Summary of Final Temporary Section 245A Regulations

The IRS and Treasury published temporary regulations section 245A that limit the dividends received deduction available for certain dividends received from current or former controlled foreign corporations and limit the applicability of the exception to foreign personal holding company income for certain dividends received by upper-tier controlled foreign corporations from lower-tier controlled foreign corporations. The regulations also contain detailed reporting rules under section 6038, including reporting requirements applicable with respect to transactions that may have occurred in taxable years prior to the publication of the regulations.

The key provisions of the regulations are summarized below.

**Applicability Dates:**

In general, the rules in the temporary regulations relating to eligibility of distributions for the section 245A deduction apply to **distributions occurring after December 31, 2017**. Pursuant to section 7805(b)(1) and (2), the rules in the temporary regulations relating to the eligibility of dividends for the section 954(c)(6) exception also apply to **distributions occurring after December 31, 2017**, subject to the transition rule in §1.245A-5T(f)(3) for determining tiered extraordinary reduction amounts.

**Section 245A**

- **General rules:** The temporary regulations limit the section 245A deduction with respect to certain dividends received by a domestic corporation in connection with specific transactions that facilitate the avoidance of taxation of subpart F income or tested income. In addition, the regulations contain a coordination rule addressing these provisions and hybrid dividends under section
245A(e) and applying similar rules to amounts subject to tax under section 964(e)(4).

- In the case of a dividend received by a domestic corporation from an SFC, the temporary regulations limit the amount of the section 245A deduction to the portion of a dividend not constituting an “ineligible amount.”
  - In particular, a section 245A shareholder is allowed a section 245A deduction for any dividend received from an SFC (provided all other applicable requirements are satisfied) only to the extent that the dividend exceeds the ineligible amount of the dividend.
    - This rule in essence orders E&P ineligible for the 245A deduction before E&P that would be eligible for such deduction.
- The “ineligible amount” is the sum of (i) 50 percent of the portion of a dividend attributable to certain earnings and profits resulting from transactions between related parties during a period after the measurement date under section 965(a)(2) and in which the SFC was a CFC but during which section 951A did not apply to it (referred to as the “extraordinary disposition amount”) and (ii) the portion of a dividend attributable to certain earnings and profits generated during any taxable year ending after December 31, 2017, in which the domestic corporation reduces its ownership of the CFC (referred to as the “extraordinary reduction amount”).

- Extraordinary disposition amount: The deduction is limited to 50 percent of the extraordinary disposition amount, which is the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the section 245A shareholder’s “extraordinary disposition account.”
  - The temporary regulations provide shareholder account rules to ensure that a section 245A shareholder’s extraordinary disposition account is properly tracked and reduced in appropriate cases, including successor rules. In general, this account represents the shareholder’s pro rata share of the SFC’s “extraordinary disposition E&P,” reduced by the section 245A shareholder’s prior extraordinary disposition amounts, if any.
    - Extraordinary disposition E&P is an amount equal to the earnings of an SFC arising from gain recognized by reason of one or more “extraordinary dispositions.”
For a disposition to be an **extraordinary disposition**, the disposition must (i) be of specified property, as any property other than property that produces gross income described in section 951A(c)(2)(A)(i)(I) through (V)), (ii) occur during the SFC’s disqualified period and when the SFC was a CFC, (iii) be outside of the ordinary course of the SFC’s activities, and (iv) be to a related party.

- **Exception:** No dispositions by an SFC are considered to be an extraordinary disposition if they do not exceed a threshold of the lesser of $50 million or 5 percent of the gross value of the SFC’s property.

- **Ordinary Course Transaction:** Facts-and-circumstances rule for determining whether a disposition occurs outside of the ordinary course of an SFC’s activities.
  - The temporary regulations also provide a per se rule that a disposition is treated as outside of the ordinary course of an SFC’s activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or if the disposition is of intangible property.
  - **Important:** It is worth noting that this per se rule could impact planning undertaking by clients utilizing accounting method elections to affect the income of its
CFCs during various periods.

- **Coordination with Disqualified Basis Rules of 951A regulations:** In general, the Treasury Department and the IRS also request comments on whether and how the rules applicable to disqualified basis in proposed §1.951A-2 should be coordinated with §1.245A-5T.

  - **Extraordinary reduction amount:**
    - The preamble provides that these provisions are targeted at transactions relying on the interaction of section 245A and the subpart F and GILTI regimes, which form an integrated set of rules to tax post-2017 foreign earnings, to allow a section 245A deduction for a dividend paid out of earnings and profits attributable to subpart F income or tested income where such dividends, by operation of section 951(a)(2)(B), and could result in double non-taxation of such income.
    - Including in this rule is transactions in which the stock of a CFC is transferred during a CFC’s tax year by a U.S. shareholder to a foreign person where, after the transfer, the CFC remains a CFC but has no U.S. shareholder that owns (within the meaning of section 958(a)) stock of the CFC.
    - The temporary regulations limit the amount of the section 245A deduction allowed to a “controlling section 245A shareholder” with respect to a dividend from a CFC to the portion of the dividend that is paid out of earnings other than the “extraordinary reduction amount.”

- **Controlling section 245A shareholder:** A controlling section 245A shareholder of a CFC is a section 245A shareholder of the CFC that, taking into account ownership of the CFC by certain other persons (such as related persons), owns more than 50 percent of the stock of the CFC.
  - For purposes of applying these rules, a controlling section 245A shareholder also includes any other shareholder who would not otherwise be a controlling section 245A shareholder but acts in concert with the controlling section 245A shareholder.

- For an extraordinary reduction amount to exist with respect to a controlling section 245A shareholder of a CFC, an
“extraordinary reduction” must occur during the CFC’s taxable year with respect to the shareholder’s ownership of the CFC.

- An extraordinary reduction generally occurs when either (i) the controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC (for example, an extraordinary reduction occurs if the shareholder owns 90 percent of the stock of the CFC and it transfers stock representing more than nine percent of the stock of the CFC) or (ii) there is a greater than ten percent change in the controlling section 245A shareholder’s overall ownership of the CFC (for example, if the shareholder owns 90 percent of the stock of the CFC and, as a result of an issuance to a foreign person, the shareholder’s ownership of the CFC is reduced such that it no longer owns at least 81 percent of the stock of the CFC).

- **Extraordinary reduction amount** is earnings and profits representing the amount of dividends paid by the corporation that are attributable to subpart F income or tested income with respect to a CFC, to the extent such subpart F income or tested income (i) would have been taken into account by the controlling section 245A shareholder under section 951 or 951A had the extraordinary reduction not occurred and (ii) is not taken into account by a domestic corporation or a citizen or resident of the United States (that is, a person described in section 7701(a)(30)(A) or (C)).

- **Important Exceptions:**
  - The temporary regulations provide an election under which a controlling section 245A shareholder is not required to reduce its section 245A deduction if it elects (and, in some cases, certain other United States persons also agree) to close the CFC’s taxable year for all purposes of the Code on the date of the extraordinary reduction. The closing of the taxable year of
the CFC results in all U.S. shareholders that own (within the meaning of section 958(a)) stock of the CFC on such date taking into account their pro rata share of subpart F income or tested income earned by the CFC as of that date.

- No amount is considered an extraordinary reduction amount if the sum of the CFC’s subpart F income and tested income for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC’s total income for the year.

Section 954(c)(6)

- **General rule**: The temporary regulations rely on authority under section 954(c)(6)(A) to prevent the section 954(c)(6) exception from applying in cases where a dividend from a lower-tier CFC to an upper-tier CFC would be an extraordinary disposition amount if distributed directly to the section 245A shareholders of the lower-tier CFC.
  
  - In these cases, the section 954(c)(6) exception applies only to the extent that the amount of the dividend exceeds the sum of each section 245A shareholder’s extraordinary disposition account with respect to the lower-tier CFC, divided by the aggregate ownership of all U.S. tax residents of the upper-tier CFC that have section 951(a) inclusions and multiplied by 50 percent.
    - The amount is multiplied by 50 percent in order to provide similar treatment for a dividend received by a section 245A shareholder from a CFC and a dividend received by an upper-tier CFC from a lower-tier CFC.
  
  - Similarly, the temporary regulations apply to limit the amount of any distribution from that CFC out of earnings and profits attributable to subpart F income or tested income that can qualify for the section 954(c)(6) exception in a taxable year in which an extraordinary reduction occurs with respect to the stock of a CFC.
    - Similar to the rules relating to extraordinary disposition amounts, the limitation to the section 954(c)(6) exception with respect to a dividend received by an upper-tier CFC.
Preamble Discussion of the Application of 245A to CFC to CFC Dividends

- Section 245A(a), by its terms, applies only to certain dividends received by “a domestic corporation.” Section 1.952-2, however, which sets forth rules for determining gross income and taxable income of a foreign corporation, provides that for these purposes a foreign corporation is treated as a domestic corporation. See §1.952-2(a)(1) and (b)(1). Accordingly, questions have arisen as to whether §1.952-2 could be interpreted such that a foreign corporation could claim a section 245A deduction despite the statutory restriction in section 245A(a) expressly limiting the deduction to domestic corporations. See H.R. Rep. No. 115-466, at 599, fn. 1486 (2017). The Treasury Department and the IRS intend to address issues related to the application of §1.952-2, taking into account various comments received in connection with the Act, including in connection with the proposed section 951A regulations, in a future guidance project. This guidance will clarify that, in general, any provision that is expressly limited in its application to domestic corporations does not apply to CFCs by reason of §1.952-2. The Treasury Department and the IRS continue to study whether, and to what extent, proposed regulations should be issued that provide that dividends received by a CFC are eligible for a section 245A deduction. The Treasury Department and the IRS have determined, however, that in no case would any person, including a foreign corporation, be allowed a section 245A deduction directly or indirectly for the portion of a dividend paid to a CFC that is not eligible for the section 954(c)(6) exception as a result of these temporary regulations. Permitting the deduction in such a case would undermine the application of the rule that reduces the amount of the dividend eligible for the section 954(c)(6) exception (discussed in Part III.A of this Explanation of Provisions).