHED IN THE FEDERAL REGISTER]--

(i) All controlling domestic shareholders (as defined in §1.964-1(c)(5)) of the CFC (or, in the case of an election made by a partnership, the partnership) each attach a revocation statement (in the manner described in paragraph (c)(2) of this section) to an amended return, for the taxable year to which the election applies, that revokes the election (or, in the case of a partnership subject to subchapter C of chapter 63 of the Internal Revenue Code, requests administrative adjustment under section 6227); and

(ii) The controlling domestic shareholders (or the partnership) each file an amended tax return, for any other taxable years reflecting the election to eliminate the disqualified basis, that reflects the election having been revoked (or, in the case of a partnership subject to subchapter C of chapter 63, requests administrative adjustment under section 6227).

(2) Revocation statement. Except as otherwise provided in publications, forms, instructions, or other guidance, a revocation statement attached by a person to an amended tax return must include the person's name, taxpayer identification number, and a statement that the revocation statement is filed pursuant to paragraph (c)(1) of
this section to revoke an election pursuant to §1.951A-3(h)(2)(ii)(B)(3). In addition, the revocation statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(d) **Definitions.** In addition to the definitions in §1.245A-5, the following definitions apply for purposes of §§1.245A-6 through 1.245A-11.

(1) The term adjusted earnings has the meaning provided in §1.245A-7(c)(3) or §1.245A-8(c)(3), as applicable.

(2) The term basis benefit account has the meaning provided in §1.245A-8(b)(4)(i).

(3) The term basis benefit amount has the meaning provided in §1.245A-8(b)(4)(ii).

(4) The term disqualified basis has the meaning provided in §1.951A-3(h)(2)(ii).

(5) The term domestic affiliate means, with respect to a section 245A shareholder, a domestic corporation that is a related party with respect to the section 245A shareholder. See also §1.245A-5(i)(19) (defining related party).

(6) The term duplicate DQB has the meaning provided in §1.245A-8(d)(2)(iii).

(7) The term ECTI means, with respect to a taxable year of a specified foreign person, the taxable income (or loss) of the specified foreign person determined by taking into account only items of income and gain that are, or are treated as, effectively connected with the conduct of a trade or business in the United States (as described in §1.882-4(a)(1)) and are not exempt from U.S. tax pursuant to a treaty obligation of the United States, and items of deduction and loss that are allocated and apportioned to such items of income and gain.
(8) The term **exchanged basis property** has the meaning provided in §1.245A-8(d)(2)(ii).

(9) The term **qualified deficit** has the meaning provided in section 952(c)(1)(B)(ii).

(10) The term **qualified related party** has the meaning provided in §1.245A-8(b)(3)(ii).

(11) The term **RGI account** means, with respect to a CFC and an extraordinary disposition account of a section 245A shareholder with respect to an SFC, an account of the section 245A shareholder with respect to an SFC (the initial balance of which is zero), adjusted at the end of each taxable year of the CFC pursuant to the rules of §1.245A-7(c)(4) or §1.245A-8(c)(4), as applicable. The RGI account must be maintained in the functional currency of the CFC.

(12) The term **specified foreign person** means a nonresident alien individual (as defined in section 7701(b) and the regulations under section 7701(b)) or a foreign corporation (including a CFC) that conducts, or is treated as conducting, a trade or business in the United States (as described in §1.882-4(a)(1)).

(13) The term **specified property owner** has the meaning provided in §1.245A-8(b)(2)(iii).

(14) The term **subpart F income** has the meaning provided in section 952(a).

(15) The term **substituted property** has the meaning provided in §1.245A-8(d)(1)(ii).

(16) The term **tested income** has the meaning provided in section 951A(c)(2)(A).

(17) The term **tested loss** has the meaning provided in section 951A(c)(2)(B).
(a) **Scope.** This section provides examples illustrating the application of §§1.245A-6 through 1.245A-9.

(b) **Presumed facts.** For purposes of the examples in the section, except as otherwise stated, the following facts are presumed:

1. US1 and US2 are both domestic corporations that have calendar taxable years.

2. CFC1, CFC2, CFC3, and CFC4 are all SFCs and CFCs that have taxable years ending November 30.

3. Each entity uses the U.S. dollar as its functional currency.

4. There are no items of deduction or loss attributable to an item of specified property.

5. Absent the application of §1.245A-5, any dividends received by US1 from CFC1 would meet the requirements to qualify for the section 245A deduction.

6. All dispositions of items of specified property by an SFC during a disqualified period of the SFC to a related party give rise to an extraordinary disposition.

7. None of the CFCs have a deficit subject to §1.381(c)(2)-1(a)(5), and none of the CFCs are engaged in the conduct of a trade or business in the United States (and therefore none of the CFCs have ECTI).

8. There is no previously taxed earnings and profits account with respect to any CFC for purposes of section 959. In addition, each hybrid deduction account with respect to a share of stock of a CFC has a zero balance at all times. Further, there is no extraordinary disposition account with respect to any CFC.
(9) Under §1.245A-11(b), taxpayers choose to apply §§1.245A-6 through 1.245A-11 to the relevant taxable years.

(c) Examples--(1) Example 1. Reduction of disqualified basis under rule for simple cases by reason of dividend paid out of extraordinary disposition account--(i) Facts. US1 owns 100% of the single class of stock of CFC1 and CFC2. On November 30, 2018, in a transaction that is an extraordinary disposition, CFC1 sells two items of specified property, Item 1 and Item 2, to CFC2 in exchange for $150x of cash (the “Disqualified Transfer”). Item 1 is sold for $90x and Item 2 is sold for $60x. Item 1 and Item 2 each has a basis of $0 in the hands of CFC1 immediately before the Disqualified Transfer, and therefore CFC1 recognizes $150x of gain as a result of the Disqualified Transfer ($150x - $0). After the Disqualified Transfer, CFC2’s only assets are Item 1 and Item 2. On November 30, 2018, and thus during US1’s taxable year ending December 31, 2018, CFC1 distributes $150x of cash to US1, and all of the distribution is characterized as a dividend under section 301(c)(1) and treated as a distribution out of earnings and profits described in section 959(c)(3). For CFC1’s taxable year ending on November 30, 2018, CFC1 has $160x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year. CFC2 continues to hold Item 1 and Item 2. Lastly, because the conditions of §1.245A-6(b)(1) and (2) are satisfied for US1’s 2018 taxable year, US1 chooses to apply §1.245A-7 (rules for simple cases) in lieu of §1.245A-8 (rules for complex cases) for that taxable year.

(ii) Analysis--(A) Application of §§1.245A-5 and 1.951A-2 as a result of the Disqualified Transfer. As a result of the Disqualified Transfer, under §1.951A-2(c)(5), Item 1 has disqualified basis of $90x, and Item 2 has disqualified basis of $60x. In addition, as a result of the Disqualified Transfer, under §1.245A-5(c)(3)(i)(A), US1 has an extraordinary disposition account with respect to CFC1 with an initial balance of $150x. Under §1.245A-5(c)(2)(i), $10x of the dividend is considered paid out of non-extraordinary disposition E&P of CFC1 with respect to US1, and $140x of the dividend is considered paid out of US1’s extraordinary disposition account with respect to CFC1 to the extent of the balance of the extraordinary disposition account ($150x). Thus, the dividend of $150x is an extraordinary disposition amount, within the meaning of §1.245A-5(c)(1), to the extent of $140x. As a result, the balance of the extraordinary disposition account is reduced to $10x ($150x - $140x).

(B) Correspondence requirement. Under §1.245A-9(b)(1), each of Item 1 and Item 2 corresponds to US1’s extraordinary disposition account with respect to CFC1, because as a result of the Disqualified Transfer CFC1 recognized gain with respect to Item 1 and Item 2, and the gain was taken into account in determining the initial balance of US1’s extraordinary disposition account with respect to CFC1.

(C) Reduction of disqualified basis of Item 1. Because Item 1 corresponds to US1’s extraordinary disposition account, the disqualified basis of Item 1 is reduced pursuant to §1.245A-7(b)(1) by reason of US1’s $140x extraordinary disposition amount
for US1’s 2018 taxable year. Paragraphs (c)(2)(ii)(C)(1) through (3) of this section describe the determinations pursuant to §1.245A-7(b)(1).

(1) To determine the reduction to the disqualified basis of Item 1, the disqualified basis of Item 1, as well as the disqualified basis of Item 2, must be determined as of the date described in §1.245A-9(b)(2)(i) (and before the application of §1.245A-7(b)(1)). See §1.245A-7(b)(1)(ii). For each of Item 1 and Item 2, that date is December 1, 2018. December 1, 2018, is the first day of the taxable year of CFC2 (the CFC that holds Item 1 and Item 2) beginning on December 1, 2018, which is the taxable year of CFC2 that includes December 31, 2018, the date on which US1’s 2018 taxable year ends. See §1.245A-9(b)(2)(i).

(2) Pursuant to §1.245A-7(b)(1), the disqualified basis of Item 1 is reduced by $84x, computed as the product of--

(i) $140x, the extraordinary disposition amount; and

(ii) A fraction, the numerator of which is $90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of §1.245A-7(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of §1.245A-7(b)(1)). See §1.245A-7(b)(1).

(3) The $84x reduction to the disqualified basis of Item 1 occurs on December 1, 2018, the date on which the disqualified basis of Item 1 is determined for purposes of determining the reduction pursuant to §1.245A-7(b)(1). See §1.245A-9(b)(2)(ii).

(D) Reduction of disqualified basis of Item 2. For reasons similar to those described in paragraph (c)(2)(ii)(C) of this section, on December 1, 2018, the disqualified basis of Item 2 is reduced by $56x, the amount equal to the product of $140x, the extraordinary disposition amount, and a fraction, the numerator of which is $60x (the disqualified basis of Item 2 on December 1, 2018, and before the application of §1.245A-7(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of §1.245A-7(b)(1)).

(2) Example 2. Basis benefit amount and impact on reduction to disqualified basis under rule for complex cases--(i) Facts. The facts are the same as in paragraph (c)(1)(i) of this section (Example 1) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that, on December 1, 2018, CFC2 sells Item 1 for $90x of cash to an individual that is not a related party with respect to US1 or CFC2 (such transaction, the “Sale,” and such individual, “Individual A”). At the time of the Sale, CFC2’s basis in Item 1 is $90x (all of which is disqualified basis, as described in §1.951A-3(h)(2)(ii)(A)). CFC2 takes into the account the disqualified basis of Item 1 for purposes of determining the amount of gain recognized on the Sale, which is $0 ($90x - $90x); but for the disqualified basis, CFC2 would have had $90x of gain that would have
been taken into account in computing its tested income. As a result of the Sale, the condition of §1.245A-6(b)(2) is not satisfied, because on at least one day of CFC2’s taxable year beginning on December 1, 2018 (which begins within US1’s 2018 taxable year) CFC2 does not hold Item 1. See §1.245A-6(b)(2)(ii)(C)(1). US1 therefore applies §1.245A-8 (rules for complex cases) for its 2018 taxable year. See §1.245A-6(b).

(ii) Analysis--(A) Ownership requirement. With respect to each of Item 1 and Item 2, the ownership requirement of §1.245A-8(b)(3)(i) is satisfied for US1’s 2018 taxable year. This is because on at least one day that falls within US1’s 2018 taxable year, each of Item 1 and Item 2 is held by CFC2, and US1 directly owns all of the stock of CFC2 throughout such taxable year (and thus, for purposes of applying §1.245A-8(b)(3)(i), US1 owns at least 10% of the interests of CFC2 on at least one day that falls within such taxable year). See §1.245A-8(b)(3).

(B) Basis benefit amount with respect to Item 1 as a result of the Sale. Under §1.245A-8(b)(4)(i), US1 has a basis benefit account with respect to its extraordinary disposition account with respect to CFC1. As described in paragraphs (c)(2)(ii)(B)(1) through (3) of this section, the balance of the basis benefit account (which is initially zero) is, on December 31, 2018, increased by $90x, the basis benefit amount with respect to Item 1 and assigned to US1’s 2018 taxable year.

By reason of the Sale, for CFC2’s taxable year beginning December 1, 2018, and ending November 30, 2019, the entire $90x of disqualified basis of Item 1 is taken into account for U.S. tax purposes by CFC2 and, as a result, reduces CFC2’s tested income or increases CFC2’s tested loss. Accordingly, for such taxable year, there is a $90x basis benefit amount with respect to Item 1. See §1.245A-8(b)(4)(ii)(A). The result would be the same if the Sale were to a related person and thus, pursuant to §1.951A-3(h)(2)(ii)(B)(1)(ii), no portion of the $90x of disqualified basis were eliminated or reduced by reason of the Sale. See §1.245A-8(b)(4)(ii)(B).

The $90x basis benefit amount with respect to Item 1 is assigned to US1’s 2018 taxable year. This is because the ownership requirement of §1.245A-8(b)(3)(i) is satisfied with respect to Item 1 for US1’s 2018 taxable year, and the basis benefit amount occurs in CFC2’s taxable year beginning December 1, 2018, a taxable year of CFC2 that begins within US1’s 2018 taxable year (and, but for §1.245A-8(b)(4)(iii)(A)(2)(ii), the basis benefit amount would not be assigned to a taxable year of US1, such as the taxable year of US1 beginning January 1, 2019, given that, as result of the Sale, the ownership requirement of §1.245A-8(b)(3)(i) would not be satisfied with respect to Item 1 for such taxable year). See §1.245A-8(b)(4)(iii)(A).

On December 31, 2018 (the last day of US1’s 2018 taxable year), US1’s basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is increased by $90x, the $90x basis benefit amount with respect to Item 1 and assigned to US1’s 2018 taxable year. The basis benefit account is increased by such amount because Item 1 corresponds to US1’s extraordinary disposition account with
respect to CFC1, and the extraordinary disposition ownership percentage applicable to such extraordinary disposition account is 100. See §1.245A-8(b)(4)(i)(A).

(C) Basis benefit amount limitation on reduction to disqualified basis. By reason of US1’s $140x extraordinary disposition amount for US1’s 2018 taxable year, the disqualified basis of Item 1 is reduced by $30x, and the disqualified basis of Item 2 is reduced by $20x, pursuant to §1.245A-8(b)(1). See §1.245A-8(b). Paragraphs (c)(2)(ii)(C)(1) through (4) of this section describe the determinations pursuant to §1.245A-8(b)(1).

(1) For purposes of determining the reduction to the disqualified bases of Item 1 and Item 2, the disqualified bases of the Items are determined on December 1, 2018 (and before the application of §1.245A-8(b)(1)). See §1.245A-8(b)(1)(ii). The disqualified bases of the Items are determined on December 1, 2018, because that date is the first day of the taxable year of CFC2 beginning on December 1, 2018, which is the taxable year of CFC2 (the specified property owner of each of Item 1 and Item 2) that includes December 31, 2018, the date on which US1’s 2018 taxable year ends. See §1.245A-8(b)(2)(i). For purposes of applying §§1.245A-8(b)(1) and §1.245A-9(b)(2) for US1’s 2018 taxable year, CFC2 is the specified property owner of each of Item 1 and Item 2 because, on at least one day of CFC2’s taxable year that includes the date on which US1’s 2018 taxable year ends (that is, on at least one day of CFC2’s taxable year beginning December 1, 2018), CFC2 held the Item. See §1.245A-9(b)(2)(iii). CFC2 is the specified property owner of Item 1 even though Individual A also held Item 1 during Individual A’s taxable year that includes the date on which US1’s 2018 taxable year ends because CFC2 held Item 1 on an earlier date than Individual A. See §1.245A-9(b)(2)(iii).

(2) Pursuant to §1.245A-8(b)(1), the disqualified basis of Item 1 is reduced by $30x, computed as the product of--

(i) $50x, the excess of the extraordinary disposition amount ($140x) over the balance of the basis benefit account with respect to US1’s extraordinary disposition with respect to CFC1 ($90x); and

(ii) A fraction, the numerator of which is $90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of §1.245A-8(b)(1)), and the denominator of which is $150x (the disqualified basis of Item 1, $90x, plus the disqualified basis of Item 2, $60x, in each case determined on December 1, 2018, and before the application of §1.245A-8(b)(1)). See paragraph §1.245A-8(b)(1).

(3) Pursuant to §1.245A-8(b)(1), the disqualified basis of Item 2 is reduced by $20x, computed as the product of--

(i) $50x, the excess of the extraordinary disposition amount ($140x) over the balance of the basis benefit account with respect to US1’s extraordinary disposition with respect to CFC1 ($90x); and
(ii) A fraction, the numerator of which is $60x$ (the disqualified basis of Item 2 on December 1, 2018, and before the application of paragraph (b)(1) of this section), and the denominator of which is $150x$ (the disqualified basis of Item 1, $90x$, plus the disqualified basis of Item 2, $60x$, in each case determined on December 1, 2018, and before the application of §1.245A-8(b)(1)). See §1.245A-8(b)(1).

(4) The $30x$ and $20x$ reductions to the disqualified bases of Item 1 and Item 2, respectively, occur on December 1, 2018, the date on which the disqualified bases of the Items are determined for purposes of determining the reductions pursuant to §1.245A-8(b)(1). See §1.245A-9(b)(2)(ii).

(D) Reduction of basis benefit account. The balance of the basis benefit account with respect to US1’s extraordinary disposition account with respect to CFC1 is decreased by $90x$, the amount by which, for CFC2’s taxable year beginning December 1, 2018, the disqualified bases of Item 1 and Item 2 would have been reduced pursuant to §1.245A-8(b)(1) but for the $90x$ balance of the basis benefit account. See §1.245A-8(b)(4)(i)(B). The reduction to the balance of the basis benefit account occurs on December 31, 2018, and after the completion of all other computations pursuant to §1.245A-8(b). See §1.245A-8(b)(4)(i)(B).

(3) Example 3. Reduction in balance of extraordinary disposition account under rules for simple cases by reason of allocation and apportionment of deductions to residual CFC gross income--(i) Facts. The facts are the same as in paragraph (c)(1)(i) of this section (Example 1) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make a distribution to US1. In addition, during CFC2’s taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 1 gives rise to a $6x$ amortization deduction, and the disqualified basis of Item 2 gives rise to a $4x$ amortization deduction, and each of the amortization deductions is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5) (though, but for §1.951A-2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further, as of the end of CFC2’s taxable year ending November 30, 2019, CFC2 has $15x$ of earnings and profits. Lastly, because the conditions of §1.245A-6(b)(1) and (2) are satisfied for US1’s 2018 taxable year, US1 chooses to apply §1.245A-7 (rules for simple cases) in lieu of §1.245A-8 (rules for complex cases) for that taxable year.

(ii) Analysis. Pursuant to §1.245A-7(c)(1), US1’s extraordinary disposition account with respect to CFC1 is reduced by the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. See §1.245A-7(c)(1). Paragraphs (c)(3)(ii)(A) through (D) of this section describe the determinations pursuant to §1.245A-8(c)(1).

(A) Computation of adjusted earnings of CFC2, and amount described in §1.245A-7(c)(1)(i) with respect to US1. To determine the amount described in §1.245A-
7(c)(1)(i) with respect to US1, the adjusted earnings of CFC2 must be computed for CFC2’s taxable year ending November 30, 2019. See §1.245A-7(c)(1)(i). Paragraphs (c)(3)(ii)(A)(1) and (2) of this section describe these determinations.

(1) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $25x, computed as $15x (CFC2’s earnings and profits as of November 30, 2019, the last day of that taxable year), plus $10x (the sum of the $6x and $4x amortization deductions of CFC2 for that taxable year, which is the amount of all deductions or losses of CFC2 that is or was attributable to disqualified basis of items of specified property and allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5)(i)). See §1.245A-7(c)(3).

(2) For CFC2’s taxable year ending November 30, 2019, the amount described in §1.245A-7(c)(1)(i) with respect to US1 is $25x, computed as the excess of $25x (the adjusted earnings) over $0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2).

(B) Increase to balance of RGI account. Under §1.245A-9(d)(11), US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. On November 30, 2019 (the last day of CFC2’s taxable year), the balance of the RGI account (which is initially zero) is increased by $10x, the sum of the $6x and $4x amortization deductions of CFC2 for its taxable year ending November 30, 2019. See §1.245A-7(c)(4)(i). Each of the amortization deductions is taken into account for this purpose because, but for §1.951A-2(c)(5)(i), the deduction would have decreased CFC2’s tested income or increased or given rise to a tested loss of CFC2. See §1.245A-7(c)(4)(i).

(C) Reduction in balance of extraordinary disposition account. Pursuant to §1.245A-7(c)(1), US1’s extraordinary disposition account with respect to CFC1 is reduced by $10x, the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC2’s taxable year ending November 30, 2019 ($25x), and the balance of US1’s RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 ($10x, determined as of November 30, 2019, but without regard to the application of §1.245A-7(c)(4)(ii) for the taxable year of CFC2 ending on that date). See §1.245A-7(c)(1). The $10x reduction in the balance of US1’s extraordinary disposition account occurs on December 31, 2019, the last day of US1’s taxable year that includes November 30, 2019 (the last day of CFC2’s taxable year). See §1.245A-9(c)(3).

(D) Reduction in balance of RGI account. On November 30, 2019 (the last day of CFC2’s taxable year), the balance of US1’s RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by $10x, the amount of the reduction, pursuant to §1.245A-7(c)(1) section and by reason of the RGI account, to US1’s extraordinary disposition account with respect to CFC1. See §1.245A-7(c)(4)(ii). Therefore, following that reduction, the balance of the RGI account is zero ($10x - $10x).
(iii) Alternative facts in which the reduction is limited by earnings and profits. The facts are the same as in paragraph (c)(3)(i) of this section (Example 3), except that CFC2 has a $5x deficit in its earnings and profits as of the end of its taxable year ending November 30, 2019. In this case--

(A) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $5x, computed as -$5x (CFC2’s deficit in earnings and profits as of November 30, 2019) plus $10x (the sum of the $6x and $4x amortization deductions of CFC2), see §1.245A-7(c)(3);

(B) The amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC’s taxable year ending November 30, 2019, is $5x, computed as the excess of $5x (the adjusted earnings) over $0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2), see §1.245A-7(c)(1)(i);

(C) On December 31, 2019, US1’s extraordinary disposition account with respect to CFC1 is reduced by $5x, the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC2’s taxable year ending November 30, 2019 ($5x), and the balance of US1’s RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 ($10x, determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date), see §§1.245A-7(c)(1) and 1.245A-9(c)(3); and

(D) On November 30, 2019 (the last day of CFC2’s taxable year), the balance of US1’s RGI account with respect to CFC2 is decreased by $5x (the amount of the reduction, pursuant to §1.245A-7(c)(1) and by reason of the RGI account, to US1’s extraordinary disposition account with respect to CFC1) and, therefore, following such reduction, the balance of the RGI account is $5x ($10x - $5x), see §1.245A-7(c)(4)(ii).

(4) Example 4. Reduction to extraordinary disposition accounts limited by §1.245A-8(c)(6)--(i) Facts. The facts are the same as in paragraph (c)(3)(iii) of this section (Example 3, alternative facts in which the reduction is limited by earnings and profits) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that US1 also owns 100% of the stock of US2, which owns 100% of the stock of CFC3, and on November 30, 2018, in a transaction that was an extraordinary disposition, CFC3 sold an item of specified property (“Item 3”) to CFC2 in exchange for $200x of cash. Item 3 had a basis of $0 in the hands of CFC3 immediately before the sale and, therefore, CFC3 recognized $200x of gain as a result of the sale ($200x - $0), Item 3 has $200x of disqualified basis under §1.951A-2(c)(5), and US2 has an extraordinary disposition account with respect to CFC3 with an initial balance of $200x under §1.245A-5(c)(3)(ii)(A). Moreover, during CFC2’s taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 3 gives rise to a $20x amortization deduction, which is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5) (though, but for §1.951A-2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further,
as of the end of US1’s 2018 taxable year, the balance of US1’s basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is $0; similarly, as of the end of US2’s 2018 taxable year, the balance of US2’s basis benefit account with respect to its extraordinary disposition account with respect to CFC2 is $0. Because CFC2 holds items of specified property that correspond to more than one extraordinary disposition account (that is, Item 1 and Item 2 correspond to US1’s extraordinary disposition account with respect to CFC2, and Item 3 corresponds to US2’s extraordinary disposition account with respect to CFC2), the condition of §1.245A-6(b)(2) is not satisfied. See §1.245A-6(b)(2)(ii)(C)(3). US1 and US2 therefore apply §1.245A-8 (rules for complex cases) for their 2018 taxable years.

(ii) Analysis. Pursuant to §1.245A-8(c)(1), US1’s extraordinary disposition account with respect to CFC1 is, subject to the limitation in §1.245A-8(c)(6), reduced by the lesser of the amount described in §1.245A-8(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. See §1.245A-8(c)(1). Similarly, US2’s extraordinary disposition account with respect to CFC3 is, subject to the limitation in §1.245A-8(c)(6), reduced by the lesser of the amount described in §1.245A-8(c)(1)(i) with respect to US2, and the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3. See §1.245A-8(c)(1). Paragraphs (c)(4)(ii)(A) through (F) of this section describe the determinations pursuant to §1.245A-8(c)(1).

(A) Ownership requirement. Each of US1 and US2 satisfy the ownership requirement of §1.245A-8(c)(5) for CFC2’s taxable year ending November 30, 2019, because on the last day of that taxable year each is a United States shareholder with respect to CFC2. See §1.245A-8(c)(5).

(B) Computation of adjusted earnings of CFC2, and amount described in §1.245A-8(c)(1)(i) with respect to US1 and US2. The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is $25x, computed as -$5x (CFC2’s deficit in earnings and profits as of November 30, 2019), plus $30x (the sum of the $6x, $4x, and $20x amortization deductions of CFC2). See §1.245A-8(c)(3). For CFC2’s taxable year ending November 30, 2019, the amount described in §1.245A-8(c)(1)(i) with respect to US1 is $25x, computed as the excess of the product of $25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US1 and its domestic affiliate, US2, own), over $0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). See §1.245A-8(c)(1)(i). Similarly, for CFC2’s taxable year ending November 30, 2019, the amount described in §1.245A-8(c)(1)(i) with respect to US2 is $25x, computed as the excess of the product of $25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US2 and its domestic affiliate, US1, own), over $0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). See §1.245A-8(c)(1)(i).
(C) Increase to balance of RGI account. As described in paragraph (c)(3)(ii)(B) of this section, US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1, and the balance of the RGI account is $10x on November 30, 2019 (the last day of CFC2’s taxable year). Similarly, US2 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3, and the balance of the RGI account is $20x on November 30, 2019 (reflecting a $20x increase to the balance of the account for the $20x amortization deduction of CFC2 for its taxable year ending November 30, 2019). See §1.245A-8(c)(4)(i).

(D) Reduction in balance of extraordinary disposition accounts but for §1.245A-8(c)(6). But for the application of §1.245A-8(c)(6), US1’s extraordinary disposition account with respect to CFC2 would be reduced by $10x, which is the lesser of $25x, the amount described in §1.245A-8(c)(1)(i) with respect to US1 for CFC2’s taxable year ending November 30, 2019, and $10x, the balance of the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 (determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date). See §1.245A-8(c)(1)(i) and (ii). Similarly, but for the application of §1.245A-8(c)(6), US2’s extraordinary disposition account with respect to CFC3 would be reduced by $20x, which is the lesser of $25x, the amount described in §1.245A-8(c)(1)(i) with respect to US2 for CFC2’s taxable year ending November 30, 2019, and $20x, the balance of the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 (determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date). See §1.245A-8(c)(1)(i) and (ii).

(E) Application of limitation of §1.245A-8(c)(6). As described in paragraph (c)(4)(ii)(D) of this section, but for the application of §1.245A-8(c)(6), there would be a total of $30x of reductions to US1’s extraordinary disposition account with respect to CFC1, and US2’s extraordinary disposition account with respect to CFC3, by reason of the application of §1.245A-8(c)(1) with respect to CFC2’s taxable year ending November 30, 2019. Because that $30x exceeds the amount described in §1.245A-8(c)(1)(i) with respect to US1 and US2 ($25x)--

1. US1’s extraordinary disposition account with respect to CFC1 is reduced by $7.86x, computed as $10x (the reduction that would occur but for §1.245A-8(c)(6)) less the product of $5x (the excess amount, computed as $30x, the total reductions that would occur but for the application of §1.245A-8(c)(6), less $25x, the amount described in §1.245A-8(c)(1)(i)) and a fraction, the numerator of which is $150x (the balance of US1’s extraordinary disposition account with respect to CFC1) and the denominator of which is $350x ($150x, the balance of US1’s extraordinary disposition account with respect to CFC1, plus $200x, the balance of US2’s extraordinary disposition account with respect to CFC3), see §1.245A-8(c)(6); and
(2) US2’s extraordinary disposition account with respect to CFC3 is reduced by $17.14x, computed as $20x (the reduction that would occur but for §1.245A-8(c)(6)) less the product of $5x (the excess amount, computed as $30x, the total reductions that would occur but for the application of §1.245A-8(c)(6), less $25x, the amount described in §1.245A-8(c)(1)(i)) and a fraction, the numerator of which is $200x (the balance of US2’s extraordinary disposition account with respect to CFC3) and the denominator of which is $350x ($150x, the balance of US1’s extraordinary disposition account with respect to CFC1, plus $200x, the balance of US2’s extraordinary disposition account with respect to CFC3), see §1.245A-8(c)(6) of this section.

(F) Reduction in balance of RGI accounts. On November 30, 2019 (the last day of CFC2’s taxable year)--

(1) The balance of US1’s RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by $7.86x (the amount of the reduction, pursuant to §1.245A-8(c)(1) and by reason of the RGI account, to US1’s extraordinary disposition account with respect to CFC1) and, thus, following that reduction, the balance of the RGI account is $2.14x ($10x - $7.86x), see §1.245A-8(c)(4)(i)(B); and

(2) The balance of US2’s RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 is decreased by $17.14x (the amount of the reduction, pursuant to §1.245A-8(c)(1) and by reason of the RGI account, to US2’s extraordinary disposition account with respect to CFC3) and, thus, following that reduction, the balance of the RGI account is $2.86x ($20x - $17.14x), see §1.245A-8(c)(4)(i)(B).

(5) Example 5. Computation of duplicate DQB--(i) Facts. The facts are the same as in paragraph (c)(1)(i) of this section (Example 1) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make any distribution to US1, and on November 30, 2018, immediately after the Disqualified Transfer, CFC2 transfers Item 1 to newly-formed CFC3 solely in exchange for the sole share of stock of CFC3 (the contribution, “Contribution 1,” and the share of stock of CFC3, the “CFC3 Share”) and, immediately after Contribution 1, CFC3 transfers Item 1 to newly-formed CFC4 solely in exchange for the sole share of stock of CFC4 (the contribution, “Contribution 2,” and the share of stock of CFC4, the “CFC4 Share”). Pursuant to section 358(a)(1), CFC2’s basis in its share of stock of CFC3 is $90x, and CFC3’s basis in its share of stock of CFC4 is $90x basis. As a result of Contribution 1, the condition of §1.245A-6(b)(2) is not satisfied, because on at least one day of CFC2’s taxable year ending on November 30, 2018 (which ends within US1’s 2018 taxable year), CFC2 does not hold Item 1. See §1.245A-6(b)(2)(ii)(C)(1). US1 therefore applies §1.245A-8 (rules for complex cases) for its 2018 taxable year. See §1.245A-6(b).

(ii) Analysis--(A) Application of exchanged basis rule under section 951A to Contribution 1 and Contribution 2. As a result of Contribution 1, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), the disqualified basis of CFC3 Share includes the disqualified basis
of Item 1 ($90x), and therefore the disqualified basis of CFC3 Share is $90x. Similarly, as a result of Contribution 2, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), the disqualified basis of CFC4 Share also includes the disqualified basis of Item 1 ($90x), and therefore the disqualified basis of CFC4 Share is $90x.

(B) Determination of duplicate DQB of CFC3 Share as a result of Contribution 1. Because the disqualified basis of CFC3 Share includes the disqualified basis of Item 1, CFC3 Share is an item of exchanged basis property that relates to Item 1. See §1.245A-8(d)(2)(ii). In addition, because CFC3 Share is an item of exchanged basis property that relates to Item 1 (which corresponds to US1’s extraordinary disposition account with respect to CFC1), CFC3 Share is, for purposes of §1.245A-8, treated as an item of specified property that corresponds to US1’s extraordinary disposition account with respect to CFC1. See §1.245A-8(d)(2)(i). Further, the duplicate DQB of CFC3 Share as to Item 1 is $90x, the portion of the disqualified basis of CFC3 Share that includes Item 1’s disqualified basis of $90x. See §1.245A-8(d)(2)(iii)(A).

(C) Determination of duplicate DQB of CFC4 Share as a result of Contribution 2. For reasons similar to those described in paragraph (c)(5)(ii)(B) of this section, CFC4 Share is an item of exchanged basis property that relates to Item 1, CFC4 is treated for purposes of §1.245A-8 as an item of specified property that corresponds to US1’s extraordinary disposition account with respect to CFC1, and the duplicate DQB of CFC4 Share as to Item 1 is $90x.

(D) Determination of duplicate DQB of CFC3 Share as a result of Contribution 2. Because the disqualified basis of CFC3 Share and the disqualified basis of CFC4 Share each includes $90x of the disqualified basis of Item 1 and CFC3 receives the CFC4 Share in Contribution 2, the $90x of disqualified basis of CFC3 Share is attributable to the $90x of disqualified basis of CFC4 Share, and CFC3 Share is an item of exchanged basis property that relates to CFC4 Share. See §1.245A-8(d)(2)(i) and (d)(2)(iii)(C). In addition, the duplicate DQB of CFC3 Share as to CFC4 Share is $90x. See §1.245A-8(d)(2)(iii)(A).

(E) Application of duplicate basis rules in §1.245A-8(b)(5). For purposes of computing the fraction described in §1.245A-8(b)(1)(ii), if US1’s extraordinary disposition account with respect to CFC1 were to give rise to an extraordinary disposition amount or a tiered extraordinary disposition amount during US1’s 2018 taxable year, then the duplicate DQB of CFC3 Share and the duplicate DQB of CFC4 Share would not be taken into account, because the disqualified basis of Item 1 (an item of specified property that corresponds to US1’s extraordinary disposition account and as to which each of CFC3 Share and CFC4 share relates) would be taken into account. See §1.245A-8(b)(1)(ii) and (b)(5)(i)(A). Accordingly, in such a case, for US1’s 2018 taxable year, the numerator of the fraction described in §1.245A-8(b)(1)(ii) would reflect only the disqualified basis of Item 1 or Item 2, as applicable, and the denominator would reflect only the sum of the disqualified basis of each of Item 1 and Item 2. See §1.245A-8(b)(1)(ii) and (b)(5)(i)(A). Furthermore, to the extent there were to be a reduction under §1.245A-8(b)(1) to the disqualified basis of Item 1, then the duplicate
DQB of CFC4 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be $90x (the duplicate DQB of CFC4 Share), and the denominator of which would also be $90x (the duplicate DQB of CFC4 Share). See §1.245A-8(b)(5)(i)(B). The $90x of duplicate DQB of CFC3 Share would be excluded from the denominator of the fraction described in the previous sentence because it is attributable to the $90x of duplicate DQB of CFC4 Share. See §1.245A-8(b)(5)(i)(B)(2) (last sentence). For reasons similar to those described in this paragraph (c)(4)(ii)(E) with respect to the application of §1.245A-8(b)(5)(i)(B) to CFC4 Share, the duplicate DQB of CFC3 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be $90x, and the denominator of which would also be $90x.

§1.245A-11 Applicability dates.

(a) In general. Sections 1.245A-6 through 1.245A-11 apply to taxable years of a foreign corporation beginning on or after [INSERT DATE PUBLISHED IN FEDERAL REGISTER] and to taxable years of section 245A shareholders in which or with which such taxable years end.

(b) Exception. Notwithstanding paragraph (a) of this section, a taxpayer may choose to apply §§1.245A-6 through 1.245A-11 for a taxable year of a foreign corporation beginning before [INSERT DATE PUBLISHED IN FEDERAL REGISTER] and to a taxable year of a section 245A shareholder in which or with which such taxable year ends, provided that the taxpayer and all persons bearing a relationship to the taxpayer described in section 267(b) or 707(b) apply §§1.245A-6 through 1.245A-11, in their entirety, and §1.6038-2(f)(18) for all such taxable years and any subsequent taxable years beginning before [INSERT DATE PUBLISHED IN FEDERAL REGISTER].

Par. 4. Section 1.951A-2 is amended by:

1. Redesignating paragraph (c)(5)(iv) as paragraph (c)(5)(v).

2. Adding new paragraph (c)(5)(iv).


5. Redesignating paragraph (c)(6)(iv) as paragraph (c)(6)(v).

6. Adding new paragraph (c)(6)(iv).


The additions read as follows:

§1.951A-2 Tested income and tested loss.

* * * * *

(c) * * *

(5) * * *

(iv) Reductions to disqualified basis pursuant to coordination rules. See §1.245A-7(b) or §1.245A-8(b), as applicable, for reductions to disqualified basis resulting from the application of §1.245A-5.

* * * * *

(6) * * *

(iv) Reductions to disqualified payments pursuant to coordination rules. See §1.245A-5(j)(8) and §1.245A-7(b) or §1.245A-8(b), as applicable, for reductions to disqualified payments resulting from the application of §1.245A-5.

* * * * *
Par. 5. Section 1.6038-2 is amended by adding paragraphs (f)(17) and (18) and (m)(5) to read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(f) * * *

(17) Reporting of disqualified basis and disqualified payments. If for the annual accounting period of a corporation it holds an item of property having disqualified basis within the meaning of §1.951A-3(h)(2)(ii) or §1.951A-2(c)(5), or incurs an item of deduction or loss related to a disqualified payment (within the meaning of §1.951A-2(c)(6)(ii)(A)), then Form 5471 (or successor form) must contain such information about the disqualified basis, or such information relating to the disqualified payment, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(18) Adjustments to extraordinary disposition accounts and disqualified basis. If for the annual accounting period a section 245A shareholder of the corporation reduces its extraordinary disposition account pursuant to §1.245A-7(c) or §1.245A-8(c), as applicable, or the corporation reduces the disqualified basis in an item of specified property pursuant to §1.245A-7(b) or §1.245A-8(b), as applicable, then Form 5471 (or a successor form) must contain such information about the reduction to the extraordinary disposition account or disqualified basis, as applicable, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

* * * * *
(m) * * *

(5) Special rule for paragraphs (f)(17) and (18) of this section. Paragraphs (f)(17) and (18) of this section apply with respect to information for annual accounting periods beginning after [INSERT DATE PUBLISHED IN FEDERAL REGISTER]. In addition, as provided in §1.245A-11(b), paragraph (f)(18) of this section applies with respect to information for an annual accounting period that includes a taxable year for which a taxpayer has chosen to apply §§1.245A-6 through 1.245A-11 pursuant to §1.245A-11(b).

* * * * *

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

Approved:

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).