February 28, 2025

Internal Revenue Service
CC:PA:01:PR (REG-105479-18)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

**Re: National Foreign Trade Council Comments on Previously Taxed Earnings and Profits (REG-105479-18)**

The National Foreign Trade Council (the "NFTC") is writing to provide comments on REG-105479-18 ("Proposed Regulations") regarding previously taxed earnings and profits ("PTEP") of foreign corporations and related basis adjustments released by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on December 2, 2024.

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members support establishing and maintaining international tax norms that provide certainty to enterprises conducting cross-border operations.

**General Comments**

The Proposed Regulations address key complexities surrounding the treatment of PTEP under Sections 959 and 961. PTEP refers to the earnings and profits of a Controlled Foreign Corporation ("CFC") that have already been included in the gross income of a U.S. shareholder under certain provisions, such as Section 951 (Subpart F income) or Section 951A (global intangible low-taxed income ("GILTI")). These amounts are generally excluded from taxation when distributed to the shareholder, provided certain conditions are met, to ensure that the same earnings are not taxed twice. In addition, basis adjustments are provided to ensure that taxpayers are not taxed again on the same earnings when the stock is sold before PTEP is distributed. In general, income inclusions increase the basis of U.S. shareholders in the stock of CFCs, while distributions of PTEP decrease basis, and similar adjustments are provided under Section 961(c) for basis of CFCs in lower-tier CFCs. The PTEP rules have become much more important following the 2017 Tax Cuts and Jobs Act ("TCJA"), which dramatically increased the portion of CFC earnings subject to current U.S. taxation. The Proposed Regulations aim to clarify and modernize PTEP rules as well as provide much-needed guidance on PTEP accounting, basis adjustments, and related statutory provisions, resolving many longstanding questions in this area that have taken on increased significance since 2017.

Notably, the Proposed Regulations introduce significant updates to the PTEP accounting framework, including requirements for detailed tracking of PTEP at both the shareholder and corporate levels. They also include provisions such as the introduction of "derived basis" for partnerships holding CFC stock and clarification that Section 961(c) basis can apply to reduce tested income on the sale by one CFC of the stock of another CFC. However, some provisions may have varying impacts depending on taxpayers' specific circumstances. In particular, and as described in more detail below, some provisions may result in double taxation of the same earnings, which is at odds with the policy underpinnings of Sections 959 and 961.

NFTC members appreciate the opportunity to provide comments on the Proposed Regulations. We urge Treasury to revisit these regulations, as they introduce complexity and additional administrative burdens, potentially resulting in unintended consequences such as double taxation. Furthermore, there may be a risk that some aspects of these regulations diverge from one of the key policy objectives of the TCJA—namely, simplifying the treatment of dividends and facilitating their repatriation to the U.S. Rather than achieving this goal, some aspects might inadvertently introduce additional complexities and challenges for taxpayers, which could, in turn, create unintended constraints on distributions.

**Specific Comments**

*Basis adjustments under Section 961(b)*

The NFTC respectfully recommends that Treasury reconsider the approach to basis adjustments under Section 961(b) to mitigate the potential double taxation of earnings.

Section 961 of the Code provides for adjustments to the basis of CFC stock held by a U.S. shareholder to avoid double taxation. Under Section 961(a), the U.S. shareholder's basis in the stock of a CFC, and any property by reason of which the U.S. shareholder is considered to own (indirectly, within the meaning of Section 958(a)(2)) the stock of the CFC, must be increased by the amount of any inclusion in such U.S. person's gross income under Sections 951 or 951A. Under Section 961(b), the U.S. shareholder's basis in the CFC stock is then reduced by the PTEP distributed by the CFC, with gain recognized to the extent distributions exceed PTEP and contributed basis in the CFC stock.

Under Prop. Regs. §1.961-4(b)(2) and §1.961-3(d)(2)-(3) and (e)(1), the Proposed Regulations provide for basis adjustments to each "ownership unit" through which a U.S. shareholder other than a U.S. partnership (a “covered shareholder”) owns CFC stock. This share-by-share approach prevents PTEP accounts from being maintained for all stock owned by a covered shareholder and PTEP from being blended across shares. However, while the Proposed Regulations may prevent some scenarios of non-economic loss recognition, in certain common circumstances it may also result in gain recognition from routine repatriation transactions. This is because PTEP basis increases are allocated on a share-by-share basis under Prop. Reg. §1.961-4(b)(2)(i) and may result in different basis values, while distributions are treated as having been made pro-rata across shares under Prop. Regs. §1.961-4(b)(2)(i)-(ii) and §1.959-4(d)(4).

Indeed, the following example illustrates how the share-by-share approach included in the proposed regulations can result in double taxation.

> Year 1: A U.S. corporation (“USH”), the sole shareholder, owns the 1 outstanding share of stock of a CFC (“Share 1”) that has a FMV of $50. USH’s basis in its CFC share is $50. In year 1, CFC earns $50 of Subpart F income and has a corresponding income inclusion, resulting in Section 959(c)(2) PTEP. Thus, USH increases its adjusted basis in Share 1 to $100 under Section 961(a).
>
> Year 2: In year 2, USH contributes appreciated assets with a FMV of $100 and with a basis of $0 to CFC in exchange for 1 share of CFC stock (“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 net income in year 2.
>
> Year 3: CFC makes a distribution to USH of $50 at the end of year 3, which 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 2 shares of CFC stock held by USH.

Result: The Proposed Regulations allocate PTEP basis to specific shares, in other words, on a share-by-share basis. However, dividend distributions are made pro-rata with respect to each stock 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 $100 of basis and Share 2 has $0 of basis. This distribution will reduce PTEP basis in Share 1 by $25, leaving $75 basis in Share 1. But, since there is no basis in Share 2, $25 of the distribution will be treated as Section 301(c)(3) capital gain.

As evidenced by the example, in this circumstance, a routine distribution of cash attributable to PTEP which has already been subject to U.S. tax of 21% results in incremental U.S. tax for the 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 imposed on the distribution because the Section 245A dividends received deduction would have applied. Note also that under the approach of the regulations, there is a non-economic loss of $25 that persists in Share 1 as a result of the share-by-share approach.

As the example above demonstrates, the Proposed Regulations are contrary to the main purpose of Sections 959 and 961, which, as the preamble recognizes, is to prevent double taxation of PTEP. It also does not eliminate the creation of non-economic losses, which is the stated intent of the share-by-share allocation.

If, however, the USH in the above example had been able to utilize $25 of the PTEP basis from Share 1 against the $25 distributions of PTEP attributable to Share 2, double taxation would not have resulted.

To note, preventing double taxation of PTEP is recognized in the proposed regulations with respect to Section 961(c) basis of lower tier CFCs. The Preamble itself 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 that exist for S-Corps distributions.[1]

Accordingly, the suggestion here is, in the case of an actual or deemed distribution, to allow adjusted basis to be available for purposes of Section 961(b) across all of a United States 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 those shares that don't have sufficient adjusted basis (*i.e.* '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. §1.961-4(b)(2)(ii) and (iii) to provide for a transfer of basis to the extent necessary to prevent gain recognition.

[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.

We understand Treasury's concern with transactions that may be structured to achieve non-economic losses by taxpayers. 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.

Additionally, to mitigate the tax-compliance burden for U.S. consolidated groups and consistent with policies underlying the PTEP rules, we believe that solely for purposes of determining whether a PTEP distribution gives rise to gain recognition under Section 961(b)(2), the Proposed Regulations should be modified to provide that the consolidated group is treated as a *single* "covered shareholder" for Section 961(a)-(b) purposes and the consolidated group has a *single* combined basis in the stock of each first-tier CFC (*i.e.*, the "consolidated group's" combined "Section 961(a) basis" encompasses all tranches and classes of stock in the CFC owned by all members of the group)[2].

*Section 961(c) Losses*

The NFTC respectfully recommends that the IRS and Treasury reconsider the rules that prevent the use of Section 961(c) basis to offset or reduce Subpart F income or tested income, including gains from the sale of CFC stock. Section 961(c) provides for basis adjustments similar to those provided under Sections 961(a) and (b) to the stock of lower-tier CFCs for the purposes of determining the amount includible in the gross income of the U.S. shareholder upon the sale of such stock. These are referred to in the Proposed Regulations as "Section 961(c) ownership units," which are shares of lower-tier CFC stock directly owned by an upper-tier CFC and indirectly by a covered shareholder. The Proposed Regulations provide rules related to these basis adjustments and preclude positive Section 961(c) basis from creating a loss that reduces Subpart F income or tested income. For example, where a CFC sells several lower-tier CFCs in one taxable year, a Section 961(c) loss, or unused positive Section 961(c) basis, arising from the sale of one CFC may not be used to offset Subpart F income arising from the sale of another CFC. Because Section 961(c) basis results from a prior period income inclusion, the inability to use Section 961(c) basis in this manner would result in a kind of double taxation of the U.S. shareholder on gains from the sale of CFC stock.

Since basis adjustments under Section 961(c) are supposed to apply for purposes of measuring a U.S. shareholder's income under Section 951, we recommend that the final regulations reconsider this limitation and allow any loss arising by virtue of 961(c) basis as a loss for purposes of measuring income under 951, and therefore be allowed to be netted against a covered shareholder's other Section 951 income. Such an approach is consistent with (i) the plain language of Section 961(c), which expressly provides that the basis adjustments under that subsection are for purposes of measuring income under Section 951; (ii) the intent of Section 961(c); and (iii) the proposed CAMT regulations. Furthermore, the policy underlying the allowance of Section 961(c) basis to reduce gain–recognizing that the income underlying the basis has already been subject to U.S. taxation–also supports extending this logic to create losses. The final regulations should adopt an approach as described above, which is consistent with both the text and policy of Section 961.

---

[2] The Proposed Regulations cite *Johnson v. United States*, 435 F.2d 1257 (4th Cir. 1971) in support of a "share-by-share" approach for maintaining PTEP basis. Given the overarching policy objective of facilitating tax-free repatriation of PTEP to the U.S., *Johnson* should be distinguished from a scenario involving a PTEP distribution from a first-tier CFC where adjusted basis could be made available across all of a U.S. shareholder's shares in such CFC to preclude (or limit) gain recognition under Section 961(b)(2). This consideration is particularly relevant where the U.S. shareholder is a member of a U.S. consolidated group, given that Section 1502 rules often diverge from those applicable to other taxpayers (including single corporations). *See*, *e.g.*, current Regs. §§1.1502-34; 1.1502-80 (providing consolidated group rules divergent from rules applicable to other taxpayers).

Moreover, a "basis sharing" approach currently exists in Subchapter S, with policy objectives (and statutory scheme) analogous to the PTEP rules. (*See* Reg. §1.1367-1(c)(3)).

*Negative Section 961(c) Basis*

The NFTC recommends that the IRS and Treasury reconsider the rules that can result in unexpected taxable gain due to "negative" Section 961(c) basis. Indeed, gain may be triggered even in otherwise nonrecognition transactions. For example, the Proposed Regulations state that a tax-free Section 332 liquidation would trigger any gain from negative Section 961(c) basis, whereas similar transactions in a consolidated context under the excess loss account rules do not result in taxation.

In addition, it is important to note that by allowing a negative basis under Section 961(c) and creating a new type of gain related to such negative Section 961(c) basis that is neither Subpart F nor tested income, Treasury has drafted rules for Section 961(c) that go beyond the provision of basis adjustments "similar" to those provided under the rules in Sections 961(a) and (b) and, as a result, the rules appear to exceed Treasury's authority under Section 961(c).

Furthermore, beyond the fact that the rules differ from those of these Sections, several adjustments should be considered regarding covered distributions and the Section 961(c) basis. First, a U.S. shareholder should be allowed to reduce their basis in another Section 961(c) ownership unit (*i.e.*, another CFC stock at a lower tier) in order to limit the appreciation recognized under Section 961(c). Second, regarding the transition rules for reconstituting the Section 961(c) basis, it would be preferable for taxpayers to begin with a Section 961(c) basis of zero rather than retroactively applying negative basis concepts. Third, a covered distribution should include an amount treated as a dividend by reason of Section 78. By excluding the Section 78 gross-up from the definition of a covered distribution, the Proposed Regulations result in double taxation on PTEP in certain fact patterns due to withholding taxes paid as part of the distribution.

The NFTC recommends that the final regulations take these elements into consideration and reconsider rules providing for gain in these circumstances. At the very least, it would be useful to consider extending the example relating to this part in example (7)(i) of Prop. Reg. Sec. §1.961-12(c)(7) to provide greater clarity on the potential tax consequences under the Proposed Regulations and thus illustrate both the gain recognition under Prop. Reg. §1.961-10(c)(1) related to negative "Section 961(c) basis" (resulting in an overall gain of £2.5x) and the concurrent transaction referenced in Prop. Reg. §1.961-10(c)(4), which appears to result in an overall loss of £2x. The updated example should also indicate that the attributes (*e.g.*, character and sourcing) of the £2x loss and the £2.5x "Section 961(c) gain" would match (*i.e.*, they would offset each other to the extent thereof).

*Other Consequences of Changes to Section 961(c)*

As background, Section 965 imposes a transition tax on the untaxed foreign earnings of specified foreign corporations that are deferred foreign income corporations ("DFIC"). Under Section 965(b), a taxpayer that is a U.S. shareholder of at least one DFIC and at least one E&P deficit foreign corporation may reduce the amount it would otherwise be required to include in gross income under Section 951(a)(1) by the amount of the aggregate foreign E&P deficit allocable to each DFIC. Because Section 965(b)(4)(A) limits the treatment of such offset (*i.e.*, the aggregate foreign E&P deficit allocable to a DFIC) as PTEP to the application of Section 959, Section 965(b) PTEP does not give rise to a basis increase under Section 961(a).

The proposed changes to Section 961(c) could have a significant impact on taxpayers that still have Section 965(b) PTEP, especially those who did not make the basis election under Reg. §1.965-2(f)(2). Since Section 965(b) PTEP has no basis, taxpayers could now face a 21% tax on distributions of earnings between CFCs, even though such PTEP arose from E&P deficits previously used to offset earnings that were subject to the lower tax rates under the transition tax in Section 965 (set at 15.5% or 8%). Adding to

the challenge, the ordering rules require Section 965(b) PTEP to be distributed before other attributes (other than Section 965(a) PTEP), making the issue even more pressing. Under the current framework, this basis analysis only comes into play when distributions are made to the U.S., which helps reduce compliance burdens. The NFTC recommends that the final regulations should take these elements into consideration and adjust them accordingly.

Similar to the comment above relating to Section 961(b) basis adjustments, we believe that solely for purposes of determining whether a PTEP distribution gives rise to gain recognition under Section 961(b)(2) principles, the Proposed Regulations should be modified to provide that a consolidated group has a single combined "Section 961(c) basis" in the stock of each lower-tier CFC (*i.e.*, the "consolidated group's" combined "Section 961(c) basis" encompasses all tranches and classes of stock in the CFC indirectly owned by all members of the group). This would mitigate the tax-compliance burden for U.S. consolidated groups and is consistent with the policies underlying Section 961(c), which requires basis adjustments "similar to" those made under Sections 961(a) and (b).

Finally, it would be helpful if the IRS and Treasury could confirm that Section 961(c) applies to PTEP distributions from a "specified foreign corporation" (that is *not* a CFC) to its CFC shareholder. This confirmation would ensure the rule is consistent with Prop. Reg. §1.959-4(b)(2)(ii).

*Request for Further Clarification*

NFTC suggests expanding the example in Prop. Reg. §1.961-12(c)(7) Example (7)(i) to provide additional clarity on the potential tax consequences under the Proposed Regulations. Specifically, including a discussion of income inclusions and Section 961(a) basis adjustments for each covered shareholder would provide valuable guidance. Additionally, we would appreciate confirmation in the example that the overall income inclusion of £0.5x is allocated between US1 and US2, leading to a corresponding increase in "Section 961(a) basis."

Additionally, some points are not addressed in the Proposed Regulation. We request that Treasury specify the rules concerning Section 304 transactions (as provided in Section 304(b)(6)) and other similar transactions and allow PTEP basis transfer in these cases.

Finally, the Proposed Regulations state that once finalized, taxpayers may elect to apply them beginning in an earlier taxable year, provided they maintain consistency and that the taxable year and all subsequent years remain open. However, if finalization is delayed, some taxable years may close, which could lead to uncertainty and potential disputes over how the rules should be applied. Given this concern, the IRS and Treasury should consider issuing a notice allowing taxpayers to early adopt and rely on the Proposed Regulations for prior periods. This would provide much-needed certainty and help ensure a consistent and predictable application of the regulations.

**Conclusion**

Thank you for your consideration of our comments. We are happy to answer any questions or clarify any of the comments raised.