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subject: How the taxable income limitation in section 246(b) applies to limit the deductions under sections 243, 245, and 250

At the end of 2017, the tax reform legislation known as the Tax Cuts and Jobs Act ("TCJA"), Public Law No. 115-97, included the new section 250 deduction[1] in the list of deductions limited by the rules of section 246(b). This memorandum provides non-taxpayer-specific legal advice on how the taxable income limitation in section 246(b) applies to limit the deductions under sections 243, 245, and 250. This advice should not be used or cited as precedent.

Facts

This memorandum addresses three scenarios that are affected by the first reference to section 250 in section 246(b)(1). In each scenario, DC, a domestic C corporation that is not a regulated investment company (as defined in section 851) or a real estate investment trust (as defined in section 856), incurs the items in a single taxable year (and incurs no other items). Other than the potential applicability of section 246(b), no other restrictions or limitations on claiming dividends-received deductions are applicable.

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[1] Unless otherwise noted, all section references herein are to the Internal Revenue Code of 1986, as amended (the "Code").

a. Scenario 1

DC has a global intangible low-taxed income ("GILTI") inclusion under section 951A of $200x, a gross-up for deemed paid foreign tax credits under section 78 (a "section 78 gross-up") of $20x attributable to its GILTI inclusion, and a $10x deductible expense unrelated to the GILTI inclusion.

b. Scenario 2

DC has a GILTI inclusion of $200x, a section 78 gross-up of $60x attributable to its GILTI inclusion, $40x of dividends from domestic 20-percent-owned corporations (as defined in section 243(c)(2)) that are dividends described in section 243(a)(1),[2] $20x of dividends from domestic corporations that are not 20-percent-owned corporations that are dividends described in section 243(a)(1), and a $130x deductible expense unrelated to the GILTI Inclusion or the dividends.

c. Scenario 3

The facts are the same as in Scenario 2, except that DC also has $10x of foreign-derived intangible income, as defined in section 250(b) ("FDII").

Law

The proper interpretation of section 246(b) is dictated by its text and is informed by both the evolution of the statutory language and policy considerations.

a. Background of section 246(b) and amendments

Sections 243 and 245 permit certain corporations to deduct a certain percentage of the dividends they receive based on the size of their equity interest in the distributing corporation. Specifically, under section 243, dividends received by a corporation from a domestic corporation may give rise to a dividends-received deduction ("DRD") of 50 percent (70 percent for tax years beginning before January 1, 2018), 65 percent (80 percent for tax years beginning before January 1, 2018), or 100 percent of the amount of the dividend received. Similarly, under section 245, the U.S.-source portion of dividends received by a corporation from certain foreign corporations may give rise to a DRD of the same percentages.

The aggregate amount of these DRDs that are allowed has long been limited under section 246(b) to a certain percentage of taxable income computed without regard to

[2] Section 243(c)(2) defines a 20-percent owned corporation as "any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer."

certain deductions (for example, DRDs and net operating loss deductions) and other items. As a general matter, the limitation in section 246(b) prevents dividends that are eligible for DRDs from being taxed at effective rates below those established by the statutory rate and the percentage of the DRD (e.g., if the statutory rate of tax imposed on the dividend is 15% and the DRD is 50 percent, the statutory rate and the DRD produces an effective rate of 7.5 percent). As a result of the section 246(b) limitation, in effect, all or part of a DRD may be reduced by other deductions. Any portion of a DRD in excess of the limitation is lost.

i. Pre-TCJA

Before the enactment of the TCJA, section 246(b)(1) read:

> Except as provided in paragraph (2), the aggregate amount of the deductions allowed by section 243(a)(1) and subsection (a) or (b) of section 245 shall not exceed the percentage determined under paragraph (3) of the taxable income computed without regard to the deductions allowed by sections 172, 199, 243(a)(1), and subsection (a) or (b) of section 245, without regard to any adjustment under section 1059, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

Section 246(b)(3) as then in effect provided that the limitation in section 246(b)(1) was applied first to dividends received from 20-percent owned corporations (as defined in section 243(c)(2)), the DRDs with respect to which were limited to 80 percent of taxable income (as adjusted), and then separately with respect to dividends received from corporations that are not 20-percent owned corporations, the DRDs with respect to which were limited to 70 percent of taxable income (as adjusted and without regard to dividends received from 20-percent owned corporations). Thus, when read together with section 246(b)(3), section 246(b)(1) provided a two-step sequential limitation on DRDs based on the taxpayer's ownership of the distributing corporation.

ii. The TCJA

The TCJA altered elements of the corporate tax regime, including DRDs. Of relevance here, the TCJA reduced the corporate tax rate to 21 percent and introduced the GILTI regime under section 951A and the FDII regime under section 250(b). Section 250(a)(1) provides deductions with respect to both GILTI and FDII equal to certain percentages of each type of income. For taxable years beginning on or before December 31, 2025, the applicable percentage is 50 percent in the case of GILTI (and any section 78 gross-up attributable to GILTI) and 37.5 percent in the case of FDII. For taxable years beginning after December 31, 2025, the applicable percentage is 37.5 percent in the case of GILTI (and any section 78 gross-up attributable to GILTI) and 21.875 percent in the case of

FDII.[3] These deductions have the effect of reducing the rate of tax on GILTI and FDII in much the same manner that the DRDs reduce the rate of tax on dividends received by corporations. Section 250(a)(2) limits the aggregate of GILTI and FDII used to calculate the deductions under section 250, with the limit being taxable income (calculated without regard to section 250).

In conjunction with the reduction to the corporate rate, the TCJA reduced the percentage of dividends that could be deducted under sections 243 and 245,[4] maintaining a constant effective tax rate for dividends received, given the decreased corporate tax rate.[5] Relatedly, the percentage-of-taxable-income limits in section 246(b)(3) were decreased to 65 percent and 50 percent with respect to dividends from 20-percent owned corporations and corporations that are not 20-percent owned corporations, respectively.[6]

In conjunction with adding the section 250 deductions for FDII and GILTI to the Code,[7] the TCJA revised section 246(b)(1) to read as follows:

> Except as provided in paragraph (2), the aggregate amount of the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250 shall not exceed the percentage determined under paragraph (3) of the taxable income computed without regard to the deductions allowed by sections 172, 199A, 243(a)(1), subsection (a) and (b) of section 245, and 250, without regard to any adjustment under section 1059, and without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

The notable changes are underlined. The second and third underlined changes insert sections 199A and 250 into the list of sections that are disregarded in calculating income for purposes of the section 246(b) limitation. The first change – the addition of section 250 to the list of deductions that are limited by section 246(b) – subjects the FDII and GILTI deductions (including the portion of the GILTI deduction that is based on the amount of the section 78 gross-up that is attributable to GILTI) to a second taxable income limitation, on top of the one already present for GILTI and FDII under section 250(a)(2).

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[3] The remainder of this analysis refers to the percentages in section 250 that are in effect for taxable years beginning before January 1, 2026.

[4] TCJA, § 13002.

[5] *See* Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 114-15 (Comm. Print 2017); H.R. Rep. No 115-409, at 226-27 (2017).

[6] TCJA, § 13002.

[7] TCJA, § 14202(b).

b. Textual analysis of section 246(b)

The plain language of section 246(b) provides that the section 250 deduction is limited by the two limitations described in section 246(b)(3).

The relevant portions of the statute for understanding the first reference to section 250 in section 246(b)(1) are section 246(b)(1) itself, quoted above, and section 246(b)(3), which reads as follows:

> (3) Special rules
> The provisions of paragraph (1) shall be applied-
> (A) first separately with respect to dividends from 20-percent owned corporations (as defined in section 243(c)(2)) and the percentage determined under this paragraph shall be 65 percent, and
> (B) then separately with respect to dividends not from 20-percent owned corporations and the percentage determined under this paragraph shall be 50 percent and the taxable income shall be reduced by the aggregate amount of dividends from 20-percent owned corporations (as so defined).

Starting with paragraph (1), section 246(b) provides that the aggregate of three amounts – the deduction allowed by section 243(a)(1), the deduction allowed by subsections (a) and (b) of section 245, and the deduction allowed by section 250 – cannot exceed the percentage determined in paragraph (3) of taxable income, with certain adjustments.[8] Paragraph (3) then contains two percentage limitations that apply sequentially: first, paragraph (1) is applied with respect to dividends from 20-percent owned corporations, using a 65-percent limitation; and second, paragraph (1) is again applied, but this time with respect to dividends not from 20-percent owned corporations, using a 50-percent limitation. Subparagraph (B) of paragraph (3) states that it applies "separately," and that taxable income (as adjusted) must be reduced for that purpose by the amount of any dividends from 20-percent owned corporations.

The language of section 246(b) is clear: paragraph (1) is applied twice, once with respect to dividends from 20-percent owned corporations and then separately with respect to dividends from all other corporations. And paragraph (1), by its terms, limits an aggregate of three amounts, two of which are DRDs, and the third of which is the deduction allowed by section 250. Thus, for each of the two applications of paragraph (1), different groups of DRDs are combined with the section 250 deduction and compared to a specified percentage of taxable income (as adjusted); to the extent the DRDs plus the section 250 deduction exceed the specified percentage of taxable income, the deductions are reduced.

[8] In particular, taxable income for this purpose is computed without regard to the deductions limited by the rule (i.e., the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250).

The full amount of the section 250 deduction is included in the application of both subparagraphs (A) and (B) of section 246(b)(3). The section 250 deduction is a single deduction made up of two components: (1) 37.5 percent of FDII; and (2) 50 percent of the GILTI inclusion (and 50 percent of the section 78 gross-up attributable to the GILTI inclusion). Subparagraphs (A) and (B) of section 246(b)(3) apply separately with respect to dividends from 20-percent owned corporations and dividends not from 20-percent owned corporations, but the section 250 deduction is not calculated with respect to dividends from or not from 20-percent owned corporations and cannot be subdivided on that basis in the same manner as the DRDs. FDII is earned directly by the taxpayer, not by entities owned by the taxpayer; GILTI is not a dividend; and while the section 78 gross-up generally is treated as a dividend, it is calculated on an aggregate basis across all CFCs,[9] is not attributed to particular CFCs, and does not affect the earnings and profits of any CFC,[10] in contrast with a dividend, defined in section 316(a) as a distribution out of earnings and profits. Thus, the single section 250 deduction is not amenable to being divided and specifically allocated between section 246(b)(3)(A) and (B), and there is no textual basis for doing so.

c. Policy rationale

Applying the first reference to section 250 in section 246(b) as described above furthers what appears to be the policy rationale for including section 250 in the section 246(b) limitation: it prevents the amount of FDII and GILTI inclusions (and the section 78 gross-up attributable to GILTI inclusions) from being reduced by deductions or items other than those specified, and thus preserves taxation of FDII and GILTI inclusions at an effective rate calculated by reference to the statutory rate (or, viewed from the perspective of available DRDs, avoids neutralizing the limitation on the DRDs that may be claimed).

For example, assume a domestic corporation, USC, has $200x of dividend income from a domestic corporation that does not meet the definition of a 20-percent owned corporation in section 243(c)(2) and that is eligible for the DRD described in section 243(a)(1). USC has no GILTI inclusion, no FDII, and a current-year deductible expense of $100x from other activities. In this case, the taxable income limitation for purposes of section 246(b) is $50x (i.e., 50 percent of taxable income without regard to the deduction allowed under section 243(a)(1), or $100x), and the $100x DRD, therefore, is limited to $50x. After taking into account the DRD and the deductible expense, taxable

[9] See section 960(d)(1)(A) and (B) (providing that the amount of taxes deemed paid by a domestic corporation with respect to inclusions under section 951A are calculated by multiplying the domestic corporation's inclusion percentage – a number calculated based on tested income and tested losses of all of the domestic corporation's CFCs with tested income or tested loss – multiplied by the aggregate tested foreign income taxes (as defined in section 960(d)(3)) paid by CFCs of the domestic corporation.

[10] See Treas. Reg. sec. 1.78-1(a) (providing that a section 78 dividend "does not increase the earnings and profits of the domestic corporation or decrease the earnings and profits of the foreign corporation").

income for the year is $50x (i.e., the $200x of dividend income, less the $100x deduction, and less the $50x DRD as limited by section 246(b)). This result prevents dividend income that is offset by the $100x expense from generating a DRD.

Now consider the effect if, in addition to the $200x of dividend income and the $100x expense, USC has a $100x GILTI inclusion (with respect to which there is no section 78 gross-up) that gives rise to a section 250 deduction of $50x, first hypothetically if the section 250 deduction were not subject to the section 246(b) limitation (contrary to present law), and then assuming present law applies (i.e., the section 250 deduction is subject to the section 246(b) limitation).

The section 246(b)(3)(B) taxable income limitation in this fact pattern with respect to the DRD is $100x (i.e., 50 percent of taxable income without regard to the deductions allowed under section 243(a)(1) and 250, or $200x).

Were the section 250 deduction not subject to the 246(b) limitation, the DRD of $100x would be compared to a taxable income limitation of $100x, and the DRD would not be limited. Taxable income therefore would be $50x (i.e., the $200x of dividend income plus $100x of GILTI, less the $100x deduction, the $100x DRD, and the $50x section 250 deduction). Thus, on this fact pattern, where the taxpayer has an incremental $100x GILTI inclusion, there would nonetheless be no increase in taxable income. In other words, the $100x of GILTI inclusion has in effect served to offset the $100x deduction otherwise taken into account in the calculation of the section 246(b)(3)(B) limitation and so increase the limit, freeing the DRD (or, viewed differently, has resulted in the GILTI inclusion being subject to a zero rate of tax).[11]

Compare that result with the result under present law, where the section 250 deduction is subject to the section 246(b) limitation. The taxable income limitation under section 246(b)(3)(B) remains $100x, as described above, but now the amount being compared to that limitation is the sum of the $100x DRD and the $50x section 250 deduction, or a total of $150x. Because $150x exceeds the section 246(b)(3)(B) taxable income limitation of $100x, the aggregate amount of the DRD and the section 250 deduction is reduced by the $50x excess. Applying that reduction proportionally to the DRD and the

[11] Note that similar results can occur where the taxpayer's DRD with respect to 20-percent owned corporations is limited. Consider the fact pattern discussed in these paragraphs, with modifications that the dividends are from 20-percent owned corporations and the deductible expense is only $50x (reducing the loss to avoid application of section 246(b)(2)). Where there is no GILTI inclusion, the taxable income limitation is $97.5x (i.e., 65 percent of $150x), the DRD of $130x is reduced to $97.5x, and taxable income is $52.5x ($200x less $50x and less $97.5x). Adding in $100x of GILTI inclusion but ignoring the first reference to section 250 in section 246(b)(1), the taxable income limitation increases to $162.5x (i.e., 65 percent of $250x), and the full DRD and section 250 deduction are allowed, for taxable income of $70x ($300x less the sum of $50x, $130x, and $50x). In this scenario, adding $100x of GILTI inclusion has increased taxable income by $17.5x (i.e., $70x - $52.5x), meaning that $100x of income is being taxed at 17.5 percent of the full rate, well below the 50 percent rate reduction provided by section 250.

section 250 deduction,[12] taxable income increases to $100x (i.e., the $200x dividend plus $100x GILTI, less the $100x deductible expense, the $66.7x DRD, and a $33.3x section 250 deduction). Thus, under present law, the $100x of GILTI increases taxable income by $50x, consistent with the GILTI being taxed at a 10.5% rate (or half of the 21% corporate rate). That is, the additional GILTI has been taxed appropriately and has not escaped taxation.

Analysis

Applying the law as described above to the three scenarios introduced under Facts produces the following results.

a. Scenario 1

DC has a GILTI inclusion of $200x, a section 78 gross-up of $20x attributable to its GILTI inclusion, and a $10x deductible expense unrelated to the GILTI inclusion.

Section 250(a)(2) limitation. DC's taxable income, solely for the purpose of applying the taxable income limitation in section 250(a)(2), is $210x ($200x GILTI inclusion, plus $20x section 78 gross-up, less $10x deduction). That amount exceeds DC's $200x GILTI inclusion, and therefore DC's section 250 deduction with respect to its GILTI inclusion is not reduced by the section 250(a)(2) taxable income limitation. DC is thus allowed a deduction under section 250 (before application of section 246(b))[13] of $110x, equal to 50 percent of $220x (the sum of DC's $200x GILTI inclusion and $20x section 78 gross-up).[14]

Section 246(b)(3)(A) limitation. Next, it must be determined whether the section 250 deduction is limited under section 246(b). Starting with the limitation in section 246(b)(3)(A), compare (1) the sum of (a) DRDs arising from dividends received from 20-percent owned corporations (i.e., $0x) and (b) the section 250 deduction (i.e., $110x) to (2) 65 percent of taxable income computed without regard to the deductions allowed by

[12] Given the absence of statutory language requiring that any reduction required by section 246(b) be applied to the components of the aggregate amount that is subject to limitation in a particular order, the best reading of the statute is to apply the limitation pro rata to each component based on its contribution to the total amount subject to limitation.

[13] Section 246(b) applies to limit the section 250 deduction. Therefore, the section 250 deduction is determined before application of section 246(b), and then section 246(b) imposes an additional taxable income limitation. As a result, the section 250(a)(2) taxable income limitation, which is part of the determination of the section 250 deduction before application of section 246(b), applies before section 246(b).

[14] For simplicity, figures in this analysis of the three scenarios have been rounded to the nearest tenth. Note that the section 250 deduction attributable to the section 78 gross-up is not subject to the limitation under section 250(a)(2) because the gross-up is not part of the "global intangible low-taxed income amount."

section 243(a)(1), subsection (a) and (b) of section 245, and section 250 (i.e., 65 percent of $210x, or $136.5x). Because $110x is less than $136.5x, section 246(b)(3)(A) does not limit DC's section 250 deduction.

Section 246(b)(3)(B) limitation. Turning next to the limitation in section 246(b)(3)(B), compare (1) the sum of (a) DRDs arising from dividends received from corporations that are not 20-percent owned corporations (i.e., $0x) and (b) the section 250 deduction (i.e., $110x) to (2) 50 percent of taxable income computed without regard to the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250, and also reduced by the aggregate amount of dividends from 20-percent owned corporations (i.e., 50 percent of $210x, or $105x). Because the $105x limitation is less than $110x, section 246(b)(3)(B) applies to limit DC's deduction otherwise allowed by section 250 to $105x. Therefore, DC is allowed a section 250 deduction of $105x.

b. Scenario 2

DC has a GILTI inclusion of $200x, a section 78 gross-up of $60x attributable to its GILTI inclusion, $40x of dividends from 20-percent-owned corporations (as defined in section 243(c)(2)), $20x of dividends from corporations that are not 20-percent-owned corporations, and a $130x deductible expense unrelated to the GILTI inclusion or the dividends.

Section 250(a)(2) limitation. DC's taxable income, solely for the purpose of applying the taxable income limitation in section 250(a)(2), is $154x.[15] That amount is less than DC's GILTI inclusion of $200x. As a result, the amount of GILTI inclusion DC takes into account for purposes of calculating the section 250 deduction is $154x. DC is thus allowed a deduction under section 250 (before application of section 246(b)) of $107x, equal to 50 percent of the sum of (1) the amount of GILTI permitted to be taken into account for purposes of calculating the section 250 deduction, or $154x, and (2) the amount of the section 78 gross-up, or $60x.

[15] Taxable income for this purpose is determined without regard to section 250 but with regard to the DRDs (but again, without regard to the section 250 deduction). Here, the DRDs calculated without regard to section 250 would be $26x (i.e., 65 percent of $40x), in the case of the dividends from 20-percent owned corporations, and $10x (i.e., 50 percent of $20x), in the case of the dividends from corporations that are not 20-percent owned corporations. Thus, taxable income for this purpose equals $154x ($200x + $60x + $40x + $20x - $130x - $26x - $10x). As noted in n. 13, above, for purposes of this calculation, the section 246(b) limitation applies, but because section 250(a)(2) specifies that taxable income is calculated without regard to section 250, section 246(b) limits only the DRDs, and not the aggregate of the DRDs and section 250. Here, where the DRDs with respect to dividends from 20-percent owned and from non-20-percent owned corporations before limitation are $26x and $10x, respectively, while the relevant amounts of taxable income for purposes of section 246(b)(3)(A) and (B) are $123.5x (i.e., 65 percent of $190x ($200x + $60x + $40x + $20x - $130x)) and $75x (i.e., 50 percent of $150x ($200x + $60x + $20x - $130x)), respectively, the DRDs are not limited by section 246(b) for purposes of the section 250(a)(2) calculation.

Section 246(b)(3)(A) limitation. Next, it must be determined whether the DRDs and the section 250 deduction are limited under section 246(b). Starting with the limitation in section 246(b)(3)(A), compare (1) the sum of (a) DRDs arising from dividends received from 20-percent owned corporations (i.e., 65 percent of $40x, or $26x) and (b) the section 250 deduction before the application of section 246(b) (i.e., $107x)) (total of $133x) to (2) 65 percent of $190x, which is taxable income computed without regard to the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250) (i.e., $123.5x).

Because the $123.5x limitation is less than $133x, the aggregate of DC's DRD attributable to dividends received from 20%-owned corporations and its section 250 deduction is reduced by the difference, $9.5x. This $9.5x reduction is allocated proportionally to the DRD and section 250 deduction in the ratio that each bears to the total of both deductions (19.5 percent and 80.5 percent, respectively). Accordingly, DC's DRD from 20-percent owned corporations is reduced by $1.9x to $24.1x, and its section 250 deduction (before application of section 246(b)(3)(B)) is reduced by $7.6x to $99.4x.[16]

Section 246(b)(3)(B) limitation. Turning next to the limitation in section 246(b)(3)(B), compare (1) the sum of (a) the DRD arising from dividends received from corporations that are not 20-percent owned corporations (i.e., 50 percent of $20x, or $10x) and (b) the section 250 deduction remaining after application of section 246(b)(3)(A)) (i.e., $99.4x) (together, $109.4x) to (2) 50 percent of taxable income computed without regard to the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250, and also reduced by the aggregate amount of dividends from 20-percent owned corporations (i.e., 50 percent of $150x, or $75x). Because the $75x limitation is less than $109.4x (the sum of DRDs attributable to dividends from corporations that are not 20% owned, or $10x, and the section 250 deduction after reduction under section 246(b)(3)(A), or $109.4) the aggregate of DC's DRD arising from dividends received from corporations that are not 20-percent owned corporation and its section 250 deduction is reduced by the difference, $34.4x. This $34.4x reduction is allocated proportionally to the DRD and section 250 deductions in the ratio that each bears to the total of both deductions (9.1 percent and 90.9 percent, respectively). Accordingly, DC's DRD from corporations that are not 20-percent owned corporations is reduced by $3.1x, from $10x to $6.9x, and its section 250 deduction is further reduced by $31.3x, from $99.4x to $68.1x.

c. Scenario 3

DC has a GILTI inclusion of $200x, a section 78 gross-up of $60x attributable to its GILTI inclusion, $40x of dividends from 20-percent-owned corporations (as defined in

[16] Section 246(b) requires sequential application of the limitations in section 246(b)(3)(A) and (b)(3)(B). Therefore, in this analysis, any reduction to the section 250 deduction required by application of section 246(b)(3)(A) is taken into account in the application of section 246(b)(3)(B).

section 243(c)(2)), $20x of dividends from corporations that are not 20-percent-owned corporations, and a $130x deductible expense unrelated to the GILTI Inclusion or the dividends. DC also earns $10x of FDII, as defined in section 250(b).

Section 250(a)(2) limitation. DC's taxable income, solely for the purpose of applying the taxable income limitation in section 250(a)(2), is $164x.[17] That amount is less than the sum of DC's FDII and GILTI inclusion, or $210x ($10x + $200x). As a result, the amount of FDII and GILTI inclusion DC takes into account for purposes of calculating the section 250 deduction is $164x. The $46x reduction is allocated between FDII and the GILTI inclusion proportionately (see section 250(a)(2)(B)), resulting in a $2.2x reduction to FDII (leaving $7.8x) and a $43.8x reduction to GILTI (leaving $156.2x). DC is thus allowed a deduction under section 250 (before application of section 246(b)) of $111x, equal to the sum of (1) 37.5 percent of $7.8x (i.e., $2.9x), and (2) 50 percent of the sum of (a) the amount of GILTI inclusion permitted to be taken into account for purposes of calculating the section 250 deduction, or $156.2x, and (b) the amount of the section 78 gross-up, or $60x (i.e., $108.1x).

Section 246(b)(3)(A) limitation. Next, it must be determined whether the DRDs and the section 250 deduction are limited under section 246(b). Starting with the limitation in section 246(b)(3)(A), compare (1) the sum of (a) DRDs arising from dividends received from 20-percent owned corporations (i.e., 65 percent of $40x, or $26x) and (b) the section 250 deduction before the application of section 246(b) (i.e., $111x)) (total of $137x) to (2) 65 percent of $200x, which is taxable income computed without regard to the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250) (i.e., $130x).

Because the $130x limitation is less than $137x, the aggregate of DC's DRD attributable to dividends received from 20%-owned corporations and its section 250 deduction is reduced by the difference, $7x. This $7x reduction is allocated proportionally to the DRD and section 250 deduction in the ratio that each bears to the total of both deductions (19 percent and 81 percent, respectively). Accordingly, DC's DRD from 20-percent owned corporations is reduced by $1.3x to $24.7x, and its section 250 deduction (before application of section 246(b)(3)(B)) is reduced by $5.7x to $105.3x.

Section 246(b)(3)(B) limitation. Turning next to the limitation in section 246(b)(3)(B), compare (1) the sum of (a) the DRD arising from dividends received from corporations that are not 20-percent owned corporations (i.e., $10x) and (b) the section 250

[17] Taxable income for this purpose is determined without regard to section 250 but with regard to the DRDs (but again, without regard to section 250). Here, the DRDs calculated without regard to section 250 would be $26x (i.e., 65 percent of $40x), in the case of the dividends from 20-percent owned corporations, and $10x (i.e., 50 percent of $20x), in the case of the dividends from corporations that are not 20-percent owned corporations. Thus, taxable income for this purpose equals $164x ($10x + $200x + $60x + $40x + $20x - $130x - $26x - $10x).

deduction remaining after application of section 246(b)(3)(A)) (i.e., $105.3x) (together, $115.3x) to (2) 50 percent of taxable income computed without regard to the deductions allowed by section 243(a)(1), subsection (a) and (b) of section 245, and section 250 and also reduced by the aggregate amount of dividends from 20-percent owned corporations (i.e., 50 percent of $160x,[18] or $80x). Because the $80x limitation is less than $115.3x, the aggregate of DC's DRD arising from dividends received from corporations that are not 20-percent owned corporation and its section 250 deduction is reduced by the difference, $35.3x. This $35.3x reduction is allocated proportionally to the DRD and section 250 deductions in the ratio that each bears to the total of both deductions (8.7 percent and 91.3 percent, respectively). Accordingly, DC's DRD from corporations that are not 20-percent owned corporations is reduced by $3.1x to $6.9x, and its section 250 deduction is further reduced by $32.2x to $73.1x.

Allocation of reduction between FDII and GILTI (and the section 78 gross-up). DC's section 250 deduction before application of section 246(b) was $111x. After application of section 246(b), that deduction is reduced by $37.9x to $73.1x. As discussed above, the section 250 deduction that is limited by section 246(b) is the sum of two amounts, one based on FDII and one based on the GILTI inclusion (and the section 78 gross-up attributable to the GILTI inclusion). In this scenario, the section 250 deduction before application of section 246(b) comprises $2.9x attributable to FDII (calculated under section 250(a)(1)(A)) and $108.1x attributable to GILTI and the section 78 gross-up (calculated under section 250(a)(1)(B)). Because $2.9x is 2.6 percent of $111x and $108.1x is 97.4 percent of $111x, 2.6 percent of the section 250 deduction before application of section 246(b) is attributable to FDII, and 97.4 percent is attributable to GILTI and the section 78-gross-up. Accordingly, for purposes of determining the amount of the deductions allowed by section 250(a)(1)(A) and (a)(1)(B), the $37.9x reduction of the section 250 deduction is allocated as follows: the FDII deduction is reduced by $0.99x to $1.91x, and the GILTI (and section 78 gross-up) deduction is reduced by $36.91x to $71.19x. In the absence of statutory language requiring that any reduction to the section 250 deduction that is required by section 246(b) be applied to the GILTI (and section 78 gross-up) and FDII components of the section 250 deduction in a particular order, the best reading of the statute is to apply the limitation pro rata to each component based on its contribution to the total amount subject to limitation.[19]

Please call (202) 317-3800 if you have any questions.

[18] I.e., $200x + 60x + 40x + 20x + 10x - 130x - 40x = $160x.

[19] Note that the effect on the amount of the GILTI and FDII deductions may have follow-on effects with respect to other rules affected by the amount of those deductions (e.g., foreign tax credit calculations).