Office of Chief Counsel
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memorandum

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subject: Determination of Aggregate Foreign Cash Position Under Section 965(c)(3)

This advice may not be used or cited as precedent.

LEGEND

USP =

FC =

DRE =

Date 1 =

Date 2 =

Amount 1 = $

Amount 2 = $

Amount 3 = $

Amount 4 = $

ISSUES

1. Whether, under section 965(c)(3)(F) and Treas. Reg. § 1.965-4,[1] an amount of cash (Amount 1) that was recorded by USP on DRE's accounts as of Date 1 but was no longer included in DRE's cash balance as of Date 2, the final cash measurement date as defined under Treas. Reg. § 1.965-1(f)(24), should be included for purposes of determining USP's aggregate foreign cash position ("AFCP") as defined in section 965(c)(3)(A) because USP failed to provide information or responses sufficient to explain its use of cash to create this difference over the seven-day period.

2. Whether USP is permitted to treat DRE's negative cash balance (Amount 2) with respect to a notional cash pooling program as an accounts payable for purposes of section 965(c)(3)(C), such that it can be used to offset FC's cash position, as defined in section 965(c)(3)(B), and other foreign corporations' cash positions for purposes of determining AFCP.

CONCLUSIONS

1. Under section 965(c)(3)(F) and Treas. Reg. § 1.965-4(b)(1), Amount 1 should be included in USP's AFCP.

2. USP is not allowed to treat the negative cash of Amount 2 as an accounts payable under section 965(c)(3)((C)(ii) and Treas. Reg. § 1.965-1(f)(5) to reduce net accounts receivable under section 965(c)(3)(C). Also, nothing in the statute or the regulations allows cash itself, or cash equivalents, to be reduced by a negative cash amount resulting from a notional cash pooling arrangement. Therefore, Amount 2 should not be permitted to reduce FC's cash position and USP's AFCP.

FACTS

USP, a U.S. corporation, wholly owns FC, a specified foreign corporation ("SFC"), as defined under section 965(e). USP's and FC's U.S. taxable years are fiscal, with the 2018 taxable year ending on Date 2. On Date 1, a date after November 2, 2017, but before Date 2, FC received cash of Amount 1 in repayment of a loan. On Date 1, USP accounted for this cash of Amount 1 in the account of DRE, an entity wholly owned by FC but disregarded as an entity separate from FC. Date 1 was seven days before Date 2.

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[1] Unless otherwise indicated, (i) any reference herein to "section" is to a section of the Internal Revenue Code of 1986, as amended (the "Code"); and (ii) any reference to "Treas. Reg. §" is to a section of the United States Department of the Treasury regulations promulgated under the Code.

As of Date 2, USP no longer included cash of Amount 1 for DRE in its books and records or as a component of USP's AFCP. Rather, the amount recorded as cash for DRE was Amount 2, a negative amount, which USP used to reduce FC's cash position, and thus USP's AFCP. Specifically, in USP's AFCP computation, Amount 2 was used to offset DRE's "cash equivalents." USP explained that Amount 2 resulted in part from a notional cash pooling arrangement FC engaged in with the other foreign entities in USP's group. However, USP has not stated that FC's participation in the cash pooling arrangement accounts for the entire difference between Amount 1 and Amount 2, and it is unclear whether that is the case.

During the examination of USP's 2018 taxable year, USP was asked where cash of Amount 1 was included in the AFCP as of Date 2, and, if it was not included in AFCP, why it was not included. USP, in responding, failed to adequately explain FC's use of cash between Date 1 and Date 2. USP's response is that cash is fungible and FC could have used cash, for example, for business expenses or for a loan to another foreign corporation.

The amount that USP reported as its AFCP was Amount 3.

USP's aggregate section 965(a) inclusion amount was reported by USP as Amount 4.

The sum of Amount 1, Amount 2,[2] and Amount 3 does not exceed Amount 4.

Amount 1 and Amount 2 are 18% and 13%, respectively, of Amount 4.

<u>LAW AND ANALYSIS</u>

<u>LAW</u>

Section 965(a) requires, in the case of the last taxable year of a deferred foreign income corporation ("DFIC") which begins before January 1, 2018, an increase in the subpart F income of such foreign corporation (as otherwise determined for such taxable year under section 952) by the greater of the accumulated post-1986 deferred foreign income (as defined in section 965(d)(2)) of such corporation determined as of November 2, 2017, or as of December 31, 2017.

Section 951(a)(1) requires a United States shareholder, as defined in section 951(b) ("U.S. shareholder"), to include in gross income the amount determined under section 965. Treas. Reg. § 1.965-1(b)(1) generally refers to the amount of the increase to the income of the U.S. shareholder with respect to a DFIC as the section 965(a) inclusion amount.[3]

Section 965(e) defines an SFC to include a controlled foreign corporation.[4]

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[2] Amount 2 is positive for this purpose.

[3] This amount takes into account reductions under section 965(b), Treas. Reg. § 1.965-1(b)(2), and Treas. Reg. § 1.965-8(b), as applicable, but these provisions are not relevant to the issues herein.

The U.S. shareholder with an aggregate section 965(a) inclusion amount from the DFICs it owns is allowed a deduction equal to the sum of (A) the U.S. shareholder's 8 percent rate equivalent percentage of the excess (if any) of—(i) the aggregate section 965(a) inclusion amount, over (ii) the amount of such U.S. shareholder's aggregate foreign cash position ("AFCP"), plus (B) the U.S. shareholder's 15.5 percent rate equivalent percentage of so much of the AFCP as does not exceed the aggregate section 965(a) inclusion amount.[5]

Section 965(c)(3)(A) defines AFCP as the greater of:

(i) the aggregate of the U.S. shareholder's pro rata share of the cash position of each SFC of such U.S. shareholder determined as of the close of the last taxable year of such SFC which begins before January 1, 2018, or

(ii) one half of the sum of—

(I) the aggregate of the U.S. shareholder's pro rata share of the cash position of each SFC of the U.S. shareholder determined as of the close of the last taxable year of each such SFC which ends before November 2, 2017, plus

(II) the aggregate the U.S. shareholder's pro rata share of the cash position of each SFC of such U.S. shareholder determined as of the close of the taxable year of each such SFC which precedes the taxable year described in section 965(c)(3)(ii)(I).[6]

Section 965(c)(3)(B) provides, in relevant part, that the cash position of any SFC is the sum of (i) cash held by such foreign corporation, (ii) the net accounts receivable of such foreign corporation, and (iii) the fair market value of certain cash equivalent assets. Section 965(c)(3)(C) provides that the term net accounts receivable means, with respect to any SFC, 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)(F) provides that if the Secretary determines that a principal purpose of any transaction was to reduce the AFCP, such transaction is disregarded for purposes of section 965(c).

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[4] A controlled foreign corporation is defined in section 957 and includes a foreign corporation wholly owned by a U.S. corporation.

[5] The 8 percent rate equivalent percentage and the 15.5 percent rate equivalent percentage are defined in section 965(c)(2).

[6] The term "final cash measurement date" means, with respect to an SFC, the close of the last taxable year of the SFC that begins before January 1, 2018, and ends on or after November 2, 2017, if any. Treas. Reg. § 1.965-1(f)(24). Here, we are determining whether the AFCP at the final cash measurement date is greater than the amount of the AFCP reported by USP.

Treas. Reg. § 1.965-4(b)(1) provides that a transaction is disregarded for purposes of determining the amounts of all section 965 elements of a U.S. shareholder if each of the following conditions is satisfied with respect to any section 965 element of the U.S. shareholder—

(i) The transaction occurs, in whole or in part, on or after November 2, 2017 (the specified date);
(ii) The transaction is undertaken with a principal purpose of changing the amount of a section 965 element of the U.S. shareholder; and
(iii) The transaction would change the amount of the section 965 element of the U.S. shareholder.

Treas. Reg. § 1.965-4(d)(2) defines a section 965 element to include the AFCP of the U.S. shareholder. Treas. Reg. § 1.965-4(e)(1) provides that there is a change in the amount of a section 965 element of a U.S. shareholder as a result of a transaction if the transaction would reduce the amount of the AFCP of the U.S. shareholder, but only if the AFCP is less than the U.S. shareholder's aggregate section 965(a) inclusion amount.

Treas. Reg. § 1.965-1(f)(5) provides the term accounts payable means payables arising from the purchase of property described in § 1221(a)(1) or § 1221(a)(8) or the receipt of services from vendors or suppliers, provided the payables have a term upon issuance of less than one year.

Section 1221(a)(1) describes property that consists of stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Section 1221(a)(8) describes property that consists of supplies of a type regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.

The preamble to TD 9846 (February 5, 2019) explains that the Treasury Department and the IRS specifically considered notional cash pooling arrangements and chose not to treat such arrangement as creating intercompany receivables for purposes of computing AFCP:

> Comments requested guidance providing that for purposes of computing a section 958(a) U.S. shareholder's aggregate foreign cash position, notional cash pooling arrangements are treated as creating intercompany receivables. The facts and circumstances of each notional cash pool, including the underlying contractual rights and obligations of the parties to the arrangement and the role of the unrelated cash pool provider in the arrangement, are varied. Whether a notional cash pooling arrangement is treated as in substance creating a loan between and among participants, rather than between the participant and the unrelated cash pool provider, depends

> on the application of federal income tax principles to the particular facts and circumstances of the arrangement. Accordingly, the Treasury Department and the IRS do not adopt these comments.

ANALYSIS

Issue 1. As of Date 1, USP included cash of Amount 1 in its general ledger for DRE. As of Date 2, DRE's balance sheet and USP's AFCP reflected cash of less than Amount 1 with respect to DRE. In fact, DRE's cash account reflected a negative Amount 2. In response to requests for information, USP failed to provide information or responses sufficient to explain its use of cash to reduce the cash balance from Amount 1 to Amount 2 over the seven-day period. Date 1 is after November 2, 2017. If this reduction in FC's cash position from Amount 1 to Amount 2 resulted, in whole or in part, from one or more transactions that should be disregarded under Treas. Reg. § 1.965-4, then USP's AFCP should be higher than USP reported.

Section 965(c) provides a deduction for U.S. shareholders based on the amount of the AFCP. Deductions are a matter of legislative grace, and taxpayers bear the burden of proving entitlement to the deduction claimed. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). A taxpayer is required to maintain records sufficient to establish the amount of income and deductions. Section 6001, Treas. Reg. § 1.6001-1(a), (e).

Because USP failed to provide information or responses sufficient to explain the reduction in DRE's cash between Date 1 and Date 2, unless and until USP can meet its burden of proof with respect to its use of cash during that period, the IRS is entitled to infer the reduction in cash resulted from a transaction undertaken with a principal purpose of reducing the AFCP of a U.S. shareholder. Therefore, under section 965(c)(3)(F) and Treas. Reg. § 1.965-4(b)(1), the IRS should disregard the reduction of cash of Amount 1 between Date 1 and Date 2 for purposes of determining USP's AFCP. As such, Amount 1 must be added to USP's AFCP.

Issue 2. DRE's negative cash account is not an account payable under section 965(c)(3)(C)(ii) and Treas. Reg. § 1.965-1(f)(5). In order to be treated as an account payable, an item must arise from the purchase of property described in section 1221(a)(1) or 1221(a)(8) or the receipt of services from vendors or suppliers. A negative cash amount arising from a notional cash pooling arrangement is not any of these items. Accordingly, USP is not allowed to treat the negative cash of Amount 2 as an accounts payable under section 965(c)(3)(C)(ii) and Treas. Reg. § 1.965-1(f)(5) to reduce FC's accounts receivable under section 965(c)(3)(C).

More importantly, USP did not reduce accounts receivable by the negative cash amount. Rather, USP's AFCP computation shows that USP reduced cash equivalents by the negative cash amount. Nothing in the statute or the regulations allows cash itself, or cash equivalents, to be reduced by accounts payable, let alone by a negative cash amount resulting from a notional cash pooling arrangement. *See* section 965(c)(3)(C). Therefore, Amount 2 cannot reduce USP's AFCP.