On November 3, 2016, the Internal Revenue Service ("IRS") and U.S. Department of the Treasury issued final subpart F regulations (the “Final Regulations”) addressing sections 954 and 956.1 The regulations generally adopt, with amendments, the temporary and proposed regulations that were issued on September 1, 2015.2 Along with the Final Regulations the IRS and Treasury issued additional proposed section 956 regulations.3

Structures Impacted

The following typical transactions and structures are impacted by the Final Regulations:

- Controlled foreign corporations ("CFCs") that are partners in partnerships that acquire U.S. property and make loans to, or guarantee debt of, related U.S. persons
- Taxpayers relying on the outside basis limitation for purposes of determining the amount of U.S. property held by a CFC indirectly through a partnership in accordance with Rev. Rul. 90-112
- CFCs that make loans to domestic or foreign partnerships with related partners
- CFCs that engage in related party factoring transactions
- Taxpayers that rely on the activities conducted pursuant to a cost sharing agreement to meet the "developer exception" and "active marketing exception" under Treas. Reg. §1.954-2

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1 T.D. 9792, 81 FR 76497 (Nov. 3, 2016).
3 REG-114734-16, 81 FR 76542 (Nov. 3, 2016) (the "2016 Proposed Regulations").
Key Considerations

Changes to Section 954(c) Active Trade or Business Exception

The Final Regulations finalize the changes in the Temporary Regulations regarding the developer exceptions and active marketing exceptions under Treas. Reg. §1.954-2(c) (for rents) and Treas. Reg. §1.954-2(d) (for royalties) that address, among other things, cost sharing transaction (CST) payments and platform contribution transaction (PCT) payments. (Please see the United States Tax Alert dated September 4, 2015 explaining the 2015 Temporary Regulations and 2015 Proposed Regulations. )

Section 956 Anti-abuse

In General

The Final Regulations expand the scope of the section 956 anti-abuse rule (addressing the funding by a CFC of a certain related parties followed by such party acquiring U.S. property). In particular and consistent with the temporary regulations, the anti-abuse rule now applies if the CFC funds a controlled partnership.4 In addition, the anti-abuse rule extends to cases where the funding that was done for section 956-avoidance purposes was funding "by any means" (i.e., funding through a means other than capital contributions or debt).5

Limitations to the Scope of the Anti-Abuse Rule

The Final Regulations include examples illustrating that sales of property for cash in the ordinary course of business or a repayment of a note are not subject to the anti-abuse rule.6 In addition, the Final Regulations expand the coordination rule preventing a CFC from being treated as holding duplicative amounts of United States property by reason of the anti-abuse rule of Treas. Reg. §1. 956-1(b)(4) and attribution rules of Treas. Reg. §1.956-4(b) or (c) (see below).7

Assets (Including Obligations) Held by a Partnership

The Final Regulations provide that the amount of section 956 property attributed to a CFC partner from a partnership is determined by reference to the partner's "liquidation value percentage."8 The Final Regulations retain the rule that applies the liquidation value percentage taking into account special allocations.9 However, this provision does not apply if a principal purpose of the special allocation is to avoid the

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4 Treas. Reg. §1.956-1(b)(1)(ii) and (iii).
5 Id.
7 Treas. Reg. §1.956-1(b)(3).
8 Treas. Reg. §1.956-4(b). In general, this percentage is based on a partner's relative rights to cash upon a hypothetical partnership liquidation.
application of section 956. Further, the preamble clarifies that section 704(c) is not a special allocation.

It is important to note that the IRS and Treasury also proposed a new regulation that would eliminate the ability take into account special allocations when applying the liquidation value method with respect to any partner that controls the partnership.

Under the 2015 Proposed Regulations, a partner’s liquidation value percentage is determined upon formation and upon a revaluation event. The Final Regulations retain these provisions but add an additional rule whereby if the liquidation value percentage determined for any partner on the first day of the partnership’s taxable year would differ from the most recently determined liquidation value percentage of that partner by more than 10 percentage points, then the liquidation value percentage must be redetermined. For example, as explained in the preamble, if the liquidation value percentage of a partner was determined upon a revaluation event to be 40 percent and, on the first day of a subsequent year before the occurrence of another revaluation event, the liquidation value percentage would be less than 30 percent or more than 50 percent if redetermined on that day, then the liquidation value percentage must be redetermined on that day.

Under the Final Regulations, the amount of a partnership’s U.S. property that is attributed to its partners is based upon the partnership's basis in such property. Rev. Rul. 90-112, which limited the amount of U.S. property attributed to the partner to its outside basis in the partnership, is obsolete as of November 3, 2016. Accordingly, taxpayers no longer can rely on outside basis to limit the amount of U.S. property held by a CFC indirectly through a partnership.

Obligations of a partnership

In General

The Final Regulations treat the obligation of a foreign partnership as an obligation of its partners. The Final Regulations attribute the obligations of a foreign partnership to its partners by reference to the partner's Liquidation Value Percentage (discussed above). This is a change from the 2015 Proposed Regulations, which attributed obligations of a partnership based upon a partner's interest in profits.

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10 Id.
11 See the preamble to TD 9792 (“the Preamble”), Section 4.D “Special Allocations,” 81 FR at 76500-501.
12 Prop. Reg. §1.956-4(b)(2)(iii) and (3) Examples 2-4.
15 See the Preamble, Section 4.C “Time for determining the liquidation value percentage” 81 FR at 76500.
16 Treas. Reg. §1.956-4(b)(1)
17 See the Preamble, “Effect on Other Documents,” 81 FR at 76504.
18 Treas. Reg. §1.956-4(c)(1).
19 Former Prop. Reg. § 1.956-4(c)(1).
Consistent with the 2015 Proposed Regulations, the Final Regulations provide an exception to this general rule where neither the CFC that holds (or is treated as holding) the obligation nor any person related to such CFC (within the meaning of section 954(d)(3)) is a partner in the partnership on the CFC's quarterly measuring date under section 956.20

The Final Regulations also provide that an obligation of a domestic partnership is treated as an obligation of a United States person.21

**Anti-Abuse Distribution Rule**

In addition, the Final Regulations include a special funded distribution rule which applies where a CFC makes a loan to a partnership and the partnership makes a distribution to a partner (who is related to the CFC within the meaning of section 954(d)(3)) whose obligation would be treated as U.S. property if held by the CFC, if the partnership would not have made the distribution but for the funding of the partnership.22 In such a case, the partner's share of the partnership's obligation is the greater of (i) its share under the Liquidation Value Percentage method or (ii) the lesser of the amount of the distribution that would not have been distributed but for the funding and the amount of the obligation.23

The Final Regulations add a new rule that provides that a partnership is treated as if it would not have made the distribution but for the funding of the partnership by a related CFC to the extent that, immediately before the distribution, the partnership does not have sufficient liquid assets to make the distribution without taking the obligations into account.24

**Guarantees**

The Final Regulations finalize rules addressing pledges and guarantees of a partnership.25 However, the preamble declined to provide a rule to protect a U.S. person from multiple section 956 inclusions with regard to the same loan, where multiple CFCs serve as pledgors or guarantors with regard to the same section 956 loan.26 The preamble states that Treasury and the IRS continue to study the issue.

**Factoring Transactions**

The Final Regulations finalize the 1988 and 2015 temporary regulations under Treas. Reg. §1.956-3 addressing various factoring transactions. The Final Regulations provide rules for treating indirect acquisitions of

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20 Treas. Reg. §1.956-4(c)(2).
21 Treas. Reg. §1.956-4(e).
22 Treas. Reg. §1.956-4(c)(3).
23 Id.
25 Treas. Reg. §1.956-2(c).
26 See the Preamble, Section 6 "Comments concerning multiple inclusions," 81 FR at 76503.
trade or service receivables as acquired by a CFC.\textsuperscript{27} The Final Regulations also treat a CFC as acquiring the trade or service receivable of a related U.S. person where unrelated parties engage in swap or pooling arrangements such that the parties engage in reciprocal acquisitions of the trade or service receivable from an unrelated U.S. person that is a party to the arrangement.\textsuperscript{28}

A CFC is also treated as indirectly acquiring the trade or service receivable from a related U.S. person where the CFC participates in a lending transaction that results in (i) a loan to a U.S. person who purchases inventory property or services from a related U.S. person or (ii) the purchases of trade or service receivables from a related U.S. person, if the loan would not have been made or maintained on the same terms but for the corresponding purchase.\textsuperscript{29} The amount of the U.S. property is the lesser of the amount of the loan and the purchase price.\textsuperscript{30}

**Effective Dates**

All but four rules apply with respect to obligations, guarantees or property acquired after September 1, 2015. For these items, the CFC becomes subject to the rules for any taxable year that ends on or after November 3, 2016.

The rules with different effective dates are:

1. Changes to the "developer exceptions” and "active marketing exceptions,” which generally apply beginning September 1, 2015
2. The rule providing that an obligation of a domestic partnership is an obligation of a US person, which applies to property acquired after November 3, 2016
4. The rules that attribute property held by a partnership that is attributed to its partners under Treas. Reg. §1.956-4(b) only apply to a CFC’s taxable year that ends on or after November 3, 2016 with regard to property acquired on or after November 3, 2016. Former Treas. Reg. §1.956-3(a)(3) applies for taxable years of a CFC prior to this date.

The 2016 Proposed Regulations addressing special allocations under the Liquidation Value Method are only effective with respect to taxable years of a CFC ending on or after the publication of the final rule adopting the proposed regulation with respect to property acquired on or after such date.\textsuperscript{31}

\textsuperscript{27} Treas. Reg. §1.956-3(b)(2).
\textsuperscript{28} Treas. Reg. §1.956-3(b)(2)(iii).
\textsuperscript{29} Treas. Reg. §1.956-3(b)(2)(iv).
\textsuperscript{30} Id.
\textsuperscript{31} Prop. Reg. §1.956-4(f)(1).