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March 2, 2025

Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Via online submission

RE: TEI Comments on Proposed PTEP Regulations [REG–105479–18]

Dear Sir or Madam:

The Internal Revenue Service (the "Service") and U.S. Department of the Treasury ("Treasury"; together with the Service, the "Government") published long awaited proposed regulations regarding previously taxed earnings and profits ("PTEP") of foreign corporations and related basis adjustments on December 2, 2024 (the "Proposed Regulations"). The Government requested stakeholders submit comments on the Proposed Regulations by March 3, 2025. Tax Executives Institute, Inc. ("TEI") is pleased to submit this letter regarding the Proposed Regulations.

About TEI

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in North and South America, EMEA, and Asia. TEI, as the preeminent association of in-house tax professionals worldwide, has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our more than 6,000 individual members represent over 2,800 of the leading companies in the world.

TEI Comments

TEI commends the Government for the well-balanced and helpful Proposed Regulations. The Proposed Regulations answer many longstanding questions regarding earnings and profits of foreign corporations, as well as related basis adjustments, including those arising under Public Law 115-97, colloquially known as the Tax Cuts and Jobs Act ("TCJA"), as well as other legislation. Our comments are therefore limited to preventing double taxation of PTEP under the Proposed Regulations. In particular, we recommend the final PTEP regulations include a mechanism to prevent double taxation arising from the "share-by-share" approach taken by the Proposed Regulations in respect of section 961(b) basis increases.

The Proposed Regulations' "share-by-share" approach to a U.S. shareholder's controlled foreign corporation ("CFC") section 961 basis increases intends to prevent taxpayers from recognizing non-economic losses. While the Proposed Regulations may prevent some instances of non-economic loss recognition, in certain common circumstances they may also result in gain recognition from routine repatriation transactions, resulting in double taxation. This result arises because the Proposed Regulations treat distributions as being made pro-rata across shares under Prop. Treas. Reg. § 1.961-4(b)(2)(i) and (ii). The following example illustrates how the share-by-share approach may cause double taxation.

> <u>Year 1</u>: U.S. corporation ("USH") owns the sole outstanding share of a CFC ("Share 1") with a fair market value and adjusted basis of $50. Assume CFC earns $50 of subpart F income in Year 1 with a corresponding income inclusion, resulting in the same amount of section 959(c)(2) PTEP. USH thus increases its adjusted basis in Share 1 to $100 under section 961(a).
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> <u>Year 2</u>: USH contributes appreciated assets with a FMV of $100 and adjusted basis of $0 to CFC in exchange for 1 share of CFC ("Share 2"), in a tax-free section 351 exchange. USH's basis in Share 2 received in the exchange is $0 under section 358(a)(1). CFC does not recognize any income in Year 2.
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> <u>Year 3</u>: CFC distributes $50 to USH at the end of Year 3. The distribution is attributable to CFC's PTEP with respect to USH and treated for U.S. federal income tax purposes as having been made pro rata on each of the two shares of CFC stock held by USH.
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> <u>Result</u>: The Proposed Regulations allocate PTEP basis to specific shares on a share-by-share basis. However, dividend distributions are pro-rata with respect each class of shares of the foreign corporation owned at the time of the distribution. In this example, a distribution of $50 in year 3 is allocated pro-rata to each share of the CFC. As described above, Share 1 has a $100 basis and Share 2 has a $0 basis. This distribution will reduce PTEP basis in Share 1 by $25, leaving $75 basis in Share 1. But, because there is no basis in Share 2, $25 of the distribution will be treated as section 301(c)(3) capital gain.

The example demonstrates how a routine cash distribution attributable to PTEP already subject to U.S. tax can result in incremental tax for the U.S. shareholder. In other words, a clear case of double taxation. Paradoxically, if the earnings and profits distributed had not previously been subject to U.S. tax, there would be no U.S. tax on the distribution because the section 245A dividends received deduction would apply. Note also that under the Proposed Regulations' there is a $25 non-economic loss persisting in Share 1 under the share-by-share approach.

The Proposed Regulations' approach is contrary to the main purpose of sections 959 and 961 which, as the Regulations' preamble recognizes, is to prevent double taxation of PTEP. The approach also does not eliminate the creation of non-economic losses, which is the stated intent of the share-by-share allocation method. If, however, USH in the above example could utilize $25 of PTEP basis from Share 1 against the $25 PTEP distribution attributable to Share 2, there would be no double taxation.

In contrast, the Proposed Regulations state that preventing double taxation of PTEP with respect to section 961(c) basis of lower tier CFCs is a reason for an aggregate approach. The Preamble indicates: "An aggregate approach to applying positive section 961(c) basis allows positive section 961(c) basis of a transferred unit to be applied to a portion of the covered shareholder's share of the covered gain that is recognized with respect to another transferred unit." Moreover, in other areas of the Code a mechanism exists to alleviate similar issues with respect to distributions, such as the "spill-over" rules for S-Corp distributions.[1]

Accordingly, in the case of an actual or deemed distribution, final regulations should make available adjusted basis for purposes of section 961(b) across all a U.S. shareholder's shares in the distributing corporation at the time of the distribution. This could be achieved by allowing adjusted basis to move from shares that have excess adjusted basis to shares with insufficient adjusted basis (i.e., a "PTEP basis transfer") to the extent a pro-rata distribution would otherwise cause gain recognition under section 961(b). If the PTEP basis transfer suggestion is adopted, in the example above, the taxpayer would first transfer $25 of the Share 1 adjusted basis to Share 2, before recognizing gain, resulting in zero remaining PTEP in both shares, and zero gain. This rule could be adopted by inserting a step between Prop. Treas. Reg. § 1.961-4(b)(2)(ii) and (iii) to provide for a transfer of basis to the extent necessary to prevent gain recognition.

We understand the Government's concern regarding transactions taxpayers may structure to recognize non-economic losses. The proposed mechanism of only transferring basis as and when necessary to prevent gain recognition under section 961(b) is intended to mitigate this concern.

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TEI appreciates the opportunity to comment on the Proposed Regulations. Should you have any questions regarding our comments, please do not hesitate to contact Andreia Verissimo, Chair

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[1] *See* Treas. Reg. 1.1367-1(c)(3). ("Amount Of Decrease In Basis Of Individual Shares. — The basis of a shareholder's share of stock is decreased by an amount equal to the shareholder's pro rata portion of the passthrough items and distributions described in section 1367(a)(2) attributable to that share, determined on a per share, per day basis in accordance with section 1377(a). If the amount attributable to a share exceeds its basis, the excess is applied to reduce (but not below zero) the remaining bases of all other shares of stock in the corporation owned by the shareholder in proportion to the remaining basis of each of those shares.").

of TEI's Task Reform Task Force, at alveriss@amazon.com or Benjamin R. Shreck of TEI's Legal Staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,

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