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memorandum

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subject: Application of Section 269 and Temp. Treas. Reg. § 1.245A-5T To GILTI Avoidance Transaction

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

Legend

US Parent	=	
US Sub	=	
US Group	=	US consolidated group which US Parent is the common parent
Corporation Y	=	
Company Z/ Corporation Z	=	
CTB Election	=	Election for company Z to be treated as an association Taxed as corporation for Federal income tax , effective as of December 30, 2017
Country A	=	
Country B	=	

Z Products	=	products
$W	=	$Z less the amount of the Sub F PTEP
$X	=	Amount of net gain with respect to the Intercompany Sales
$Y	=	Gross value of property that Corporation Z owned for Federal income tax purposes immediately after the CTB Election
$Z	=	Amount of the 2018 Dividend
Gap Period	=	January 1, 2018, through November 30, 2018
Gap Income	=	Income earned by Corporation Z from its sales of Z Products to Corporation Y, and also potentially to certain other related persons
Intercompany Sales	=	Sales by Corporation Z of Z products to Corporation Y, and also potentially to certain other related persons, during the Gap Period
2018 Sub F Income	=	Subpart F income earned by Corporation Z during the Gap Period from sources other than the Intercompany Sales
2018 Dividend	=	Dividend of $Z paid by Corporation Z to Corporation Y at the end of Corporation Z's taxable year reported as ending November 30, 2018
Sub F PTEP	=	Previously taxed E&P associated with the 2018 Sub F Income

I. <u>Issues</u>

Issue 1: Whether section 269: (1) applies with respect to the deemed incorporation of Corporation Z resulting from the CTB Election; and (2) permits the IRS to disallow the section 898(c)(2) election of a taxable year ending November 30, 2018, made with respect to Corporation Z or provide for the allocation of the Gap Income to Corporation Y, in either case to achieve the effect of disallowing the claimed exclusion of Corporation Z's income for the first eleven months of 2018 from US Sub's GILTI calculation.

Issue 2: In the alternative, whether Temp. Treas. Reg. § 1.245A-5T applies with respect to the Intercompany Sales and the 2018 Dividend.

II. <u>Conclusions</u>

Issue 1: Yes, based on the facts presented, section 269 applies with respect to the deemed incorporation of Corporation Z. Pursuant to section 269, the Commissioner may either disallow the section 898(c)(2) election made with respect to Corporation Z for the initial taxable year to which such election purportedly applies or allocate the Gap Income to Corporation Y, which in either case disallows the claimed exclusion of

Corporation Z income for the first eleven months of 2018 from the US Sub's GILTI calculation.

Issue 2: Yes, in the alternative, based on the facts presented, Temp. Treas. Reg. § 1.245A-5T applies with respect to the Intercompany Sales and the 2018 Dividend and would disallow the application of section 954(c)(6) to an amount of the 2018 Dividend equal to (50% * $W). Accordingly, Corporation Y's subpart F Income would be increased by that amount for its 2018 taxable year.

III. Statement of Facts

("**US Parent**"), a domestic corporation, is a calendar-year taxpayer for Federal income tax purposes and is the parent entity for a multinational operating business. US Parent is also the common parent of a US consolidated group for Federal income tax purposes (the "**US Group**"). One member of the US Group is . ("**US Sub**"). US Parent directly or indirectly wholly owns US Sub. US Sub owns, within the meaning of section 958(a), 100% of the shares of ("**Corporation Y**"), a foreign corporation organized in ("**Country A**").

Corporation Y is a calendar-year taxpayer for Federal income tax purposes. Corporation Y is in the business of selling certain products. Corporation Y wholly owned ("**Company Z**"), an entity organized in ("Country B") that was disregarded as an entity separate from its owner for Federal income tax purposes before December 30, 2017. In Corporation Y's taxable years ending December 31, 2017, and December 31, 2018, Corporation Y purchased certain products (the "**Z Products**") from Company Z that Corporation Y then on-sold. When Company Z was disregarded as an entity separate from its owner, these intercompany purchases of Z Products were disregarded for Federal income tax purposes.[1]

For its taxable year ending December 31, 2017, US Sub was required to include an amount in income under section 951(a)(1) by reason of section 965.

In March 2018, an election under Treas. Reg. § 301.7701-3(c)(1)(i) was made for Company Z to be treated as an association taxed as a corporation for Federal income tax purposes, effective as of December 30, 2017 (the "**CTB Election**," and Company Z at all times when treated as an association taxed as a corporation for Federal income tax purposes, "**Corporation Z**"). The US Group reported the CTB Election as a tax-free

1 Corporation Y may engage in other activities, and owns other entities disregarded as separate from Corporation Y for Federal income tax purposes. These activities and other entities are not relevant to this legal analysis and so are omitted for simplicity.

section 351 transfer by Corporation Y to Corporation Z of all of the assets and liabilities of Company Z in exchange for stock of Corporation Z. The gross value of property that Corporation Z owned for Federal income tax purposes immediately after the CTB Election was $Y. As a newly formed corporation, Corporation Z had earnings and profits ("**E&P**") of $0 upon its deemed incorporation.

Corporation Z purported to elect to adopt, for its first taxable year as an association taxed as a corporation, a taxable year ending November 30 pursuant to section 898(c)(2). Under that purported election, Corporation Z's first taxable year as an association taxed as a corporation ended on November 30, 2018.

In response to an IRS Form 4564, Information Document Request ("**IDR**"), US Parent did not provide a business purpose for making the CTB Election and making that election effective December 30, 2017, rather than January 1, 2018. Furthermore, the CTB Election and subsequent section 898(c)(2) election had no effect on the taxpayer's operations described in this section.

During the period from January 1, 2018, through November 30, 2018 (the "**Gap Period**"), Corporation Z earned income from its sales of Z Products to Corporation Y, and also potentially to certain other related persons within the meaning of section 267(b) or 707(b) (such income, the "**Gap Income**," and such sales by Corporation Z during the Gap Period, the ("**Intercompany Sales**"). Corporation Z recognized net gain of $X with respect to the Intercompany Sales, and that gain was not of any of the types described in section 951A(c)(2)(A)(i)(I)-(V). $X is an amount greater than each of: (i) $50 million, and (ii) 5 percent of $Y. Corporation Z earned an amount of subpart F income during the Gap Period from sources other than the Intercompany Sales (the "**2018 Sub F income**").

The US Group takes the position that the CTB Election and section 898(c)(2) election permitted US Sub to change which controlled foreign corporation ("**CFC**") was treated as earning the Gap Income (and the taxable year in which the Gap Income was reported): from Corporation Y's taxable year beginning January 1, 2018, to Corporation Z's first taxable year ending November 30, 2018.[2]

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2 For simplicity, this discussion assumes that Gap Income recognized by Corporation Z following the CTB Election would have been recognized by Corporation Y for Federal income tax purposes, absent the CTB Election, during Corporation Y's 2018 taxable year. It does not alter our conclusions if Corporation Y would instead have recognized all or a portion of the Gap Income in a later taxable year or years absent the CTB Election.

And further, the US Group takes the position that the CTB Election followed by Corporation Z's purported adoption of a November 30 taxable year caused the Gap Income to be excluded from US Sub's global intangible low-taxed income ("**GILTI**") calculation under section 951A because section 951A did not apply to Corporation Z's first taxable year..[3]

At the end of its taxable year reported as ending November 30, 2018, Corporation Z paid a dividend to Corporation Y in the amount of $Z (the "**2018 Dividend**"). $Z equaled the amount of all of Corporation Z's E&P reported for its 2018 taxable year, including a small amount of previously taxed E&P associated with the 2018 Sub F Income (the "**Sub F PTEP**"). See section 959. $Z minus the amount of the Sub F PTEP equaled $W. $W is an amount less than $X. The US Group took the position that the portion of the 2018 Dividend in excess of the Sub F PTEP (i.e., $W of the 2018 Dividend) was excluded from Corporation Y's foreign personal holding company income within the meaning of section 954(c) ("**FPHCI**") pursuant to section 954(c)(6) and, therefore, excluded from Corporation Y's subpart F income. Corporation Z made no other distributions from December 1, 2017, through December 31, 2018.

In 2020, Corporation Z purported to change its taxable year from a fiscal year ending November 30 to a calendar year.

IV. Law

A. Section 269

Section 269(a) applies where: (1) "any person or persons acquire, directly or indirectly, control of a corporation" (the "**Acquisition Requirement**"); and (2) "the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy" (the "**Principal Purpose Requirement**").

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3 For purposes of this analysis, it is assumed that an increase in tested income of Corporation Y or Company Z during the Gap Period would increase the Federal income tax liability of the US Group in its taxable year ending December 31, 2018. Further, the Intercompany Sales would have been disregarded for Federal income tax purposes if Company Z remained disregarded as an entity separate from its owner. Corporation Y would have effectively recognized the Gap Income as the Z Products were on-sold to other regarded entities.

Further, the Intercompany Sales would have been disregarded for Federal income tax purposes if Company Z remained disregarded as an entity separate from its owner. Corporation Y would have effectively recognized the Gap Income as the Z Products were on-sold to other regarded entities.

Where it applies, section 269 permits the Secretary to disallow such deduction, credit, or other allowance. See section 269(a). It also permits the Secretary "to distribute, apportion, or allocate gross income . . . between or among the corporations, or properties, or parts thereof, involved" in a fact pattern to which section 269 applies. See section 269(c)(2).

Section 269(a) defines "control" as "the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation." Treas. Reg. § 1.269-1(c) provides that the contribution of assets to a newly organized corporation in exchange for all the stock of the newly organized corporation constitutes an acquisition of control for purposes of the Acquisition Requirement. See also Treas. Reg. § 1.269-3(b)(2) and (3) (indicating that the formation or organization of a corporation constitutes an acquisition of control); Borge v. Commissioner, 405 F.2d 673 (2d Cir. 1968) (affirming the application of section 269 to the incorporation of a wholly owned corporation). Similarly, Treas. Reg. § 1.269-1(c) provides that if a parent wholly owns a subsidiary and the subsidiary acquires control of a corporation, the parent has indirectly acquired control of the corporation for purposes of section 269.

For the Principal Purpose Requirement,[4] Treas. Reg.§ 1.269-3(a) provides that, "[i]f the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose." Thus, for section 269 to apply, the tax avoidance purpose need not be the only purpose, just the relatively most important purpose.

Treas. Reg. § 1.269-1(b) provides that "the phrase 'evasion or avoidance' is not limited to cases involving criminal penalties, or civil penalties for fraud." Further, the legislative history of the predecessor to section 269 makes clear that Congress phrased the statute broadly so that the provision would apply not just to particular tax avoidance schemes of which Congress was aware at the time of enactment, but also to future avoidance schemes that might be developed. As the Ways and Means Committee report addressing the predecessor to section 269 explained:

> [T]he section has not confined itself to a description of any particular methods for carrying out such tax avoidance schemes, but has included within its scope these devices in whatever form they may appear. For similar reasons, the scope of the terms used in this section is to be found in the objective of the section, namely, to prevent the tax liability from being reduced through the distortion or perversion effected through tax avoidance devices.

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4 All discussion in this memorandum of any entity's purpose with respect to the events described herein is solely for purposes of analyzing whether the Principal Purpose Requirement in section 269 is satisfied.

H.R. Rep. No. 78-871, at 49 (1943). The Tax Court has likewise concluded that section 269 "was broadly drafted to include any type of acquisition which constitutes a device by which one corporation secures a tax benefit to which it is otherwise not entitled." Briarcliff Candy Corp. v. Commissioner, T.C. Memo 1987-487.

Courts and certain IRS guidance have concluded that, even where a taxpayer forms or acquires a corporation with an eye toward obtaining a tax benefit, section 269 will not apply to prevent "tak[ing] advantage of provisions that represent a deliberate granting of tax benefits." Rocco, Inc. v. Commissioner, 72 T.C. 140, 152 (1979) (holding that section 269 did not apply to disallow deferral of tax resulting from adoption of the cash method of accounting, in part because the tax benefits of the cash method were "consciously granted" by Congress). In this vein, section 269 has been interpreted not to permit the Commissioner to disallow the benefits of incorporation for purposes of obtaining tax benefits specifically granted to Western Hemisphere trade corporations. See Rev. Rul. 70-238, 1970-1 C.B. 61 (concluding that the special deduction allowed in computing the taxable income of a Western Hemisphere trade corporation "was intended primarily to grant relief . . . to American corporations trading in foreign countries within the Western Hemisphere," and that therefore, "the creation of a new domestic corporation to carry on the business in the Western Hemisphere (other than in the United States) of an existing domestic corporation is not tax avoidance" within the meaning of section 269). Similarly, section 269 has been interpreted not to permit the Commissioner to disallow an election of status as a subchapter S corporation. See Modern Home Fire & Casualty Insurance Co. v. Commissioner, 54 T.C. 839, 853 (1970) (reasoning that, had taxpayer's sole motivation for electing to be taxed under subchapter S been to offset the taxpayer's income against its owner's losses, "the enjoyment of this benefit would be consistent with the intent of Congress . . . and thus cannot be regarded as tax avoidance"); Rev. Rul. 76-363, 1976-2 C.B. 90 (concluding that, even though the taxpayer's principal purpose for the acquisition was to secure the exemption from corporate tax provided by subchapter S, that benefit "cannot be regarded as tax avoidance," and therefore section 269 did not apply).

In each such circumstance, even though the formation or acquisition of a corporation resulted in a tax benefit, because that benefit was directly aligned with Congress's intent in enacting the underlying provisions, section 269 was not applicable. In contrast, where a deliberate granting of tax benefits by Congress is not manifest, section 269 may be invoked. See, e.g., Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396, 400 (4th Cir. 1957), affirming in part and reversing in part, 25 T.C. 1304 (1956) (holding that the predecessor of section 269 applied where multiple corporations were formed to exploit a prior-law surtax exemption).

Treas. Reg. § 1.269-1(a) defines the term "allowance" broadly to mean "anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a deduction, a credit, an adjustment, an exemption, or an exclusion." This regulatory language echoes language in the House Ways and Means Committee report for the predecessor to section 269 (old section 129). See H. Rep. No. 78-871, at 49 (1943) (explaining that "'deduction, credit or allowance' has reference to

any provision which has the effect of diminishing the tax liability resulting from the gross amount of any item of income or the aggregate of the gross amounts of any or all items thereof").

Courts have held that section 269 permits the Secretary to disallow benefits that are expected at the time of the acquisition of control, even if those benefits come into existence only as a result of or after the acquisition. See R.P. Collins & Co., Inc. v. United States, 303 F.2d 142, 146 (1st Cir. 1962) (concluding that, once a tax avoidance purpose was established, post-acquisition losses were "tarred by the same brush"); Luke v. Commissioner, 351 F.2d 568, 572 (7th Cir. 1965) (holding that section 269 may bar future tax benefits which are either contemplated or result from the basic tax avoidance transaction); Borge v. Commissioner, 405 F.2d 673, 678-79 (2d Cir. 1968) (holding that section 269 can apply to deny anticipated or prospective benefits).

To be subject to disallowance under section 269, the deduction, credit, or other allowance must be something the taxpayer "would not otherwise enjoy" absent the acquisition that resulted in control. See section 269(a); Commodores Point Terminal Corp. v. Commissioner, 11 T.C. 411, 417 (1948) (explaining that, as used in the predecessor to section 269, "[t]he word 'otherwise' can only be interpreted to mean that the deduction, credit, or allowance, if it is to be disallowed, must stem from the acquired control").

B. The "Check the Box" Regulations

Treas. Reg. § 301.7701-3(c)(1)(i) provides that, in general, any "eligible entity"—that is, any business entity not required to be classified as a corporation under Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8)—may elect to change its classification from the default classification provided by Treas. Reg. § 301.7701-3(b) by filing Form 8832, *Entity Classification Election*, with the service center designated on Form 8832.

Treas. Reg. § 301.7701-3(g)(1)(iv) provides that, if an entity that is disregarded as an entity separate from its owner elects to be classified as an association taxed as a corporation, the owner of the disregarded entity is deemed to contribute all of the assets and liabilities of the entity to the association in exchange for stock of the association.

Treas. Reg. § 301.7701-3(g)(2)(i) provides that the tax treatment of an election under Treas. Reg. § 301.7701-3(c)(1)(i) is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine. The preamble to the notice of proposed rulemaking proposing Treas. Reg. § 301.7701-3 further explains that "[t]his provision . . . is intended to ensure that the tax consequences of an elective change will be identical to the consequences that would have occurred if the taxpayer had actually taken the steps described in the . . . regulations." REG-105162-97, 62 Fed. Reg. 55768 (Oct. 28, 1997) (emphasis added). See also Dover Corp. v. Commissioner, 122 T.C. 324, 348 (2004) (characterizing the deemed liquidation pursuant to a "disregarded entity election . . . as an actual liquidation . . . for income tax purposes."); id. at 350 ("As stated by respondent on brief, pursuant to

section 301.7701–3(g)(1)(ii) and (2)(i), Proced. & Admin. Regs., ‘there is no difference between a check-the-box liquidation and an actual liquidation.’”).

In accordance with this treatment, courts apply anti-abuse doctrines to the deemed transactions pursuant to a “check the box” election in the same manner that those doctrines apply to actual transactions. See, e.g., Tucker v. Commissioner, T.C. Memo 2017-183 (applying the economic substance doctrine to a transaction including a “check the box” election because “[t]his manipulation of the elective regime for creating a partnership is patently inconsistent with legislative intent”), aff'd, 766 F. App’x 132 (5th Cir. 2019).

C. Section 898

Section 898(c)(1)(A) generally provides that a CFC must have the same taxable year as its majority U.S. shareholder. Section 898(c)(2), however, allows a CFC to elect a taxable year beginning one month before the majority U.S. shareholder’s taxable year, providing that “[a] specified foreign corporation[5] may elect, in lieu of the taxable year under [section 898(c)(1)(A)], a taxable year beginning 1 month earlier than the majority U.S. shareholder year.”

Section 898 was intended to address:

> improper deferral of income to U.S. shareholders of controlled foreign corporations. . . . Where present law allows subpart F income earned by a controlled foreign corporation . . . to be subjected to Federal income tax in a taxable year later than that in which it was earned, the value of the income earned is understated. Such a deferral of income generally is only available to certain taxpayers, resulting in preferential treatment of those taxpayers at the overall expense of others.

H.R. Rep. No. 101-247, at 1285 (1989). The report used an example to explain the problem that the provision addressed:

> For example, assume a controlled foreign corporation has a taxable year ending on January 31, while its U.S. shareholder uses the calendar year as its taxable year. Any subpart F income earned by the controlled foreign corporation is deemed distributed to the U.S. shareholder on January 31, thus allowing the U.S. shareholder to defer tax on eleven months' worth of current subpart F income.

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5 For purposes of section 898, the term “specified foreign corporation” includes all of the CFCs at issue here. Section 898(b)(1)(A).

Id. at 1283-84. The preamble to proposed regulations under section 898 similarly states, "The purpose of section 898 is to eliminate the deferral of income and, therefore, the understatement in income, by United States shareholders of certain controlled foreign corporations. . . ." 58 Fed. Reg. 290, 291 (Jan. 5, 1993). Likewise, a subsequent IRS Notice states, "Prior to the enactment of section 898, an SFC's shareholder(s) [i.e., U.S. shareholders of a CFC] could elect a taxable year for the SFC that resulted in the unwarranted deferral of U.S. tax on its subpart F . . . income. Section 898 was enacted to minimize the opportunities for such deferral." Notice 95-13, 1995-1 C.B. 296.

Section 898(c)(2)—which is titled "1-Month Deferral Allowed"—was added by the Senate without further explanation in the legislative history. Section 898(c)(2) permits a CFC to elect a taxable year "beginning 1 month earlier than the majority U.S. shareholder year." See Senate Print, Revenue Reconciliation Act of 1989: Explanation of Provisions Approved by the Committee on October 3, 1989, at *102 (Oct. 12, 1989) ("[I]n the case of a specified foreign corporation which is a controlled foreign corporation, such corporation may elect to use as its taxable year, a taxable year that begins one month earlier than the taxable year of the majority U.S. shareholder."). Thus, section 898(c)(2) permits a CFC to elect a taxable year ending one month before the end of the majority U.S. shareholder's taxable year, allowing one month of deferral to the majority U.S. shareholder. See, e.g., Rev. Proc. 2007-64, 2007-42 I.R.B. 818 (referring to the taxable year elected under section 898(c)(2) as the "one-month deferral year").

D. Section 951A; Status as a CFC; Revenue Procedure

On December 22, 2017, Congress passed the tax legislation known as the Tax Cuts and Jobs Act (the "**TCJA**"). The TCJA included the GILTI anti-deferral regime in new section 951A. Section 951A generally requires that each U.S. shareholder of a CFC include in gross income the U.S. shareholder's GILTI for the taxable year determined by taking into account the tested income or tested loss of each of the U.S. shareholder's CFCs, among other attributes. Section 951A is effective for "taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end." See Pub. L. No. 115-97, § 14201(d), 131 Stat. 2213 (2017).

Section 957(a) defines a CFC as a foreign corporation for which more than 50 percent of (1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by U.S. shareholders on any day during the taxable year of such foreign corporation.

Section 951(b) defines a U.S. shareholder as any U.S. person, which includes a domestic corporation, who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign

corporation, or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation.

Revenue Procedure 2018-17, 2018-9 I.R.B. 384, which was issued to prevent taxpayers from changing taxable years to avoid section 965, generally prohibits certain foreign corporations owned, directly or indirectly, by one or more U.S. shareholders from changing their taxable year ending December 31, 2017. Specifically, the Revenue Procedure provides that a request to change the annual accounting period of a CFC will not be approved if: (1) the CFC's taxable year (determined without regard to the requested change) ends on December 31; (2) were the change granted, the first effective year of the CFC would begin on January 1, 2017, and would end before December 31, 2017; and (3) the CFC has one or more U.S. shareholders that are required to include an amount in income under section 951(a)(1) by reason of section 965.

E. Limitation of Section 245A Deduction and Section 954(c)(6) Exception Pursuant to Temp. Treas. Reg. § 1.245A-5T

As relevant here, Temp. Treas. Reg. § 1.245A-5T provides rules that limit the applicability of section 954(c)(6) when a portion of a dividend is paid out of an extraordinary disposition account. Section 954(c)(6) provides that certain types of income that would otherwise constitute FPHCI are, when received or accrued from a related person, not FPHCI to the extent attributable or properly allocable to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States.

Temp. Treas. Reg. § 1.245A-5T(c)(1) provides that the term "extraordinary disposition amount" means the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(A) provides that the term "extraordinary disposition account" means, with respect to a section 245A shareholder of an SFC, an account the balance of which is equal to the product of the "extraordinary disposition ownership percentage" and the "extraordinary disposition E&P," reduced (but not below zero) by the "prior extraordinary disposition amount," and adjusted under Temp. Treas. Reg. § 1.245A-5T(c)(4), as applicable.

Temp. Treas. Reg. § 1.245A-5T(i)(21) provides that a "section 245A shareholder" is a domestic corporation that is a United States shareholder with respect to an SFC that owns directly or indirectly stock of the SFC. Under Temp. Treas. Reg. § 1.245A-5T(i)(27), the term "United States shareholder" has the meaning provided in section 951(b).

Temp. Treas. Reg. § 1.245A-5T(i)(22) provides that the term "SFC" has the meaning provided in section 245A(b)(1), which is any foreign corporation with respect to which

any domestic corporation is a United States shareholder with respect to such corporation.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(B) provides that the term “extraordinary disposition ownership percentage” means the percentage of stock (by value) of an SFC that a section 245A shareholder owns directly or indirectly at the beginning of the disqualified period or, if later, on the first day during the disqualified period on which the SFC is a CFC.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(iii) provides that the term “disqualified period” means, with respect to an SFC that is a CFC on any day during the taxable year that includes January 1, 2018, the period beginning on January 1, 2018, and ending as of the close of the taxable year of the SFC, if any, that begins before January 1, 2018, and ends after December 31, 2017.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(C) provides that the term ”extraordinary disposition E&P” means an amount of E&P of an SFC equal the sum of the net gain recognized by the SFC with respect to specified property in each extraordinary disposition.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(iv) provides that the term “specified property” means any property if gain recognized with respect to such property during the disqualified period is not described in section 951A(c)(2)(A)(i)(I)-(V).

Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(A) provides that, subject to a de minimis exception, the term “extraordinary disposition” means, with respect to an SFC, any disposition of specified property by the SFC on a date on which it was a CFC and during the SFC's disqualified period to a related party if the disposition occurs outside of the ordinary course of the SFC's activities.

Temp. Treas. Reg. § 1.245A-5T(i)(19) provides that the term “related party” means, with respect to a person, another person bearing a relationship described in section 267(b) or 707(b) to the person.

As described in Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(B), a determination as to whether a disposition is undertaken outside of the ordinary course of an SFC's activities is made on the basis of facts and circumstances, taking into account whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency.

Temp Treas. Reg. § 1.245A-5T(c)(3)(ii)(C) provides a “per se” rule. As relevant here, it provides that a disposition is treated as occurring outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating E&P during the disqualified period.

Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(E) provides a de minimis exception to the concept of an extraordinary disposition if the sum of the net gain recognized by an SFC with respect to specified property in all dispositions otherwise described in the definition of extraordinary disposition does not exceed the lesser of $50 million or 5 percent of the gross value of all of the SFC's property held immediately before the beginning of its disqualified period.

Temp. Treas. Reg. 1.245A-5T(c)(3)(i)(D) provides the definition of “prior extraordinary disposition amount.”

Temp. Treas. Reg. § 1.245A-5T(c)(2)(i) provides that for purposes of determining the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to the section 245A shareholder, and the dividend is next considered paid out of the extraordinary disposition account to the extent of the section 245A shareholder's extraordinary disposition account balance.

Temp. Treas. Reg. § 1.245A-5T(d)(1) provides that if an upper-tier CFC receives a dividend from a lower-tier CFC, the dividend is eligible for the exception to FPHCI under section 954(c)(6) only to the extent that the amount that would be eligible for the section 954(c)(6) exception (determined without regard to Temp. Treas. Reg. § 1.245A-5T(d)) exceeds the “disqualified amount.” The “disqualified amount” equals: 50 percent multiplied by of the quotient of: (i) the sum of each section 245A shareholder's “tiered extraordinary disposition amount” with respect to the lower-tier CFC, and (ii) the percentage (expressed as a decimal) of stock of the upper-tier CFC (by value) owned, in the aggregate, by U.S. tax residents that include in gross income their pro rata share of the upper-tier CFC's subpart F income under section 951(a) on the last day of the upper-tier CFC's taxable year.

Temp. Treas. Reg. § 1.245A-5T(i)(28) provides that the term “upper-tier CFC” means a CFC that owns, within the meaning of section 958(a)(2), stock in another CFC.

Temp. Treas. Reg. § 1.245A-5T(i)(13) provides that the term “lower-tier CFC” means a CFC the stock of which is owned, within the meaning of section 958(a)(2), in whole or in part, by another CFC.

Temp. Treas. Reg. § 1.245A-5T(d)(2)(i) provides that the term “tiered extraordinary disposition amount” means, with respect to a dividend received by an upper-tier CFC from a lower-tier CFC, the portion of the dividend that would be an extraordinary disposition amount if the section 245A shareholder received as a dividend its pro rata share of the dividend from the lower-tier CFC.

Under Temp. Treas. Reg. § 1.245A-5T(k) and (l), Temp. Treas. Reg. § 1.245A-5T applies to distributions occurring after December 31, 2017, and before June 14, 2022. See also Treas. Reg. § 1.245A-5(k)(1); Temp. Treas. Reg. § 1.954(c)(6)-1T.

Temp. Treas. Reg. § 1.245A-5T(h) provides that the Commissioner may make appropriate adjustments to any amounts determined under Temp. Treas. Reg. § 1.245A-5T if a transaction is engaged in with a principal purpose of avoiding the purposes of Temp. Treas. Reg. § 1.245A-5T.

The preamble to the Treasury Decision promulgating Temp. Treas. Reg. § 1.245A-5T states:

> I]n certain atypical circumstances, a literal application of section 245A (read in isolation) could result in the section 245A deduction applying to earnings and profits of a CFC attributable to the types of income addressed by the subpart F or GILTI regimes—the specific types of earnings that Congress described as presenting base erosion concerns. These circumstances arise when a CFC's fiscal year results in a mismatch between the effective date for GILTI and the final measurement date under section 965 or involve unanticipated interactions between section 245A and the rules for allocating subpart F income and GILTI when there is a change in ownership of a CFC. Moreover, the Treasury Department and the IRS are aware that some taxpayers are undertaking transactions with a view to eliminating current or future taxation of all foreign earnings of a CFC, including earnings attributable to base erosion-type income, by structuring into these situations. These transactions have the potential to substantially undermine the anti-base erosion framework for post-2017 foreign earnings.

T.D. 9865 (June 18, 2019) (emphasis added).

The preamble goes on to provide:

> The Treasury Department and the IRS are aware that during the disqualified period, CFCs may have engaged in certain transactions with related parties with a goal of creating stepped-up basis for the buyer, while generating earnings and profits for the seller CFC that are not subject to any current tax and may be eligible for the section 245A deduction. Because the transactions generally are structured to avoid creating subpart F income and occur during the disqualified period, the income from these transactions generally is not subject to U.S. tax under the transition tax under section 965, the subpart F regime, or the GILTI regime.

Id. The preamble further states:

> Similar to section 245A, the exemption from subpart F income under section 954(c)(6) can be used in the context of certain transactions to avoid taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Such transactions are not dependent upon the availability of section 245A at the level of the United States shareholder. This type of concern was first generally described in Notice 2007-9, but has been exacerbated by the enactment of

> section 951A as part of the Act because (1) dividends qualifying for section 954(c)(6) generally are not treated as tested income pursuant to section 951A(c)(2)(A)(i)(IV); and (2) the same structured transactions used to avoid subpart F inclusions can also be used to avoid GILTI inclusions. Given the authority in section 954(c)(6)(A) for the Treasury Department and the IRS to issue regulations preventing the abuse of section 954(c)(6), the temporary regulations under section 954(c)(6) are designed to ensure that the section 954(c)(6) exception is not used to erode the U.S. tax base through certain transactions preventing the taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Consistent with the temporary regulations issued under section 245A, these rules are targeted to ensure that the section 954(c)(6) exception is not available for this limited category of earnings.

Id. (emphasis added).

V. Analysis

A. Section 269

If a transaction satisfies both the Acquisition Requirement and the Principal Purpose Requirement, then the Secretary may disallow a deduction, credit, or other allowance obtained as a result of the acquisition of control. This analysis first applies the Acquisition Requirement, and then the Principal Purpose Requirement, and then considers how section 269 affects US Sub's GILTI calculation.

1. Acquisition Requirement

Before the CTB Election Company Z was an eligible entity that was disregarded as an entity separate from its owner. Company Z was eligible to make the CTB Election. Under Treas. Reg. § 301.7701-3(g)(1)(iv), as a result of the CTB Election, Corporation Y was deemed to contribute all of the assets and liabilities of Company Z to Corporation Z in exchange for stock of Corporation Z. Treas. Reg. § 301.7701-3(g)(2)(i) provides that the tax treatment of an election under Treas. Reg. § 301.7701 3(c)(1)(i) is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law.

Corporation Y's deemed contribution of assets and liabilities to the newly regarded Corporation Z constitutes the organization of a corporation, and as such constitutes the acquisition of control of a corporation under section 269(a)(1), as set out in Treas. Reg. § 1.269-1(c). US Sub indirectly acquires 100 percent of the stock of Corporation Z for purposes of section 269 because US Sub owns 100 percent of the stock of Corporation Y. See Treas. Reg. 1.269-1(c). Therefore, US Sub meets the Acquisition Requirement with respect to the CTB Election.

2. Principal Purpose Requirement

The Principal Purpose Requirement, as defined above, has four elements, each of which is discussed below: (1) whether US Group secured the benefit of a “deduction, credit, or other allowance”; (2) whether the benefit is one which the taxpayer “would not otherwise enjoy” absent the acquisition; (3) whether the acquisition of control resulted in “evasion or avoidance of Federal income tax”; and (4) whether the principal purpose for the acquisition of control was evasion or avoidance of Federal income tax. As explained below, the attempt to exclude the Gap Income from US Sub’s GILTI computation via Corporation Z’s election under section 898(c)(2) satisfies all of these elements.

a) Allowance

Corporation Z's ability to elect a new taxable year under section 898(c)(2) gave rise to the exclusion of Gap Income and therefore, for the initial year, is an "allowance."

Focusing first on the statute, the term “other allowance” follows the specified items “deduction” and “credit.” Section 269. Each of a deduction and a credit has the effect of reducing tax liability. This commonality informs the meaning of “other allowance.” Accordingly, Treas. Reg. § 1.269-1(a) defines an allowance as “anything in the internal revenue laws that has the effect of diminishing tax liability.” The regulation goes on to provide that an allowance “includes, among other things, a deduction, a credit, an adjustment, an exemption, or an exclusion.” Deductions and credits are defined by the statute as types of allowance, and adjustments, exemptions, and exclusions are described in Treas. Reg. § 1.269-1(a) as examples of other items that are allowances. This list is non-exclusive by its terms, reflecting that other rules in the Federal income tax law can be allowances provided they share the tax-reducing effect of deductions, credits, adjustments, exemptions, and exclusions.

Corporation Z’s section 898(c)(2) election for its fiscal year, ended November 30, 2018, resulted in the exclusion of the Gap Income from US Sub’s GILTI tax base. Thus, it is an “allowance” within the meaning of section 269(a) and Treas. Reg. § 1.269-1(a). Were it not for the section 898(c)(2) election, Corporation Z would have been a calendar year taxpayer. See section 898(a)(1). Had Corporation Z been a calendar year taxpayer, US Sub would have been required to include the Gap Income in the calculation of its GILTI inclusion, increasing its tax liability relative to the liability it would have had if the Gap Income were not required to be included. Corporation Z’s section 898(c)(2) election thus caused the Gap Income to be permanently excluded from US Sub’s GILTI calculation (and the US Group’s income more generally), thereby permanently reducing the US Group’s U.S. Federal income tax liability. Although no authority has specifically held that a section 898(c)(2) election can be an allowance within the meaning of section 269(a), the provision as applied here is within the scope of the types of provisions that Congress envisioned section 269 would address. As the Tax Court described, section 269 “was broadly drafted to include any type of acquisition which constitutes a device by which one corporation secures a tax benefit to which it is otherwise not entitled.” Briarcliff Candy Corp. v. Commissioner, T.C. Memo 1987-487.

The formation of a new corporation (for Federal income tax purposes) to exclude income using a section 898(c)(2) election is similar to the formation of a new corporation to exclude income under the former surtax exemption, to which section 269 was applied. Congress and the courts concluded the $25,000 corporate surtax exemption granted by prior-law section 15(b) to be an "allowance" soon after the enactment of section 129 (the predecessor to section 269). A 1949 Senate Finance Committee report noted that section 129 empowered the Secretary to address abuse of the surtax exemption:

> It is not intended, however, that the exemption of the first $25,000 of a corporation's surtax net income from the surtax shall be abused by the splitting up, directly or indirectly, of a business enterprise into two or more corporations or the forming of two or more corporations to carry on an integrated business enterprise. It is believed that sections 45 and 129 will prevent this form of tax avoidance.

S.Rep. No. 81-2375, at 70 (1950). The surtax exemption was a per-corporation benefit; absent the application of an anti-abuse rule like section 269, an enterprise with enough surtax net income to soak-up a second exemption could split its business across multiple newly formed corporations and multiply the exemption amount. When a taxpayer attempted precisely this abuse and the IRS denied a second surtax exemption, the Tax Court held that section 129 did not apply on other grounds, but did not question that the exemption was an "allowance." On appeal, the Fourth Circuit held that section 129 did apply, which necessarily entailed holding that the exemption was an allowance. See Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396, 400 (4th Cir. 1957), affirming in part and reversing in part, 25 T.C. 1304 (1956). Thus, Congress and the courts viewed the surtax exemption as an allowance to which section 129 could apply.

Under Taxpayer's position, the exclusion from GILTI during the Gap Period provided by a section 898(c)(2) election would be available to calendar year U.S. shareholders of a calendar year CFC that owned a disregarded entity eligible to elect to be treated under Treas. Reg. § 301.7701-3(c)(1)(i) as an association taxed as a corporation for Federal income tax purposes. Taxpayers that had this fact pattern and made the "check the box" election to treat the disregarded entity as an association could argue that the elective incorporation for tax purposes caused the otherwise unavailable section 898(c)(2) election to spring into existence, giving them the option to elect a November 30 taxable year, just as a new surtax exemption amount sprang into existence with the creation of a new corporation under prior-law section 15(b). In both cases, taxpayers would be forming a new corporation to "split[] up" the operation of "an integrated business enterprise" and obtain otherwise unavailable tax benefits. S.Rep. No. 81-2375, at 70 (1950). If allowed, this section 898(c)(2) election could have the effect of excluding eleven months of tested income from the U.S. shareholder's GILTI calculation, just as the surtax exemption would have shielded a fixed amount of surtax net income from taxation.

In sum, the section 898(c)(2) election, whereby Corporation Z purported to adopt a taxable year ending November 30, 2018, which resulted in a claimed exclusion of Gap Income from the US Sub and US Group's GILTI tax base, is an allowance within the meaning of section 269(a).

b) "Would not otherwise enjoy"

US Sub would not have been able to make a section 898(c)(2) election with respect to Corporation Z and create Gap Income excluded from GILTI if it did not make the CTB Election with respect to Corporation Z. In other words, the deemed acquisition that occurred pursuant to the CTB election permitted US Sub to secure the benefit of an allowance that US Sub would not otherwise have enjoyed. Absent the CTB Election, the activities of Corporation Z would have been treated for Federal income tax purposes as undertaken by Corporation Y because Company Z was disregarded as an entity separate from its owner. Corporation Y was at all relevant times a CFC with a calendar taxable year for Federal income tax purposes, meaning its taxable year ends on December 31. US Sub, which is Corporation Y's sole U.S. shareholder, was required to include an amount in income under section 951(a)(1) by reason of section 965. Based on these facts, Revenue Procedure 2018-17 prevented Corporation Y itself from adopting a taxable year ending before December 31, 2017. As a result, the first taxable year of Corporation Y to which section 951A was applicable was its taxable year beginning January 1, 2018. Given that all of the Gap Income was earned on or after January 1, 2018, the Gap Income would have been included in US Sub's calculation of its GILTI inclusion absent the CTB Election.

As a result of the CTB Election, Corporation Z was treated as a newly formed corporation and was not prohibited by Revenue Procedure 2018-17 from electing under section 898(c)(2) a taxable year ending November 30, 2018, for its first year of existence. By making the section 898(c)(2) election for Corporation Z, US Sub obtained the benefit of excluding the Gap Income from its calculation of its GILTI inclusion because section 951A did not apply to income earned by Corporation Z during the Gap Period. Section 951A did not apply with respect to Corporation Z until its taxable year beginning on December 1, 2018, which is eleven months later than the beginning of the first taxable year of Corporation Y to which section 951A applied. In short, as a result of the CTB Election (i.e., the acquisition of control of Corporation Z within the meaning of section 269(a)(1)), US Sub obtained the benefit of the section 898(c)(2) election for Corporation Z (with the resulting exclusion of Gap Income from the GILTI tax base of US Sub and the US Group), which it would not have otherwise enjoyed absent the CTB Election.

c) Evasion or Avoidance of Federal Income Tax

The exclusion from US Sub's GILTI calculation of the Gap Income here constitutes the evasion or avoidance of Federal income tax within the meaning of section 269.

The regulations provide that the term “evasion or avoidance” is “not limited to cases involving criminal penalties, or civil penalties for fraud.” Treas. Reg. § 1.269-1(b). And as described above in Part IV.A of this memorandum, the legislative history to section 269 also describes the scope of the “evasion or avoidance” addressed by the statute as encompassing anything that results in the reduction of tax liability “through the distortion or perversion effected through tax avoidance devices.” H.R. Rep. No. 78-871, at 49 (1943). Here, the section 898(c)(2) election was used as a device to reduce US Sub’s taxable income by excluding the Gap Income from US Sub’s GILTI calculation. Indeed, it had no meaningful effect on the US Group other than to exclude the Gap Income and thereby reduce the US Group’s tax liability. Corporation Z adopted a calendar year soon after the device had served its purpose. The regulations and legislative history confirm that, through its use of the broad term “evasion or avoidance,” section 269 encompasses abuses like the scheme at issue here.

Furthermore, the exclusion from GILTI provided by a section 898(c)(2) election made in connection with the retroactive CTB Election during the Gap Period does not reflect the type of “deliberate granting of tax benefits” that courts have held may not be the subject of adjustment under section 269. See Rocco, Inc. v. Commissioner, 72 T.C. 140, 152 (1979). The statutory structure of section 898, the provision’s legislative history, and related IRS guidance demonstrate that the provision was intended to curb tax abuse and level the playing field across similarly situated taxpayers by generally preventing deferral of Subpart F income. These same sources demonstrate that section 898(c)(2) was intended to allow only limited, one-month deferral of Subpart F income from a CFC. But Corporation Z’s use of the section 898(c)(2) election on these facts does the opposite: it creates not just deferral (which is what section 898 was enacted to combat) but permanent exclusion of the Gap Income from US Group’s GILTI. Indeed, the legislative history of section 898 explained that the provision was intended to prevent as much as eleven months of deferral of tax on CFC income. US Parent has used that same provision to purport to achieve permanent exclusion of eleven months of tested income. That result is a clear abuse of the provision and does not reflect a deliberate grant of tax benefits by Congress, but rather the type of device that section 269 was enacted to address. See H.R. Rep. No. 78-871, at 49 (1943) (explaining that section 129, the predecessor to section 269, “has not confined itself to a description of any particular methods for carrying out such tax avoidance schemes, but has included within its scope these devices in whatever form they may appear”).

d) Principal Purpose

The only remaining question is whether the evasion or avoidance of Federal income tax provided by the allowance was the principal purpose for which the acquisition was made.

As described above, the acquisition of control in this case resulted from the CTB Election with respect to Company Z. Treas. Reg. § 301.7701-3(g)(2)(i) provides that the tax treatment of an election under Treas. Reg. § 301.7701-3(c)(1)(i) is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law,

including the step transaction doctrine. Therefore, just as section 269 may apply to the actual formation of a new corporation undertaken with the relevant principal purpose, so too can it apply to the deemed formation of a new corporation pursuant to a "check the box" election, if all other statutory requirements are satisfied.

US Parent's sole purpose for acquiring Corporation Z was the evasion or avoidance of Federal income tax. When asked in an IDR, US Parent did not provide a business purpose for making the CTB Election and making that election effective December 30, 2017, rather than January 1, 2018. Furthermore, the CTB Election and subsequent section 898(c)(2) election had no effect on the taxpayer's business operations described herein. Rather the CTB Election and subsequent section 898(c)(2) election served no purpose other than to exclude permanently eleven months of tested income from US Sub's GILTI calculation. As such, tax avoidance or evasion was the principal purpose of the transaction. Moreover, the fact that Corporation Z's taxable year was changed to a calendar year in 2020 reinforces the artificial nature of, and aggressive tax planning involved with, the original transaction.

In sum, these facts satisfy both the Acquisition Requirement and the Principal Purpose Requirement. Section 269(a) thus gives the authority to disallow the exclusion from GILTI provided by the section 898(c)(2) election.

3. Effect of Applying Section 269

Section 269 permits the Secretary to disallow the section 898(c)(2) election made with respect to Corporation Z or to allocate to Corporation Y the Gap Income reported as earned by Corporation Z. See section 269(a) and (c)(2). Either of these approaches disallows the exclusion of the Gap Income from the US Sub's GILTI calculation purportedly effected by Corporation Z's section 898(c)(2) election and, thus, properly reflects the Gap Income in US Sub's GILTI calculation.

B. Limitation of Section 245A Deduction and Section 954(c)(6) Exception Pursuant to Temp. Treas. Reg. § 1.245A-5T

In the alternative, if section 269 were not applied in the manner described in Part V.A of this memorandum, Temp Treas. Reg. § 1.245A-5T applies to the transactions described above to increase Corporation Y's subpart F income by (50% * $W).

1. US Sub's Extraordinary Disposition Account with Respect to Corporation Z

US Sub's "extraordinary disposition account" with respect to Corporation Z, before taking into account the 2018 Dividend, was $X.

The term "extraordinary disposition account" means, with respect to a section 245A shareholder of an SFC, an account the balance of which is equal to the product of the "extraordinary disposition ownership percentage" and the "extraordinary disposition

E&P," reduced (but not below zero) by the "prior extraordinary disposition amount," and adjusted under Temp. Treas. Reg. § 1.245A-5T(c)(4), as applicable. Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(A).

During the Gap Period, US Sub was a United States shareholder with respect to Corporation Z within the meaning of section 951(b) because US Sub indirectly wholly owned Corporation Z. Temp. Treas. Reg. § 1.245A-5T(i)(27). Accordingly, Corporation Z was an SFC, and US Sub was a section 245A shareholder with respect to Corporation Z. Temp. Treas. Reg. § 1.245A-5T(i)(21) and (22).

US Sub's "extraordinary disposition ownership percentage" with respect to Corporation Z was 100%. Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(B). US Sub indirectly wholly owned Corporation Z by value on January 1, 2018, which was the beginning of the disqualified period, and Corporation Z was a CFC as of that date. See Temp. Treas. Reg. § 1.245A-5T(c)(3)(iii).

Corporation Z's extraordinary disposition E&P was $X. Corporation Z's extraordinary disposition E&P equals an amount of Corporation Z's E&P equal to the sum of the net gain recognized by Corporation Z with respect to specified property in each extraordinary disposition. Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(C). The Z Products that Corporation Z sold during the disqualified period (i.e., the Gap Period) in the Intercompany Sales constituted specified property because Corporation Z recognized net gain of $X with respect to the Intercompany Sales during the Gap Period, and that gain is not described in section 951A(c)(2)(A)(i)(I)-(V). Temp. Treas. Reg. § 1.245A-5T(c)(3)(iv).

Each Intercompany Sale constituted an extraordinary disposition. An "extraordinary disposition" means, with respect to Corporation Z, any disposition of specified property by Corporation Z on a date on which it was a CFC and during Corporation Z's disqualified period to a related party if the disposition occurs outside of the ordinary course of Corporation Z's activities. Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(A). Further, Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(B) provides that a determination as to whether a disposition is undertaken outside of the ordinary course of an SFC's activities is made on the basis of the facts and circumstances, taking into account whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency. However, a disposition is "per se" treated as occurring outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating E&P during the disqualified period. Temp Treas. Reg. § 1.245A-5T(c)(3)(ii)(C).

Each Intercompany Sale was a disposition of specified property (the Z Products) to a related party (Corporation Y or other related parties) during the disqualified period (the Gap Period). The Intercompany Sales occurred outside of the ordinary course of

Corporation Z's activities within the meaning of Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii) because they are subject to the relevant "per se" rule.[6] US Parent engaged in tax structuring to create the Intercompany Sales as regarded dispositions to attempt to cause the Gap Income to be excluded from US Sub's GILTI under section 951A. In other words, the intent was to newly create the Intercompany Sales as regarded dispositions that generated E&P (i.e., the Gap Income) during the disqualified period. Temp Treas. Reg. § 1.245A-5T(c)(3)(ii)(C).[7] Accordingly, the Intercompany Sales were undertaken with a principal purpose of generating E&P during the disqualified period within the meaning of this "per se" rule.

Further, the Intercompany Sales do not qualify for the de minimis exception of Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(E). The sum of the net gain recognized by Corporation Z with respect to the Intercompany Sales ($X) exceeded the lesser of $50 million or 5 percent of $Y (the gross value of all of Corporation Z's property held immediately before the beginning of its disqualified period).

US Sub's prior extraordinary disposition amount with respect to Corporation Z was $0 because no dividend was received from Corporation Z before the 2018 Dividend. See Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(D)(1).[8]

Accordingly, US Sub's "extraordinary disposition account" with respect to Corporation Z, before taking into account the 2018 Dividend, is calculated as follows under Temp. Treas. Reg. § 1.245A-5T(c)(3)(i)(A):

("extraordinary disposition ownership percentage" * "extraordinary disposition E&P") - "prior extraordinary disposition amount" = (100% * $X) - $0 = $X

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6 Because the "per se" rule applies, it is unnecessary to perform the facts-and-circumstances analysis under Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(B) to determine whether the Intercompany Sales were outside Corporation Z's ordinary course of business, which may require additional factual background. However, Corporation Z was newly formed for Federal income tax purposes pursuant to the CTB Election immediately before the Gap Period. Accordingly, Corporation Z had no relevant "past activities" before the Gap Period. Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii)(B).

7 A transaction is only a "disposition" within the meaning of Temp. Treas. Reg. § 1.245A-5T(c)(3)(ii) if the transaction is regarded for Federal income tax purposes. See, e.g., Treas. Reg. § 301.7701-2(a) ("if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner").

8 Further, no relevant transfer of Corporation Z's stock occurred that would implicate the successor rules of Temp. Treas. Reg. § 1.245A-5T(c)(4).

2. Application of Temp. Treas. Reg. § 1.245A-5T(d)(1) to the 2018 Dividend

Under Temp. Treas. Reg. § 1.245A-5T(d)(1), although US Sub claimed that section 954(c)(6) applied to $W of the 2018 Dividend, only (50% * $W) of that portion of the 2018 Dividend qualified for section 954(c)(6). The remainder of that portion of the 2018 Dividend—also equal to (50% * $W)—was subpart F income to Corporation Y for its 2018 taxable year.

Temp. Treas. Reg. § 1.245A-5T(d)(1) provides that if an upper-tier CFC receives a dividend from a lower-tier CFC, the dividend is eligible for the exception to FPHCI under section 954(c)(6) only to the extent that the amount that would be eligible for the section 954(c)(6) exception (determined without regard to Temp. Treas. Reg. § 1.245A-5T(d)(1)) exceeds the "disqualified amount." The "disqualified amount" equals 50 percent multiplied by the quotient of: (1) the sum of each section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC, and (2) the percentage (expressed as a decimal) of stock of the upper-tier CFC (by value) owned, in the aggregate, by U.S. tax residents that include in gross income their pro rata share of the upper-tier CFC's subpart F income under section 951(a) on the last day of the upper-tier CFC's taxable year.

Corporation Y was an upper-tier CFC because it was a CFC that wholly owned Corporation Z, another CFC. Temp. Treas. Reg. § 1.245A-5T(i)(28). Corporation Z was a lower-tier CFC because it was a CFC the stock of which was wholly owned by Corporation Y, another CFC. Temp. Treas. Reg. § 1.245A-5T(i)(13).

The "tiered extraordinary disposition amount" is, with respect to the 2018 Dividend received by Corporation Y from Corporation Z, the portion of the 2018 Dividend that would be an "extraordinary disposition amount" if US Sub received as a dividend its pro rata share of the 2018 Dividend from Corporation Z. Temp. Treas. Reg. § 1.245A-5T(d)(2)(i).

In this hypothetical, the "extraordinary disposition amount" would be $W. Temp. Treas. Reg. § 1.245A-5T(c)(1). Specifically, the "extraordinary disposition amount" in this hypothetical would be the portion of the 2018 Dividend received by US Sub from Corporation Z that is paid out of the extraordinary disposition account. Id. As described above, US Sub's extraordinary disposition account with respect to Corporation Z, before taking into account the 2018 Dividend, was $X. For purposes of determining the portion of the 2018 Dividend hypothetically received by US Sub from Corporation Z that is paid out of this extraordinary disposition account, the 2018 Dividend is first considered paid out of non-extraordinary disposition E&P and then next paid out of the extraordinary disposition account (to the extent thereof). Temp. Treas. Reg. § 1.245A-5T(c)(2)(i). Here, Corporation Z's only non-extraordinary disposition E&P was the Sub F PTEP. The amount of the 2018 Dividend ($Z) minus the amount of the Sub F PTEP equaled $W.

And $W is an amount less than $X.[9] Accordingly, under Temp. Treas. Reg. § 1.245A-5T(c)(2)(i), that remaining amount of the 2018 Dividend ($W) would be treated as made out of US Sub's extraordinary disposition account ($X). Thus, $W would be the extraordinary disposition amount in this hypothetical, and so was the tiered extraordinary disposition amount with respect to the 2018 Dividend.

Under Temp. Treas. Reg. § 1.245A-5T(d)(1), the amount of the 2018 Dividend eligible for section 954(c)(6) equals:

(amount of the 2018 Dividend otherwise eligible for section 954(c)(6) without regard to Temp. Treas. Reg. § 1.245A-5T(d)(1)) - (50% * ((US Sub's "tiered extraordinary disposition amount" with respect to Corporation Z) / (the percentage, expressed as a decimal, of stock of Corporation Y owned by US Sub))) =

($W) - (50% * ($W/1.0)) = $W - (50% * $W) = 50% * $W.

Thus, only (50% * $W) of the non-Sub F PTEP portion of the 2018 Dividend was excluded from Corporation Y's FPHCI pursuant to section 954(c)(6) and, therefore, excluded from Corporation Y's subpart F income. The remainder of that portion of the 2018 Dividend—also equal to (50% * $W)—was subpart F income to Corporation Y for its 2018 taxable year.

3. Application of Temp. Treas. Reg. § 1.245A-5T(h) to the 2018 Dividend

To the extent Temp. Treas. Reg. § 1.245A-5T(d)(1) were not applied to the 2018 Dividend as described above, the anti-abuse rule in Temp. Treas. Reg. § 1.245A-5T(h) would properly be applied to reach the same result.

Temp. Treas. Reg. § 1.245A-5T(h) provides that the Commissioner may make appropriate adjustments to any amounts determined under Temp. Treas. Reg. § 1.245A-5T if a transaction is engaged in with a principal purpose of avoiding the purposes of Temp. Treas. Reg. § 1.245A-5T.

The transactions described above with respect to Corporation Y and Corporation Z were undertaken to avoid the purposes of Temp. Treas. Reg. § 1.245A-5T. Specifically, the CTB Election and the section 898(c)(2) election were undertaken in an attempt to permanently exclude the Gap Income from US Sub's GILTI calculation (and the US Group's income more generally) by engineering "a mismatch between the effective date for GILTI and the final measurement date under section 965" with Corporation Z's

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9 The excess of $X minus $W would remain in US Sub's extraordinary disposition account with respect to Corporation Z.

purported fiscal year. T.D. 9865 (June 18, 2019) (emphasis added). In other words, the intent was to cause the Intercompany Sales to be regarded transactions that generated E&P (i.e., the Gap income) during the disqualified period. Id. ("[D]uring the disqualified period, CFCs may have engaged in certain transactions with related parties with a goal of creating stepped-up basis for the buyer, while generating earnings and profits for the seller CFC that are not subject to any current tax and may be eligible for the section 245A deduction."). Thus, the purposes of Temp. Treas. Reg. § 1.245A-5T included preventing the type of Gap Period planning that US Parent undertook. See also id. ("[S]ome taxpayers are undertaking transactions with a view to eliminating current or future taxation of all foreign earnings of a CFC, including earnings attributable to base erosion-type income, by structuring into these situations.").

Further, the 2018 Dividend paid in tandem with these transactions used "section 954(c)(6) . . . to avoid taxation of income that would otherwise be taxed under the subpart F or GILTI regimes." Id. Temp. Treas. Reg. § 1.245A-5T and related regulations were "designed to ensure that the section 954(c)(6) exception is not used to erode the U.S. tax base through certain transactions preventing the taxation of income that would otherwise be taxed under the subpart F or GILTI regimes." Id. In other words, the tax-free treatment of the non-Sub F PTEP portion of the 2018 Dividend—specifically paid out of E&P attributable to the GILTI avoidance transactions—was precisely the type of tax avoidance that Temp. Treas. Reg. § 1.245A-5T was intended to prevent.

Accordingly, the Commissioner may make appropriate adjustments with respect to these transactions because they were engaged in with a principal purpose of avoiding the purposes of Temp. Treas. Reg. § 1.245A-5T. In this context, appropriate adjustments would include adjustments that reach the same result regarding the treatment of the 2018 Dividend as under Treas. Reg. § 1.245A-5T(d)(1) (i.e., increasing Corporation Y's subpart F income for its 2018 taxable year by (50% * $W) with respect to the 2018 Dividend). That treatment appropriately addresses the attempted GILTI avoidance associated with these transactions, achieved by tax planning to cause the Intercompany Sales to be regarded transactions that generated E&P (i.e., the Gap income) during the disqualified period.