



## United States Tax Alert

### Temporary and Proposed Regulations Address Covered Asset Acquisitions under Section 901(m)

On December 7, 2016, the U.S. Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) published temporary regulations (T.D. 9800, the “Temporary Regulations”) and proposed regulations (REG-129128-14, the “Proposed Regulations”) under section 901(m) with respect to transactions that may give rise to a basis increase under U.S. law, but not under foreign law. The Temporary Regulations include the regulations previously announced in Notice 2014-44 and Notice 2014-45, without significant modification ([see U.S. Tax Alert dated July 23, 2014](#) and the discussion below in the Notice 2014-44 and Notice 2014-45 section). In general, the Temporary Regulations have retroactive effect as of July 21, 2014 in accordance with Notice 2014-44.<sup>1</sup> **The Temporary Regulations also contain an important provision, not found in the Notices, that excludes gross basis withholding taxes from the definition of foreign income taxes for purposes of section 901(m).**<sup>2</sup> Additional observations on the Temporary Regulations are noted below in the Temporary Regulations section.

The Proposed Regulations expand the scope of section 901(m), provide rules for computing the disqualified portion of foreign income taxes under section 901(m), and contain de minimis and anti-abuse rules. Importantly, the Proposed Regulations permit taxpayers to make a “foreign basis election” to calculate basis difference by reference to the difference between U.S. and foreign basis immediately after a covered asset acquisition (“CAA”).<sup>3</sup> The Proposed Regulations are generally effective only with respect to

CAAs occurring on or after the date the Proposed Regulations are finalized; however, the Proposed Regulations provide that a taxpayer may rely on the Proposed Regulations prior to finalization so long as certain consistency requirements are met.<sup>4</sup> These consistency requirements generally require that all related persons consistently apply most provisions of the Proposed Regulations to CAAs occurring on or after January 1, 2011, and to the three new CAAs described below occurring on or after December 7, 2016.<sup>5</sup> **This consistency rule may have the effect of forcing taxpayers to retrospectively apply most of the Proposed Regulations to CAAs occurring on or after January 1, 2011, so as to be able to apply the taxpayer-favorable provisions of the Proposed Regulations (such as the foreign basis election and the de minimis exceptions) to CAAs occurring before the Proposed Regulations are finalized.** Whether retroactive application of the Proposed Regulations is feasible (such as in the case of tax years for which the assessment statute has expired) may raise difficult procedural issues.

## Notice 2014-44 and Notice 2014-45

Notice 2014-44 and Notice 2014-45 were issued in response to certain taxpayers engaging in transactions shortly after a CAA with the intention of invoking the statutory disposition rule under section 901(m)(3)(B)(ii) to avoid the purposes of section 901(m). For example, taxpayers were taking the position that a transfer of relevant foreign assets ("RFAs") that was not subject to U.S. tax was a "disposition" for purposes of section 901(m). As a result, the entire amount of basis difference with respect to the RFAs would be taken into account in the year of the disposition, even though a difference between the U.S. and foreign basis of the RFAs still existed after the transfer. Notice 2014-44 provided a definition for "disposition," rules for determining the portion of basis difference that would be taken into account upon a disposition of an RFA, (the "disposition amount"), and also described the computation of basis difference and the disposition amount with respect to an RFA that was subject to a CAA described under section 901(m)(2)(C) (a "743(b) CAA"). Notice 2014-44 provided that these rules would apply to (i) dispositions occurring on or after July 21, 2014; (ii) section 743(b) CAAs occurring on or after July 21, 2014 (unless a taxpayer consistently applied those provisions to all section 743(b) CAAs occurring on or after January 1, 2011); (iii) remaining basis difference with respect to an RFA as of July 21, 2014; and (iv) basis difference with respect to an RFA that arises in a CAA occurring on or after July 21, 2014. Notice 2014-45 provided that the rules described in Notice 2014-44 would apply to determine the tax consequences under section 901(m) of an entity classification election filed on or after July 29, 2014 that has an effective date of July 21, 2014 or earlier.

## Temporary Regulations

As discussed above, the Temporary Regulations include the regulations announced in Notice 2014-44 and Notice 2014-45, without significant modification. In addition to the provisions discussed above, the Temporary Regulations provide:

- That the foreign and U.S. gain or loss for purposes of determining the amount of basis difference taken into account on a disposition of an RFA includes gains that are deferred or otherwise not taken into account currently, and losses that are deferred, disallowed, or otherwise not taken into account currently;<sup>6</sup> and

- Additional clarification regarding the continued application of section 901(m) to any unallocated basis difference with respect to an RFA after there is a transfer of the RFA for U.S. income tax purposes (a “successor transaction”), including that:
  - A successor transaction may occur, regardless of whether the transfer of the RFA is a disposition, a CAA, or a non-taxable transaction for U.S. income tax purposes;<sup>7</sup>
  - An RFA may be the subject of multiple CAAs if a successor transaction is also a CAA;<sup>8</sup> and
  - An asset received in exchange for an RFA does not become an RFA solely because the U.S. basis of the asset is determined by reference to the U.S. basis of the RFA.<sup>9</sup>

## Proposed Regulations

The Proposed Regulations include:

- Three new CAAs:
  - An acquisition of assets for U.S. income tax purposes that is treated as an acquisition of an interest in a fiscally transparent entity for foreign income tax purposes;<sup>10</sup>
  - A distribution by a partnership of one or more assets (i) the U.S. basis of which is determined by section 732(b) or 732(d), or (ii) which causes the U.S. basis of the partnership’s remaining assets to be adjusted under section 743(b), but only if the transaction results in an increase in the U.S. basis of one or more of the assets distributed by the partnership or retained by the partnership, without a corresponding increase in the foreign basis of such assets;<sup>11</sup> and
  - An acquisition of assets for both U.S. and foreign income tax purposes, but only if the transaction results in an increase in the U.S. basis without a corresponding increase in the foreign basis of one or more assets.<sup>12</sup>
- Rules for identifying assets that are RFAs (but no special rules are provided for RFAs such as goodwill and going concern value that generate income in multiple jurisdictions);<sup>13</sup>
- Computational rules (described in more detail below) related to the calculation of the disqualified portion, and rules for determining whether, and to what extent, basis difference is assigned to a taxable year and carried over to subsequent taxable years;<sup>14</sup>
- Rules for determining the basis difference with respect to an RFA;<sup>15</sup>
- Rules for taking into account basis difference under an applicable cost recovery method or as result of a disposition of an RFA, and allocating the basis difference to one or more persons subject to section 901(m);<sup>16</sup>
- Successor rules for applying section 901(m) to transfers of RFAs that have basis difference that has not yet been fully taken into account;<sup>17</sup>
- De minimis rules under which certain basis differences are not taken into account under section 901(m);<sup>18</sup> and

- Anti-abuse rules related to built-in losses, and guidance on the application of section 901(m) to pre-1987 foreign income taxes.<sup>19</sup>

Key details regarding Proposed Regulations include the following:

- There is an anti-avoidance rule targeted at transactions effectuated with a principal purpose of avoiding section 901(m) that convert assets that are not RFAs at the time of a CAA into assets that are RFAs, and a deemed principal purpose with respect to assets that become RFAs within one year following the CAA.<sup>20</sup>
- Modifications have been made to the calculation of the disqualified portion of a foreign income tax (referred to as the “disqualified tax amount” in the Proposed Regulations), which generally include:
  - A limitation of the disqualified tax amount to the lesser of the “tentative disqualified tax amount” or the foreign income tax for the year;<sup>21</sup>
  - The tentative disqualified tax amount is generally calculated as the foreign income tax (the “multiplicand”) for the year multiplied by the “disqualified ratio,” the numerator of which is the sum of the portion of the basis difference for all RFAs taken into account and assigned to the year (the “aggregate basis difference”), and the denominator of which is the portion of foreign income reflected on a foreign tax return that relates to the foreign income tax included in the multiplicand (the “allocable foreign income”);<sup>22</sup>
  - To reduce administrative burden, the Proposed Regulations provide that allocable foreign income and the foreign income tax for the year are determined using the total of those amounts on the foreign income tax return, rather than those amounts as determined only with respect to the RFAs;<sup>23</sup>
  - The multiplicand is increased by any foreign country creditable taxes (“FCCTs”) for the year,<sup>24</sup> which refer to any foreign income taxes imposed by another foreign country that were allowed as a credit to reduce the foreign income tax amount.<sup>25</sup>
- If the disqualified tax amount for a taxable year is either zero or is limited by the amount of foreign income tax in a particular U.S. tax year, the Proposed Regulations provide for a carryover of a specified amount of basis difference to the next taxable year.<sup>26</sup> This carryover provision is important where foreign tax accrues in a U.S. tax year after the aggregate basis difference is taken into account (e.g., due to a difference in tax years for U.S. and foreign tax purposes).
- The Proposed Regulations provide for the allocation of items relevant to the computation of the disqualified tax amount among the “901(m) payor,” “foreign payor,” “RFA owner (U.S.),” “RFA owner (foreign),” when such persons or a combination of such persons are different.
- The de minimis exemptions provided in Prop. Reg. §1.901(m)-7 are lower when the CAA occurs between related parties, and there is an anti-abuse provision that would deny application of the de minimis exemptions between related parties that are entered into or structured with a principal purpose of avoiding the application of section 901(m).

- Finally, there is an anti-abuse rule that would apply to disregard an RFA with a built-in loss to the extent it relates to any asset acquisition structured with a principal purpose to use that RFA to avoid the application of section 901(m).<sup>27</sup>

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<sup>1</sup> See Notice 2014-44 (2014-32 I.R.B. 270) and Treas. Reg. §§ 1.901(m)-1T(b), -2T(f), -4T(e) and (g), -5T(i), and -6T(d).

<sup>2</sup> Treas. Reg. § 1.901(m)-1T(a)(21).

<sup>3</sup> See Prop. Reg. § 1.901(m)-4(c).

<sup>4</sup> See Prop. Reg. §§ 1.901-1(b), -2(f), -3(d), -4(g), -5(i), -6(d), -7(g), and -8(d).

<sup>5</sup> *Id.*

<sup>6</sup> See Treas. Reg. § 1.901(m)-1T(a)(18), (19), (43), and (44).

<sup>7</sup> Treas. Reg. § 1.901(m)-6T(b)(2).

<sup>8</sup> Treas. Reg. § 1.901(m)-6T(b)(4).

<sup>9</sup> 81 Fed. Reg. 88106 (December 7, 2016).

<sup>10</sup> Prop. Reg. § 1.901(m)-2(b)(4).

<sup>11</sup> Prop. Reg. § 1.901(m)-2(b)(5).

<sup>12</sup> Prop. Reg. § 1.901(m)-2(b)(6).

<sup>13</sup> See generally Prop. Reg. § 1.901(m)-2.

<sup>14</sup> See generally Prop. Reg. § 1.901(m)-3.

<sup>15</sup> See generally Prop. Reg. § 1.901(m)-4.

<sup>16</sup> See generally Prop. Reg. § 1.901(m)-5.

<sup>17</sup> See generally Prop. Reg. § 1.901(m)-6.

<sup>18</sup> See generally Prop. Reg. § 1.901(m)-7.

<sup>19</sup> See generally Prop. Reg. § 1.901(m)-8.

<sup>20</sup> Prop. Reg. § 1.901(m)-2(c)(3).

<sup>21</sup> Prop. Reg. § 1.901(m)-3(b)(2)(i).

<sup>22</sup> Prop. Reg. § 1.901(m)-3(b)(2)(ii).

<sup>23</sup> 81 Fed. Reg. 88565 (December 7, 2016).

<sup>24</sup> Prop. Reg. § 1.901(m)-3(b)(2)(ii)(A)(1).

<sup>25</sup> Prop. Reg. § 1.901(m)-1(a)(1)(17).

<sup>26</sup> Prop. Reg. § 1.901(m)-3(c)(1).

<sup>27</sup> Prop. Reg. § 1.901(m)-8(c).

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