

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2018-6
February 05, 2018

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Notice 2018-05, page 341.

The notice permits qualifying withholding agents to apply the transition rules in Notice 2010-46 for calendar years 2018 and 2019.

Notice 2018-13, page 341.

This notice provides additional guidance for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code as amended by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018", P.L. 115-97, which was enacted on December 22, 2017.

Rev. Proc. 2018-12, page 349.

This revenue procedure provides safe harbors that taxpayers may use to value stock for purposes of the continuity of interest (COI) requirement under section 1.368-1(e). If the conditions set forth in the revenue procedure are met, taxpayers may use the average of the daily volume weighted average prices, the average of the average high-low daily prices, or the average of the daily closing prices of stock trading on certain stock exchanges in order to determine whether the COI requirement has been satisfied under the signing date rule or the closing date rule.

Rev. Rul. 2018-05, page 339.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for February 2018.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1274.— Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property.

(Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520.)

Rev. Rul. 2018-05

This revenue ruling provides various prescribed rates for federal income tax

purposes for February 2018 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate

percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2018-05 TABLE 1				
Applicable Federal Rates (AFR) for February 2018				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
		<i>Short-term</i>		
AFR	1.81%	1.80%	1.80%	1.79%
110% AFR	1.99%	1.98%	1.98%	1.97%
120% AFR	2.17%	2.16%	2.15%	2.15%
130% AFR	2.35%	2.34%	2.33%	2.33%
		<i>Mid-term</i>		
AFR	2.31%	2.30%	2.29%	2.29%
110% AFR	2.55%	2.53%	2.52%	2.52%
120% AFR	2.78%	2.76%	2.75%	2.74%
130% AFR	3.01%	2.99%	2.98%	2.97%
150% AFR	3.48%	3.45%	3.44%	3.43%
175% AFR	4.07%	4.03%	4.01%	4.00%
		<i>Long-term</i>		
AFR	2.66%	2.64%	2.63%	2.63%
110% AFR	2.92%	2.90%	2.89%	2.88%
120% AFR	3.20%	3.17%	3.16%	3.15%
130% AFR	3.46%	3.43%	3.42%	3.41%

REV. RUL. 2018-05 TABLE 2				
Adjusted AFR for February 2018				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term				
adjusted AFR	1.34%	1.34%	1.34%	1.34%
Mid-term				
adjusted AFR	1.72%	1.71%	1.71%	1.70%
Long-term				
adjusted AFR	1.97%	1.96%	1.96%	1.95%

REV. RUL. 2018-05 TABLE 3

Rates Under Section 382 for February 2018

Adjusted federal long-term rate for the current month	1.97%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	1.97%

REV. RUL. 2018-05 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for February 2018

Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.57%
Appropriate percentage for the 30% present value low-income housing credit	3.25%

REV. RUL. 2018-05 TABLE 5

Rate Under Section 7520 for February 2018

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	2.8%
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Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 467.—Certain Payments for the Use of Property or Services

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Section 7520.—Valuation Tables

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2018. See Rev. Rul. 2018-05, page 339.

Part III. Administrative, Procedural, and Miscellaneous

Extension of Transition Rules from Notice 2010-46

Notice 2018-05

I. PURPOSE

This Notice permits withholding agents to apply the transition rules from Notice 2010-46, 2010-24 I.R.B. 757, in calendar years 2018 and 2019, as described in more detail below.

II. BACKGROUND

Notice 2010-46 addresses potential overwithholding in the context of securities lending and sale repurchase agreements. Notice 2010-46 provides a two-part solution to the problem of overwithholding on a chain of dividends and dividend equivalents. First, it provides an exception from withholding for payments to a qualified securities lender (QSL). Second, it provides a proposed framework to credit forward prior withholding on a chain of substitute dividends paid pursuant to a chain of securities loans or stock repurchase agreements. The QSL regime requires a person that agrees to act as a QSL to comply with certain withholding and documentation requirements. The Department of Treasury (Treasury Department) and the Internal Revenue Service (IRS) permitted withholding agents to rely on transition rules described in Notice 2010-46, Part III, until guidance was developed that would include documentation and substantiation of withholding.

On September 18, 2015, temporary regulations containing rules for qualified derivatives dealers (QDD) were published in the Federal Register (80 FR 56866). The Treasury Department and the IRS stated that the final QDD regulations would supplant the proposed regulatory framework described in Notice 2010-46. 80 FR at 56878. The Treasury Department and the IRS reiterated the intent to replace the proposed regulatory framework described in Notice 2010-46 with the QDD regime in Notice 2016-42, 2016-29 I.R.B. 67, which contained the proposed qualified intermediary agreement (QI Agreement) that included provisions relating to the QDD regime. Revenue Procedure 2017-15, 2017-3 I.R.B. 437, which

sets forth the final QI Agreement, provided that taxpayers could continue to rely on Notice 2010-46 during calendar year 2017.

As part of transition relief announced in Notice 2016-76, 2016-51 I.R.B. 834, the Treasury Department and the IRS announced that taxpayers may continue to rely on Notice 2010-46 during 2017, and that Notice 2010-46 would be obsoleted as of January 1, 2018. On January 24, 2017, final regulations containing rules for QDDs were published in the Federal Register (82 FR 8144) (2017 Final Regulations). Consistent with Notice 2016-76, the “Effect on Other Documents” section of the preamble to the 2017 Final Regulations obsoleted Notice 2010-46 as of January 1, 2018. In response to a comment requesting that the QSL regime remain, the preamble to the 2017 Final Regulations noted that “[w]hile the Treasury Department and the IRS understand that the QSL regime was administratively more convenient for taxpayers than the QI regime, it created administrability problems, particularly with respect to verification, for the IRS. That regime is being replaced by incorporating the QDD rules into the existing QI framework, including the specific rules for pooled reporting on Form 1042-S, and the QI requirements for compliance review and certification.” 82 FR at 8153.

Since the 2017 Final Regulations, comments have stated that securities lending does not pose a high risk for withholding tax avoidance. In these comments, market participants have requested that the QSL regime be extended for a longer transitional period and have requested that the Treasury Department and the IRS consider simplifying the rules for securities lenders. After considering comments from participants in the securities lending market and the tax administration concerns of the IRS, particularly with respect to verification, the Treasury Department and the IRS have decided to extend the QSL regime described in Notice 2010-46, Part III, but only for payments made in calendar years 2018 and 2019. During this period, the Treasury Department and the IRS intend to consider whether additional guidance is appropriate to address the par-

ticular circumstances of foreign lenders of U.S. dividend-paying stocks.

III. EXTENSION OF TRANSITION RULES FROM NOTICE 2010-46

Notwithstanding the preamble to the 2017 Final Regulations, withholding agents may apply the transition rules described in Notice 2010-46, Part III, for payments made in calendar years 2018 and 2019.

IV. DRAFTING INFORMATION

The principal authors of this Notice are Karen Walny and Peter Merkel of the Office of Associate Chief Counsel (International). For further information regarding this Notice, contact Karen Walny or Peter Merkel at (202) 317-6938 (not a toll-free number).

Additional Guidance Under Section 965 and Guidance Under Sections 863 and 6038 in Connection with the Repeal of Section 958(b)(4)

Notice 2018-13

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”) intend to issue regulations for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code (“Code”) as amended by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the “Act”), which was enacted on December 22, 2017. See Notice 2018-07, 2018-4 I.R.B. 317, for prior guidance issued under section 965. In addition, this notice provides guidance in connection with the repeal of section 958(b)(4) by the Act.

Section 2 of this notice provides background on section 965 and the repeal of section 958(b)(4) by the Act. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue with respect to section 965. Section 4 of this notice describes a modification that the Treasury Department and the IRS intend to make with respect to regulations under section 965 that were described in section 3.03 of Notice 2018-07. Section 5 of this notice provides guidance under section 863 in connection with the repeal of section 958(b)(4) by the Act and announces the IRS's intention to update the Instructions for Form 5471 as a result of such repeal. Section 6 of this notice describes the effective dates of the regulations and other guidance described in this notice. Section 7 of this notice requests comments and provides contact information.

SECTION 2. BACKGROUND

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

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation ("DFIC") that begins before January 1, 2018 (such year of the DFIC, the "inclusion year"), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, a "measurement date," and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the "section 965(a) earnings amount").

The section 965(a) earnings amount is not subject to the rules or limitations in section 952 and is not limited by the accumulated earnings and profits of the DFIC as of the close of the inclusion year.

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

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

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

The aggregate foreign E&P deficit of any United States shareholder is allocated to each DFIC of the United States shareholder in an amount that bears the same proportion to such aggregate as (A) such United States shareholder's pro rata share of the section 965(a) earnings amount of each such DFIC bears to (B) the aggregate of such United States shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such United States shareholder. Section 965(b)(2). The term "aggregate foreign E&P deficit" means, with respect to any United States shareholder, the lesser of (I) the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder or (II) the aggregate of such shareholder's pro rata shares of the section 965(a) earnings amounts of all DFICs of such shareholder. Section 965(b)(3)(A)(i).

The term "E&P deficit foreign corporation" means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if, as of No-

vember 2, 2017, (i) such specified foreign corporation has a deficit in post-1986 earnings and profits, (ii) such corporation was a specified foreign corporation, and (iii) such taxpayer was a United States shareholder of such corporation. Section 965(b)(3)(B). The term "specified E&P deficit" means, with respect to an E&P deficit foreign corporation, the amount of such corporation's deficit in post-1986 earnings and profits as of November 2, 2017. *See* section 965(b)(3)(C). A specified foreign corporation that is a DFIC cannot also be an E&P deficit foreign corporation. *See* H.R. Rep. No. 115-466, at 618 (2017) (Conf. Rep.) ("Deferred earnings of a U.S. shareholder are reduced (but not below zero) by the shareholder's share of deficits as of November 2, 2017, from a specified foreign corporation that is not a [DFIC] . . .").

.04 Application of the Participation Exemption

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

Section 965(c)(3)(A) provides that the term "aggregate foreign cash position" means, with respect to any United States shareholder, the greater of (i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the inclusion year, or (ii) one half of the sum of (I) the aggregate

¹In contrast to Notice 2018-07, this notice uses the term "section 965(a) inclusion amount" to refer to an amount included in the gross income of the United States shareholder with respect to a DFIC, rather than an amount of the DFIC.

described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation that ends before November 2, 2017, plus (II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I). Each date referred to in the preceding sentence is referred to in this notice as a “cash measurement date.”

The cash position of any specified foreign corporation is the sum of (i) cash held by such corporation, (ii) the net accounts receivable of such corporation, and (iii) the fair market value of the following assets held by such corporation: (I) personal property which is of a type that is actively traded and for which there is an established financial market; (II) commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government; (III) any foreign currency; (IV) any obligation with a term of less than one year (“short-term obligation”); and (V) any asset which the Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B). Section 965(c)(3)(B). For purposes of section 965(c)(3), the term “net accounts receivable” means, with respect to any specified foreign corporation, the excess (if any) of (i) such corporation’s accounts receivable, over (ii) such corporation’s accounts payable (determined consistent with the rules of section 461). Section 965(c)(3)(C).

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

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term “accumulated post-1986 deferred foreign income” means the post-1986 earnings and profits of the specified foreign corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under chapter 1

(“effectively connected income”), or (B) in the case of a controlled foreign corporation (“CFC”), if distributed, would be excluded from the gross income of a United States shareholder under section 959 (“previously taxed income”). Section 965(d)(2).

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

.06 Specified Foreign Corporation

Section 965(e)(1) provides that the term “specified foreign corporation” means (A) any CFC and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (10-percent corporation). For purposes of sections 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a). Section 965(e)(2). However, if a passive foreign investment company (as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

.07 Determination of Pro Rata Share

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

.08 Repeal of Section 958(b)(4)

Section 958 provides rules for determining stock ownership of a foreign cor-

poration for purposes of sections 951 through 965. Section 958(b) provides, in relevant part, that section 318(a) (relating to the constructive ownership of stock) applies, subject to certain modifications, to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b) or to treat a foreign corporation as a CFC under section 957. Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, the Act repeals section 958(b)(4). As in effect prior to repeal, section 958(b)(4) provided that subparagraphs (A), (B), and (C) of section 318(a)(3) were not to be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person. The subparagraphs of section 318(a)(3) generally attribute stock owned by a person to a partnership, estate, trust, or corporation in which such person has an interest (so-called “downward attribution”). For example, stock of a corporation owned by a person that owns 50 percent or more in value of the stock of another corporation is treated as owned by such other corporation. See section 318(a)(3)(C).

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

.01 Determination of Status of a Specified Foreign Corporation as a DFIC or an E&P Deficit Foreign Corporation

The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining the status of a specified foreign corporation as a DFIC or an E&P deficit foreign corporation, it must first be determined whether the specified foreign corporation is a DFIC. If the specified foreign corporation meets the definition of a DFIC, it is classified solely as a DFIC and not also as an E&P deficit foreign corporation, even if such specified foreign corporation otherwise satisfies the requirements of section 965(b)(3)(B). If a specified foreign corporation does not

meet the definition of a DFIC, the United States shareholder must then determine whether it is an E&P deficit foreign corporation. In some cases, as illustrated in *Example 2*, a specified foreign corporation may be classified as neither a DFIC nor an E&P deficit foreign corporation, despite having post-1986 earnings and profits greater than zero or a deficit in accumulated post-1986 deferred foreign income.

Example 1. (i) *Facts.* USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of November 2, 2017, FS has a deficit in post-1986 earnings and profits of 150u. As of December 31, 2017, FS has 200u of post-1986 earnings and profits. FS does not have previously taxed income or effectively connected income for any taxable year.

(ii) *Analysis.* Because FS, a specified foreign corporation, does not have previously taxed income or effectively connected income for any taxable year, FS's accumulated post-1986 deferred foreign income is equal to its post-1986 earnings and profits. Because FS has accumulated post-1986 deferred foreign income as of December 31, 2017, FS is a DFIC. See section 965(d)(1). Accordingly, FS is not an E&P deficit foreign corporation.

Example 2. (i) *Facts.* USP, a domestic corporation, owns all of the stock of FS, a foreign corporation. As of both November 2, 2017, and December 31, 2017, FS has 100u of previously taxed income described in section 959(c)(2) and a deficit of 90u in earnings and profits described in section 959(c)(3), all of which were accumulated in taxable years beginning after December 31, 1986, while FS was a specified foreign corporation. Accordingly, as of both November 2, 2017, and December 31, 2017, FS has 10u of post-1986 earnings and profits.

(ii) *Analysis.* (A) *Determination of status as a DFIC.* For purposes of determining whether FS is a DFIC, a determination must be made whether FS has accumulated post-1986 deferred foreign income greater than zero as of either November 2, 2017, or December 31, 2017. Under section 965(d)(2), FS's accumulated post-1986 deferred foreign income is its post-1986 earnings and profits, except to the extent such earnings are effectively connected income or previously taxed income. Disregarding FS's 100u of previously taxed income, FS has a 90u deficit in accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017. Accordingly, FS does not have accumulated post-1986 deferred foreign income greater than zero as of either measurement date and therefore FS is not a DFIC.

(B) *Determination of status as an E&P deficit foreign corporation.* For purposes of determining whether FS is an E&P deficit foreign corporation, a determination must be made whether FS has a deficit in post-1986 earnings and profits as of November 2, 2017. As described in paragraph (i) of this *Example 2*, FS has 10u of post-1986 earnings and profits as of both November 2, 2017, and December 31, 2017. As a result, FS does not have a deficit in post-1986 earnings and profits as of November 2, 2017, and therefore FS is not an E&P deficit foreign corpora-

tion. Accordingly, FS is neither a DFIC nor an E&P deficit foreign corporation.

.02 Alternative Method for Calculating Post-1986 Earnings and Profits

The Act provides that the earnings and profits of a specified foreign corporation must be determined as of two measurement dates and “in accordance with sections 964(a) and 986.” See section 965(a) and (d)(3). Consistent with this requirement, the Treasury Department and the IRS have determined that, for purposes of measuring the post-1986 earnings and profits of a specified foreign corporation as of a measurement date, the extent to which an item of income, deduction, gain, or loss is taken into account as of such measurement date must generally be determined under principles applicable to the calculation of earnings and profits, including the application of sections 312 and 964.

For purposes of determining whether a specified foreign corporation is a DFIC and for purposes of determining a DFIC's section 965(a) earnings amount, the actual post-1986 earnings and profits of the specified foreign corporation must be determined as of the close of both November 2, 2017, and December 31, 2017. In addition, for purposes of determining whether a specified foreign corporation is an E&P deficit foreign corporation and for purposes of determining the amount of the specified E&P deficit of an E&P deficit foreign corporation, the actual post-1986 earnings and profits (including a deficit) of the specified foreign corporation must be determined as the close of November 2, 2017.

However, the Treasury Department and the IRS recognize that it may be impractical for taxpayers to determine the post-1986 earnings and profits of a specified foreign corporation as of a measurement date that does not fall on the last day of a month. Therefore, the Treasury Department and the IRS intend to issue regulations providing that an election may be made to determine a specified foreign corporation's post-1986 earnings and profits as of a measurement date based on the amount of post-1986 earnings and profits (including a deficit) as of another date as provided in this section 3.02 (the “alternative method”). If an election to use the

alternative method is made, the amount of the post-1986 earnings and profits (including a deficit) of a specified foreign corporation (other than a specified foreign corporation with a 52–53-week taxable year described in § 1.441–2(a)(1)) as of November 2, 2017, will equal the sum of (1) the corporation's post-1986 earnings and profits as of October 31, 2017, and (2) the corporation's annualized earnings and profits amount. For this purpose, the term “annualized earnings and profits amount” means, with respect to a specified foreign corporation, the amount equal to the product of two (the number of days after October 31, 2017, and on or before the measurement date on November 2, 2017) multiplied by the daily earnings amount of the specified foreign corporation. The term “daily earnings amount” means, with respect to a specified foreign corporation, the post-1986 earnings and profits (including a deficit) of the specified foreign corporation as of the close of October 31, 2017, that were earned (or incurred) during the specified foreign corporation's taxable year that includes October 31, 2017, divided by the number of days that have elapsed in such taxable year as of the close of October 31, 2017. A specified foreign corporation that does not have a 52–53-week taxable year described in § 1.441–2(a)(1) may not determine its post-1986 earnings and profits under the alternative method with respect to the measurement date on December 31, 2017.

In the case of a specified foreign corporation that has a 52–53-week taxable year described in § 1.441–2(a)(1), an election may be made to use the alternative method to determine its post-1986 earnings and profits as of both measurement dates based on the amount of post-1986 earnings and profits (including a deficit) as of the closest end of a fiscal month to each measurement date consistent with the principles of the preceding paragraph. For example, if the closest end of a fiscal month of a specified foreign corporation that has a 52–53-week taxable year occurs after an applicable measurement date, the annualized earnings amount will be subtracted from (rather than added to) the post-1986 earnings and profits of the specified foreign corporation as of such fiscal month end. For a specified foreign corporation with a 52–53-week taxable year, in

order to use the alternative method for any measurement date, the election must be made for both measurement dates.

The IRS intends to issue forms, publications, regulations, or other guidance that will specify the manner and timing of an election to use the alternative method.

Example. (i) *Facts.* FS, a foreign corporation, has a calendar year taxable year and as of October 31, 2017, FS has post-1986 earnings and profits of 10,000u, 3,040u of which were earned during the taxable year that includes October 31, 2017. An election is made for FS to determine its post-1986 earnings and profits under the alternative method.

(ii) *Analysis.* As of the close of October 31, 2017, 304 days have elapsed in the taxable year of FS that includes October 31, 2017. Therefore, FS's daily earnings amount is 10u (3,040u divided by 304), and FS's annualized earnings and profits amount is 20u (10u multiplied by 2). Accordingly, FS's post-1986 earnings and profits as of November 2, 2017, are 10,020u (its post-1986 earnings and profits as of October 31, 2017 (10,000u), plus its annualized earnings and profits amount (20u)).

.03 Treatment of Deficits

(a) Allocation of Deficits to Different Classes of Stock

For purposes of determining the amount of a United States shareholder's aggregate foreign E&P deficit, the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder must be determined. Section 965(f)(1) provides that, in determining a United States shareholder's pro rata share of "any amount with respect to any specified foreign corporation," rules similar to section 951(a)(2) shall be applied. Section 1.951-1(e) provides guidance with respect to allocating subpart F income among multiple classes of stock but does not address deficits.

The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a United States shareholder's pro rata share of the specified E&P deficit of an E&P deficit foreign corporation that has multiple classes of stock outstanding, the specified E&P deficit is allocated first among the shareholders of the corporation's common stock and in proportion to the value of the common stock held by such shareholders.

(b) Treatment of Hovering Deficits

The Conference Report accompanying the Act provides that "the amount of post-

1986 earnings and profits of a specified foreign corporation is the amount of positive earnings and profits accumulated as of the measurement date reduced by any deficit in earnings and profits of the specified foreign corporation as of the measurement date, without regard to the limitation category of the earnings or deficit." H.R. Rep. No. 115-466, at 618. The Conference Report clarifies that, for this purpose, the term "deficit" includes a hovering deficit (as defined in § 1.367(b)-7(d)(2)(i)), with the following example:

For example, assume that a foreign corporation organized after December 31, 1986 has \$100 of accumulated earnings and profits as of November 2, 2017, and December 31, 2017 . . . which consist of \$120 general limitation earnings and profits and a \$20 passive limitation deficit, the foreign corporation's post-1986 earnings and profits would be \$100, even if the \$20 passive limitation deficit was a hovering deficit.

Id. at 619. Consistent with the Conference Report, the Treasury Department and the IRS intend to issue regulations clarifying that all deficits related to post-1986 earnings and profits, including hovering deficits, are taken into account for purposes of determining the post-1986 earnings and profits (including a deficit) of a specified foreign corporation.

.04 Determination of Aggregate Foreign Cash Position

(a) Definitions for Determining Net Accounts Receivable

Section 965(c)(3)(C) does not define the term "accounts receivable" for purposes of the term "net accounts receivable." The Treasury Department and the IRS intend to issue regulations providing that, for purposes of section 965(c)(3)(C), the term "accounts receivable" means receivables described in section 1221(a)(4), and the term "accounts payable" means payables arising from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers. Receivables that are treated as accounts receivable within the meaning of section 965(c)(3)

(C)(i) will not also be treated as short-term obligations.

(b) Treatment of Demand Obligations

Section 965(c)(3)(B) provides that the "cash position" of a specified foreign corporation includes the fair market value of any short-term obligation. The Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining a specified foreign corporation's cash position, a loan that must be repaid on the demand of the lender (or that must be repaid within one year of such demand) will be treated as a short-term obligation, regardless of the stated term of the instrument.

.05 Translation Rules

(a) Comparison of Accumulated Post-1986 Deferred Foreign Income as of the Measurement Dates

Generally, determinations made under subtitle A of the Code must be made in a taxpayer's functional currency. *See* section 985(a). For purposes of determining the tax under subtitle A of the Code of any shareholder of a foreign corporation, the earnings and profits of such corporation must be determined in the corporation's functional currency. *See* section 986(b)(1). Accordingly, the Treasury Department and the IRS intend to issue regulations providing that, for purposes of determining the section 965(a) earnings amount of a specified foreign corporation, the accumulated post-1986 deferred foreign income of the specified foreign corporation as of each of the measurement dates must be compared in the functional currency of the specified foreign corporation. If the functional currency of a specified foreign corporation changes between the two measurement dates, the comparison must be made in the functional currency of the specified foreign corporation as of December 31, 2017, by translating the specified foreign corporation's earnings and profits as of November 2, 2017, into the new functional currency using the spot rate on November 2, 2017. For purposes of this notice, the term "spot rate" has the meaning described in § 1.988-1(d).

(b) Determination of the Amount of Inclusion Under Section 951(a)(1) by Reason of Section 965

In the case of any United States person, the earnings and profits determined under section 986(b)(1) when distributed, deemed distributed, or otherwise taken into account are translated into U.S. dollars using the appropriate exchange rate for purposes of determining the tax on such earnings under subtitle A of the Code. See section 986(b)(2). Generally, except as provided in regulations, section 989(b) sets forth the appropriate exchange rate. In the case of an actual distribution of earnings and profits or an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the appropriate exchange rate is the spot rate on the date such distribution or deemed dividend is included into income. Section 989(b)(1) and (2). In the case of subpart F income included in income by a United States shareholder under section 951(a)(1)(A), the appropriate exchange rate is the average exchange rate for the taxable year of the foreign corporation. Section 989(b)(3). Any amounts included in income under section 951(a)(1)(B) (inclusions under section 956) are treated for this purpose as distributions made on the last day of the taxable year for which such amounts were so included, and accordingly translated at the spot rate on the last day of such taxable year. Section 989(b).

In order to calculate the section 965(a) inclusion amount of a United States shareholder with respect to a DFIC, the United States shareholder's pro rata shares of the section 965(a) earnings amounts of its DFICs and the specified E&P deficits of its E&P deficit foreign corporations must be translated into U.S. dollars. The Treasury Department and the IRS have determined that the spot rate on December 31, 2017, is the appropriate exchange rate for purposes of translating these amounts, regardless of a specified foreign corporation's taxable year or the applicable measurement date, because it is the date on which a specified foreign corporation's post-1986 earnings and profits becomes fixed and immediately precedes the transition to the participation exemption under section 245A. Furthermore, a single spot rate on December 31, 2017, is more ad-

ministrable for the IRS and less burdensome for taxpayers than the yearly average approach of section 989(b)(3) because under the yearly average approach, certain amounts required for the determination of the section 965(a) inclusion amount of a United States shareholder (for example, the United States shareholder's aggregate foreign E&P deficit) would not be determinable until the last closing of an inclusion year of a specified foreign corporation of the United States shareholder.

Accordingly, the Treasury Department and the IRS intend to issue regulations providing that the appropriate exchange rate under section 989(b) for translating the section 965(a) earnings amount will be the spot rate on December 31, 2017. The regulations will also provide that the spot rate on December 31, 2017, will apply for purposes of translating other amounts necessary for the application of section 965(b), including (1) translating a section 965(a) earnings amount into U.S. dollars in computing amounts described in section 965(b)(2)(A) and (B), (2) translating a specified E&P deficit into U.S. dollars in order to determine a United States shareholder's aggregate foreign E&P deficit under section 965(b)(3)(A), (3) translating a section 965(a) inclusion amount with respect to a DFIC (if such amount was reduced by an aggregate foreign E&P deficit under section 965(b)(1)) back into the functional currency of the DFIC for purposes of determining the previously taxed income of the DFIC, and (4) translating the portion of the U.S. dollar-denominated aggregate foreign E&P deficit allocated to a DFIC under section 965(b)(2) into the functional currency of the DFIC for purposes of determining its previously taxed income under section 965(b)(4)(A).

The regulations will also provide that, for purposes of section 986(c), foreign currency gain or loss with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965 will be determined based on movements in the exchange rate between December 31, 2017, and the date on which such previously taxed earnings and profits are actually distributed.

Example. (i) *Facts.* As of November 2, 2017, and December 31, 2017, USP, a domestic corporation, owns all of the stock of CFC1, an E&P deficit foreign corporation with the "u" as its functional currency; CFC2, an E&P deficit foreign corpora-

tion with the "v" as its functional currency; CFC3, a DFIC with the "y" as its functional currency; and CFC4, a DFIC with the "z" as its functional currency. USP, CFC1, CFC2, CFC3, and CFC4 each have a calendar year taxable year. As of December 31, 2017, $1u=\$1$, $.75v=\$1$, $.50y=\$1$, and $.25z=\$1$. CFC1 has a specified E&P deficit of $100u$, CFC2 has a specified E&P deficit of $120v$, CFC3 has a section 965(a) earnings amount of $50y$, and CFC4 has a section 965(a) earnings amount of $75z$.

(ii) *Analysis.* (A) For purposes of applying section 965(b), the section 965(a) earnings amount of each of CFC3 and CFC4 translated into U.S. dollars at the spot rate on December 31, 2017, is $\$100$ ($50y$ at $.50y=\$1$) and $\$300$ ($75z$ at $.25z=\$1$), respectively. Furthermore, USP's pro rata share of the section 965(a) earnings amounts, as translated, is $\$100$ and $\$300$, respectively, or 100% of each section 965(a) earnings amount.

(B) For purposes of applying section 965(b), the specified E&P deficit of each of CFC1 and CFC2 translated into U.S. dollars at the spot rate on December 31, 2017, is $\$100$ ($100u$ at $1u=\$1$) and $\$160$ ($120v$ at $.75v=\$1$), respectively. Furthermore USP's pro rata share of each specified E&P deficit, as translated, is $\$100$ and $\$160$, respectively, or 100% of each specified E&P deficit. Therefore, USP's aggregate foreign E&P deficit is $\$260$.

(C) For purposes of applying section 965(b), USP's aggregate foreign E&P deficit of $\$260$ is allocated $\$65$ to reduce the amount that USP would otherwise take into account under section 951(a)(1) by reason of section 965 with respect to CFC3 ($\$260 \times (\$100/\$400)$) and allocated $\$195$ to reduce the amount that USP would otherwise take into account under section 951(a)(1) by reason of section 965 with respect to CFC4 ($\$260 \times (\$300/400)$). After reduction under section 965(b)(1), the section 965(a) inclusion amount of USP with respect to CFC3 is $\$35$ ($\$100 - \65) and the section 965(a) inclusion amount of USP with respect to CFC4 is $\$105$ ($\$300 - \195). The previously taxed income of CFC3 and CFC4 resulting from the section 965(a) inclusion amounts included in gross income by USP, translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are $17.5y$ ($\$35$ at $.50y=\$1$) and $26.25z$ ($\$105$ at $.25z=\$1$), respectively.

(D) For purposes of determining the previously taxed income of each of CFC3 and CFC4 under section 965(b)(4)(A) as a result of the reduction to USP's section 965(a) inclusion amounts with respect to CFC3 and CFC4, the amounts of the aggregate foreign E&P deficit of USP are allocated to each of CFC3 and CFC4 under section 965(b)(2), which translated into the respective functional currencies of CFC3 and CFC4 at the spot rate on December 31, 2017, are $32.5y$ ($\$65$ at $.50y=\$1$) and $48.75z$ ($\$195$ at $.25z=\$1$), respectively.

(c) Determination of Cash Positions as of Cash Measurement Dates

The Treasury Department and the IRS intend to issue regulations providing that

the cash position of a specified foreign corporation with respect to any cash measurement date must be expressed in U.S. dollars. Therefore, the amount of a United States shareholder's aggregate foreign cash position will be the greater of the U.S. dollar-denominated aggregate amounts on each cash measurement date described in section 965(c)(3)(A).

In determining the cash position attributable to net accounts receivable, the amount of accounts receivables and accounts payables (in each case, if not otherwise denominated in U.S. dollars) must be translated into U.S. dollars at the spot rate on the relevant cash measurement date. The fair market value of assets described in section 965(c)(3)(B)(iii) must also be determined in U.S. dollars on the relevant cash measurement date. For example, in the case of foreign currency, the fair market value will equal the currency amount translated at the spot rate on the relevant cash measurement date.

SECTION 4. MODIFICATION TO RULE DESCRIBED IN SECTION 3.03 OF NOTICE 2018-07 RELATING TO DISTRIBUTIONS OF PREVIOUSLY TAXED INCOME

Section 3.03 of Notice 2018-07 announced that the Treasury Department and the IRS intend to issue regulations providing that if a United States shareholder receives distributions from a DFIC during the inclusion year that are attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized by the United States shareholder with respect to the stock of the DFIC under section 961(b)(2) will be reduced (but not below zero) by the section 965(a) inclusion amount (the "gain-reduction rule"). Notice 2018-07 does not expressly apply the gain-reduction rule to distributions to a United States shareholder from an entity (an "upper-tier entity") that is not a DFIC (for instance, an E&P deficit foreign corporation) that has received distributions from a DFIC (a "lower-tier DFIC") attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a). Moreover, Notice 2018-07 could be interpreted to provide that even when the upper-tier entity is a DFIC, the amount of gain recognized by

the United States shareholder that is reduced by reason of the gain-reduction rule is limited solely to the section 965(a) inclusion amount of the United States shareholder with respect to the upper-tier entity, rather than also including the section 965(a) inclusion amount with respect to the lower-tier DFIC from which such upper-tier entity has received distributions attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a).

The Treasury Department and the IRS intend to issue regulations that provide that the gain-reduction rule also applies to distributions received from a DFIC through a chain of ownership described in section 958(a). Specifically, regulations will provide that if a United States shareholder receives distributions through a chain of ownership described under section 958(a) from a DFIC during the inclusion year that are attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized under section 961(b)(2) by the United States shareholder with respect to the stock or property of any entity in the ownership chain described in section 958(a) through which the distribution is made will be reduced (but not below zero) by the section 965(a) inclusion amount of the United States shareholder with respect to such DFIC. The gain-reduction rule will apply similarly to reduce the amount of gain that would otherwise be recognized under section 961(c) by any controlled foreign corporation in the ownership chain described in section 958(a) through which the distribution is made to a United States shareholder for purposes of determining the amount included under section 951(a)(1) in the gross income of the United States shareholder.

Example. (i) *Facts.* USP, a domestic corporation, owns all of the stock of CFC1, a specified foreign corporation that has no post-1986 earnings and profits (or deficit), and CFC1 owns all the stock of CFC2, a DFIC. USP is a calendar year taxpayer. CFC1 and CFC2 have inclusion years that end on November 30, 2018. The functional currency of CFC1 and CFC2 is the U.S. dollar. USP's adjusted basis in the stock of CFC1 is zero, and CFC1's adjusted basis in the stock of CFC2 is zero. On January 1, 2018, CFC2 distributes \$100 to CFC1, and CFC1 distributes \$100 to USP. USP has a section 965(a) inclusion amount of \$100 with respect to

CFC2. CFC2 has no other earnings and profits described in section 959(c)(1) or (2), other than earnings and profits described in section 959(c)(2) by reason of section 965(a).

(ii) *Analysis.* USP receives a distribution from CFC2, a lower-tier DFIC, through a chain of ownership described in section 958(a) during the inclusion year of CFC2 that is attributable to \$100 of previously taxed income described in section 959(c)(2) by reason of section 965(a). The amount of gain that USP would otherwise recognize with respect to the stock of CFC1 under section 961(b)(2) and the amount of gain that CFC1 would otherwise recognize with respect to the stock of CFC2 under section 961(c) for purposes of determining CFC1's subpart F income is reduced (but not below zero) in each case by \$100, USP's section 965(a) inclusion amount with respect to CFC2.

SECTION 5. GUIDANCE IN CONNECTION WITH THE REPEAL OF SECTION 958(b)(4)

.01 Application of Section 863

Section 863 and the regulations thereunder provide special rules for determining the source of certain items of gross income, including gross income from space and ocean activities and international communications income. Section 863(d) provides that, except as provided in regulations, any income derived from a space or ocean activity ("space and ocean income") by a United States person is sourced in the United States (such income, "U.S. source income") and that any space and ocean income derived by a foreign person is sourced outside the United States (such income, "foreign source income"). Regulations under section 863(d) include an exception from the statutory provision regarding space and ocean income derived by a foreign person if the foreign person is a CFC. Specifically, space and ocean income derived by a CFC is treated as U.S. source income, except to the extent that the income, based on all the facts and circumstances, is attributable to functions performed, resources employed, or risks assumed in a foreign country. See § 1.863-8(b)(2)(ii).

In the case of any United States person, 50 percent of any international communications income (as defined in section 863(e)(2)) is treated as U.S. source income and 50 percent of such income is treated as foreign source income. Section 863(e)(1)(A). Subject to certain exceptions, including exceptions set forth in regulations, international communications

income derived by a foreign person is treated as foreign source income. Regulations under section 863(e) provide that international communications income derived by a CFC is treated as one-half U.S. source and one-half foreign source. *See* § 1.863-9(b)(2)(ii).

As a result of the repeal of section 958(b)(4) by the Act, stock of a foreign corporation owned by a foreign person can be attributed to a United States person under section 318(a)(3) for purposes of determining whether such United States person is a United States shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, as a result of the repeal of section 958(b)(4), section 958(b) now provides for “downward attribution” from a foreign person to a United States person in circumstances in which section 958(b), before the Act, did not so provide. As a result, foreign corporations that were not previously treated as CFCs may be treated as CFCs.

The Treasury Department and the IRS have determined that, in light of the change to the constructive ownership rules in section 958(b), further study is necessary to determine whether it is appropriate for the source of income described in section 863(d) and (e) to be determined by reference to the status of the recipient as a CFC. Accordingly, for purposes of applying §§ 1.863-8 and 1.863-9, taxpayers may determine whether a foreign corporation is a CFC without regard to the repeal of section 958(b)(4) pending further guidance (which will be prospective, as described in section 6 of this notice).

.02 Elimination of Form 5471 Filing Obligation for Certain Constructive Owners

Pursuant to section 6038(a)(4), the IRS may require any United States person treated as a United States shareholder of a CFC to file an information return on Form 5471, “Information Return of U.S. Persons with Respect to Certain Foreign Corporations,” with respect to its ownership in such CFC. For this purpose, a United States shareholder is defined in section 951(b), and the United States shareholder’s ownership in a CFC is determined based on direct and indirect ownership

under section 958(a) and constructive ownership under section 958(b). Under the Instructions for Form 5471 (Rev. Dec. 2017), a United States shareholder who owns stock in a CFC for an uninterrupted period of 30 or more days during the CFC’s tax year and owned the stock on the last day of that year is a Category 5 Filer and must file Form 5471.

As discussed in section 5.01 of this notice, as a result of the Act, section 958(b) now provides for “downward attribution” from a foreign person under section 318(a)(3) to a United States person in circumstances in which section 958(b), before the Act, did not so provide. A United States shareholder’s pro rata share of a CFC’s subpart F income and the amount determined under section 956 that a United States shareholder is required to include in gross income, however, continue to be determined based on direct and indirect ownership of the CFC under section 958(a), which does not take into account such downward attribution.

The IRS intends to amend the Instructions for Form 5471 to provide an exception from Category 5 filing for a United States person that is a United States shareholder with respect to a CFC if no United States shareholder (including such United States person) owns, within the meaning of section 958(a), stock in such CFC, and the foreign corporation is a CFC solely because such United States person is considered to own the stock of the CFC owned by a foreign person under section 318(a)(3).

SECTION 6. EFFECTIVE DATES

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

on the rules described in sections 3 and 4 of this notice.

The repeal of section 958(b)(4) is effective for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end. Taxpayers may rely on section 5.01 of this notice with respect to the last taxable year of foreign corporations beginning before January 1, 2018, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, pending the issuance of further guidance (the application of which will be prospective). Before the change to instructions described in section 5.02 of this notice, taxpayers may also rely on the exception described in section 5.02 of this notice for the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent year of such foreign corporations and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SECTION 7. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. The Treasury Department and the IRS expect to issue additional guidance under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965. In addition, comments are requested as to whether, in light of the repeal of section 958(b)(4), it would be appropriate for the Treasury Department and the IRS to reconsider the provisions of any form, publication, regulation, or other guidance that reference CFCs, and if so, what revisions may be appropriate.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR-4579, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to

Notice.comments@irs.counsel.treas.gov. Comments will be available for public inspection and copying.

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

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of tax liability

(Also Part I, §§ 368, 1.368-1.)

Rev. Proc. 2018-12

SECTION 1. PURPOSE

This revenue procedure provides methods that taxpayers may use to value certain stock received by a target corporation's shareholders in a potential reorganization for purposes of determining whether the continuity of interest (COI) requirement under § 1.368-1(e) of the Income Tax Regulations is satisfied. In the circumstances described in this revenue procedure, the Internal Revenue Service (IRS) will not challenge a taxpayer's use of one of these methods to determine the value of such stock, in lieu of using the stock's actual trading price on a particular day.

SECTION 2. BACKGROUND

.01 The provisions of subchapter C, chapter 1, of the Internal Revenue Code of 1986 generally provide nonrecognition treatment for reorganizations described in § 368. The COI requirement is one of a number of requirements that a transaction must satisfy in order to qualify as a reorganization. The COI requirement prevents transactions that resemble sales from qualifying as reorganizations. *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462 (1933). Section 1.368-1(e) of the Income Tax Regulations generally provides rules applicable to the determination of whether the COI requirement is satisfied. See generally § 1.368-1(e) for the definitions of terms used in this revenue procedure.

.02 In some reorganizations, the shareholders of a corporation (Target) transfer their Target stock to another corporation (Acquiror) in exchange for either the

stock of Acquiror or, in the case of a triangular reorganization (as defined in § 1.358-6(b)(2)), the stock of the corporation in control (within the meaning of § 368(c)) of Acquiror (in either case, Issuing Corporation stock). In these reorganizations, Target shareholders may receive only Issuing Corporation stock or, in some cases, money or other property in addition to Issuing Corporation stock. In other reorganizations, Target transfers its property to Acquiror in exchange for Issuing Corporation stock (and, in some cases, money or other property), and then Target distributes the Issuing Corporation stock (and the money or other property, if any) to its shareholders in exchange for their Target stock.

.03 The COI requirement requires that, in substance, a substantial part of the value of the Target shareholders' proprietary interests (*i.e.*, stock) in Target be preserved. Section 1.368-1(e)(1)(i); *John A. Nelson Co. v. Helvering*, 296 U.S. 374 (1935). A proprietary interest in Target is preserved if it is exchanged for Issuing Corporation stock. To the extent that the shareholders' proprietary interests in Target are acquired for money or other property, their proprietary interests are not preserved. Section 1.368-1(e)(1)(i). To determine whether the COI requirement is satisfied, the value of the Issuing Corporation stock the Target shareholders received is compared to the aggregate value of the consideration the Target shareholders received.

.04 Prior to 2011, the determination of whether the COI requirement is satisfied had been based on the value of the Issuing Corporation stock "as of the effective date of the reorganization" (Closing Date). Rev. Proc. 77-37, 1977-2 C.B. 568. Under this rule (Closing Date Rule), a decline in the value of the Issuing Corporation stock between the date a contract to effect a potential reorganization becomes binding (Signing Date) and the Closing Date could cause a transaction to fail the COI requirement.

.05 On December 19, 2011, the Department of the Treasury (Treasury Department) and the IRS issued final regulations (TD 9565, 76 FR 78540) including a special rule (Signing Date Rule) that applies if a binding contract to effect a potential reorganization pro-

vides for fixed consideration (as defined in § 1.368-1(e)(2)(iii)(A)) to be exchanged for the Target shareholders' proprietary interests. Section 1.368-1(e)(2)(i). If the Signing Date Rule applies, the consideration is valued as of the end of the last business day before the first date there is a binding contract (Pre-signing Date), rather than on the Closing Date. Thus, under the Signing Date Rule, a change between the Signing Date and the Closing Date in the value of the Issuing Corporation stock to be received by the Target shareholders does not affect the determination of whether the COI requirement is satisfied.

.06 The Treasury Department and the IRS published proposed regulations in 2011 (2011 Proposed Regulations) (REG-124627-11, 76 F.R. 78591 (Dec. 19, 2011)) that identified situations, other than those covered by the Signing Date Rule, in which the value of Issuing Corporation stock could be determined based on a value other than its actual trading price on the Closing Date. In one of these situations, the 2011 Proposed Regulations would have allowed the parties to use an average of the trading prices of Issuing Corporation stock over a number of days, in lieu of its actual trading price on the Closing Date, for purposes of determining whether the COI requirement is satisfied.

.07 The Treasury Department and the IRS received comments on the 2011 Proposed Regulations to the effect that parties to potential reorganizations frequently use average trading price methods to value Issuing Corporation stock in determining the amount and/or the mix of consideration to be exchanged for Target stock. The IRS agrees that such methods often produce a more reliable estimate of the fair market value of Issuing Corporation stock than its trading price on a single date. Accordingly, the IRS has concluded that, in certain circumstances, taxpayers should be able to rely on such methods for purposes of determining whether the COI requirement is satisfied. The IRS also agrees with commenters that taxpayers should be able to rely on such methods regardless of whether the Signing Date Rule or the Closing Date Rule applies to a particular transaction.

.08 Accordingly, the IRS is prescribing in section 4 of this revenue procedure certain Safe Harbor Valuation Methods and Measuring Periods. For COI requirement purposes, if a transaction meets the requirements of either section 3.01 or 3.02 of this revenue procedure, the parties to a potential reorganization may select one of these Safe Harbor Valuation Methods and an appropriate Measuring Period, each described in section 4 of this revenue procedure, to determine the value of certain Issuing Corporation stock.

SECTION 3. TRANSACTIONS TO WHICH THIS REVENUE PROCEDURE APPLIES

Taxpayers may apply this revenue procedure to transactions that meet the requirements of either section 3.01 or 3.02 of this revenue procedure.

.01 A taxpayer may rely on this revenue procedure if the Signing Date Rule applies to the transaction and the requirements in paragraphs (1), (2), (3), (4), and (5) of this section 3.01 are satisfied:

(1) The shareholders of Target receive Issuing Corporation stock, and either money or other property or both, in exchange for their Target stock in a transaction that, apart from the COI requirement, would qualify as a reorganization described in § 368(a)(1)(A), (B), or (C), or as a reorganization described in § 368(a)(1)(G) to which § 354, or so much of § 356 as relates to § 354, applies.

(2) Shares of one or more classes of Issuing Corporation stock that are exchanged for the Target shareholders' stock are traded on a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) with the Securities and Exchange Commission (Exchange Traded Stock).

(3) All parties to the potential reorganization, as defined in § 368(b), treat the transaction in a consistent manner (*i.e.*, as either qualifying or not qualifying as a reorganization).

(4) The transaction is effected pursuant to a binding contract that evidences the parties' agreement as to the following terms:

(a) The contract specifies—

(i) The Safe Harbor Valuation Method and an appropriate Measuring Period, each described in section 4 of this revenue

procedure, that will be used to determine the value of each class of Exchange Traded Stock to be received by the Target shareholders.

(ii) The national securities exchange and the authoritative reporting source that will be used to determine the trading prices of each class of Exchange Traded Stock throughout the Measuring Period. The national securities exchange that will be used (specified exchange) must meet the requirements of paragraph (2) of this section 3.01. If a class of Exchange Traded Stock trades on more than one national securities exchange, the contract must specify the single exchange that will be used to value that class of Exchange Traded Stock.

(b) Pursuant to the contract, the parties will utilize the value of each class of Exchange Traded Stock determined under the selected Safe Harbor Valuation Method and Measuring Period in determining the number of shares of each class of Issuing Corporation stock, the amount of money, and any other property (identified by specific value or by specific description) to be exchanged for all of the Target stock, or to be exchanged for each share of Target stock.

(5) The contract terms described in paragraph (4) of this section 3.01 are fulfilled at the Closing Date, in all material respects.

.02 Taxpayers may rely on this revenue procedure if the Closing Date Rule applies to the transaction and the requirements in paragraphs (1), (2), and (3) of this section 3.02 are satisfied:

(1) The requirements in paragraphs (1), (2), and (3) of section 3.01 of this revenue procedure are satisfied.

(2) The transaction is effected pursuant to a contract that is binding on the parties no later than the beginning of the first trading day of the Measuring Period (as defined in section 4.02 of this revenue procedure) selected by the parties, and evidences the parties' agreement as to the matters set forth in paragraph (4) of section 3.01 of this revenue procedure.

(3) The contract items described in paragraph (2) of this section 3.02 are fulfilled at the Closing Date, in all material respects.

SECTION 4. SAFE HARBOR VALUATION METHODS AND MEASURING PERIODS

This section 4 sets forth the Safe Harbor Valuation Methods and the Measuring Periods taxpayers may use to avail themselves of the safe harbor in section 5 of this revenue procedure in determining the value of Exchange Traded Stock. The safe harbor is available only if the transaction satisfies the requirements in section 3 of this revenue procedure, and if the method used to determine the value of the Exchange Traded Stock is a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure that uses the appropriate Measuring Period described in section 4.02 of this revenue procedure.

.01 *Safe Harbor Valuation Methods.*

To avail themselves of the safe harbor provided in section 5 of this revenue procedure, taxpayers may use any of the Safe Harbor Valuation Methods set forth in paragraphs (1), (2), and (3) of this section 4.01 to determine the value of Exchange Traded Stock.

(1) *Average of the Daily Volume Weighted Average Prices.* For each class of Exchange Traded Stock, taxpayers may use the average of the daily volume weighted average prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period (*see* section 4.02 of this revenue procedure).

(2) *Average of the Average High-Low Daily Prices.* For each class of Exchange Traded Stock, taxpayers may use the average of the daily average high-low trading prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period.

(3) *Average of the Daily Closing Prices.* For each class of Exchange Traded Stock, taxpayers may use the average of the daily closing prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period.

.02 Measuring Period.

A Measuring Period is a number of consecutive trading days, based on the trading days of the specified exchange, used in connection with a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure. The Measuring Period used to determine the value of a share of each class of Exchange Traded Stock must include at least five but not more than 35 consecutive trading days.

The Measuring Period must end no later than the Closing Date, if the Closing Date is a trading day on the specified exchange. If the Closing Date is not a trading day, the Measuring Period must end no later than the last trading day before the Closing Date. If the Signing Date Rule applies to the transaction, the Measuring Period must end no earlier than three trading days before the Pre-signing Date. If the Closing Date Rule applies to the transaction, the Measuring Period must end no earlier than three trading days before the Closing Date.

SECTION 5. SAFE HARBOR

If the applicable requirements in section 3 of this revenue procedure are satisfied, the IRS will not challenge the position that, for purposes of determining whether the COI requirement is satisfied, the value of Exchange Traded Stock is determined under the Safe Harbor Valuation Method and Measuring Period selected by the parties. The safe harbor is available regardless of whether the value of Exchange Traded Stock, as determined

under the Safe Harbor Valuation Method and the Measuring Period selected by the parties, satisfies the COI requirement.

SECTION 6. SCOPE AND EFFECT OF REVENUE PROCEDURE

.01 Exclusivity.

The safe harbor set forth in section 5 of this revenue procedure is available solely for purposes of determining whether the COI requirement is satisfied. Further, the safe harbor may be applied only to transactions that satisfy the requirements of section 3 of this revenue procedure and only to determine the value of Exchange Traded Stock under a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure using the appropriate Measuring Period described in section 4.02 of this revenue procedure. No inference should be drawn regarding the application of any federal tax principles outside the scope of this revenue procedure.

.02 Effect of Safe Harbor Not Applying.

If the safe harbor does not apply, this revenue procedure has no effect on the federal tax treatment of the transaction. In such cases, the determination of whether a transaction satisfies the COI requirement will be made under general federal tax principles without regard to the provisions of this revenue procedure.

.03 Private Letter Rulings.

Subject to the provisions of Rev. Proc. 2018-1, 2018-1 I.R.B. 1, and Rev. Proc. 2018-3, 2018-1 I.R.B. 130, the IRS will entertain requests for rulings and determi-

nation letters regarding transactions and legal issues to which the safe harbor does not apply and regarding the applicability of the safe harbor.

SECTION 7. EFFECT ON OTHER DOCUMENTS

This revenue procedure further amplifies Rev. Proc. 77-37, 1977-2 C.B. 568, as amplified by Rev. Proc. 86-42, 1986-2 C.B. 722, and Rev. Proc. 89-50, 1989-35 I.R.B. 12.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective with respect to transactions with an effective date on or after January 23, 2018.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Jean Broderick of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Ms. Broderick at (202) 317-6848 (not a toll-free number).

Section 368. — Definitions relating to corporate reorganizations.

26 CFR 1.368-1(e)(2): Measuring continuity of interest.
Can an average value of the issuing corporation stock be used to determine whether the continuity of Interest requirement is satisfied. See Rev. Proc. 2018-12, page 349.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as “rulings”) that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the sub-

stance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.

PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2017–27 through 2017–52 is in Internal Revenue Bulletin 2017–52, dated December 27, 2017.

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