



Federal Bar
Association

TAX LAW CONFERENCE

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Impact of TCJA on Corporations Part I Section 168(k), Qualified Opportunity Zones, and Section 245A

March 8, 2019

Donald Bakke
Ernst & Young LLP

Josh Brady
Grant Thornton LLP

Olivia Orobona
PwC LLP

Lisa Zarlenga
Steptoe & Johnson LLP

Jeremy Aron-Dine
IRS Chief Counsel (Corporate)

Colin Campbell
Department of the Treasury



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Agenda

- Section 168(k) Expensing
- Section 245A Foreign-Source Dividends Received Deduction
- Qualified Opportunity Zones

Section 168(k) Expensing

Section 168(k) – In General

Overview:

- Bonus depreciation percentage is increased from 50% to 100% for property acquired and placed in service after September 27, 2017, and before 2023.
- Phases down 20% per year through 2026.

Qualifying Property:

- Tangible property subject to MACRs predominantly used in the U.S. with a recovery period of 20 years or less.
- Computer software not subject to section 197 amortization.
- Water utility property.
- Qualified improvement property in service before January 1, 2018.

Excluded Property:

- Real property of an electing real property trade or business.
- Property with a recovery period of 10 years or more held by an electing farming business.
- Certain regulated utility property.
- Property used in a trade or business that has had floor plan financing indebtedness.

Used Property – No Prior Use Test

In General:

- Prop. Reg. § 1.168(k)-2(b)(3) provides that the acquisition of used property is eligible for the additional first year depreciation deduction only if property was not *used by the taxpayer or a predecessor at any time prior* to the acquisition.

Use:

- “Use” is defined as having a “depreciable interest” in the property (without regard to actual depreciation deductions).
- “Depreciable interest” is not defined, but appears to be akin to “tax ownership” for purposes of section 167.
- Prop. Reg. § 1.168(k)-2(b)(3)(vi), *Example 6*:
 - *Facts.* Beginning in 2016, *L* leases machine from unrelated lessor, *K*. *L* uses the machine in its trade or business. On May 15, 2018, *L* purchases the machine from *K* for its fair market value.
 - *Analysis.* *L* did not have a depreciable interest in the machine before it acquired the machine on May 15, 2018.

Predecessor:

- Not defined.
- Limited to section 381 transactions?

Used Property – No Prior Use Test (*continued*)

Unlimited Lookback Period:

- May impose significant burden on taxpayers.
- Preamble asks for comments.

Possible Safe Harbor Approaches:

- By reference to elapsed time period.
 - Might require exception for abusive plans.
- Presumption except in cases of actual or constructive knowledge?
 - Consistent with other presumptions regarding ownership.
See, e.g., Reg. §§ 1.382-2T(k)(1)(i), 1.367(a)-3(c)(5)(iii), 1.355-7(h)(8) (reliance on SEC filing to determine stock ownership).
- By reference to recovery period.

Used Property – Unrelated Purchase Test

In General:

- Prop. Reg. § 1.168(k)-2(b)(3) provides that the acquisition of used property is eligible for additional first year depreciation deduction only if the property meets the requirements of section 179(d)(2) and (3):

Relatedness:

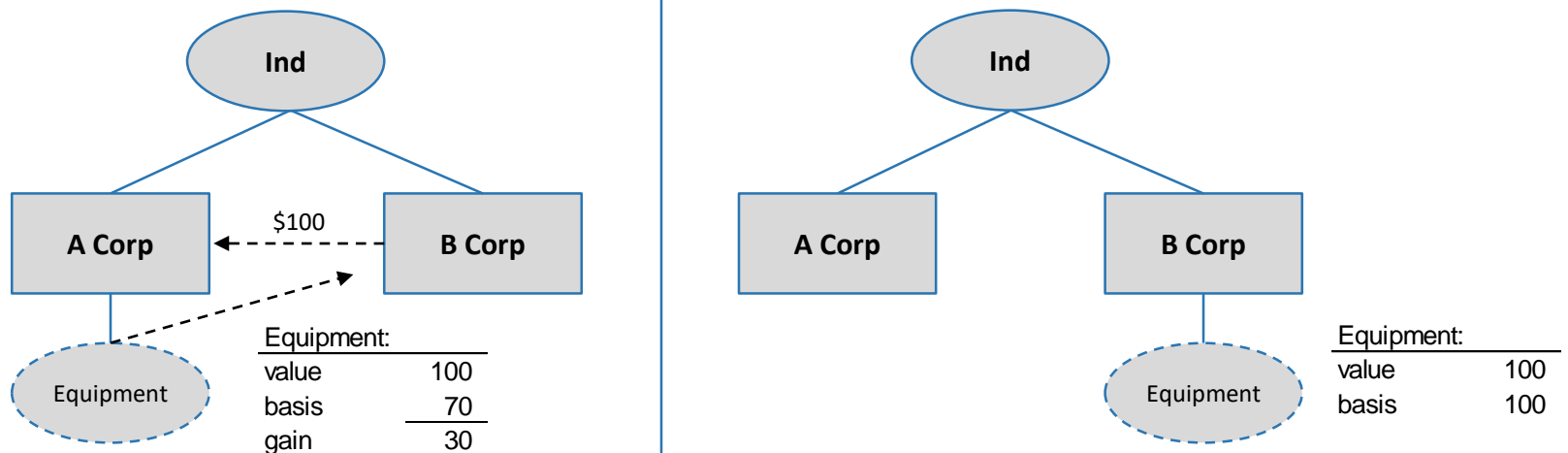
1. Property must not have been acquired from a person whose relationship with the taxpayer is described in section 267 or 707(b).
 - Two corporations are related under section 267(f) to the extent they are part of the same controlled group of corporations (more than 50% voting and value of stock).
 - Includes all consolidated groups.
 - When is relatedness tested?
2. Property must not be acquired by one component member of a controlled group from another component member of the same controlled group within the meaning of section 1563(a) and (b) modified to require more than 50% ownership under Reg. § 1.179-4(f)).
 - Parent-subsidiary controlled group – One or more chains of corporations connected through stock ownership of more than 50% vote or value with a common parent.
 - Brother-sister controlled group – Five or fewer individuals own more than 50% vote or value of each corporation (taking into account only overlapping stock ownership).

Used Property – Unrelated Purchase Test (*continued*)

Basis:

3. The basis of the acquired property cannot be determined by reference to the transferor's basis in the property (i.e., the property must be acquired in a taxable transaction).
4. The cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring such property.
 - *E.g.*, upon like-kind exchange, section 168(k) only applies with respect to the portion, if any, of the acquired property's basis that is determined by reference to the acquiring taxpayer's payment of cash or other taxable acquisition.
5. Solely for purposes of the used property acquisition requirements (i.e., no prior use and unrelated purchase requirements), in the case of a series of related transactions—
 - The property is treated as directly transferred from the original transferor to the ultimate transferee; and
 - The relation between the original transferor and the ultimate transferee is tested immediately after the last transaction in the series.

Component Member Example



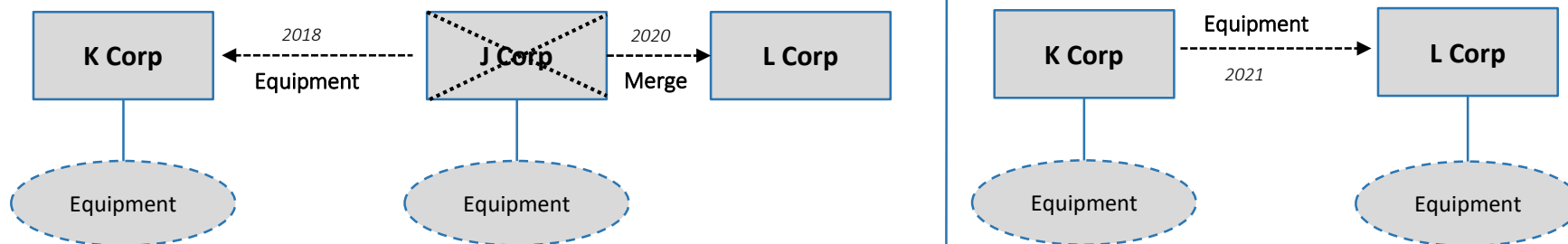
Facts:

- Individual I owns all of the stock of A and B corporations.
- A has a depreciable interest in Equipment.
- During 2018, A sells Equipment to B.
- Prior to this acquisition, B never had a depreciable interest in Equipment.

Analysis:

- B's acquisition of Equipment does not satisfy the used property acquisition requirement because A and B corporations are component members of the same controlled group.

Successor – Prop. Reg. §1.168(k)-2(b)(3)(v), Example 23



Facts:

- K Corp, J Corp, and L Corp are unrelated parties within the meaning of section 179(d)(2)(A) or (B) and Reg. § 1.179-4(c) and are not members of a consolidated group.
- J Corp has a depreciable interest in Equipment. In 2018, J Corp sells Equipment to K Corp.
- In 2020, J Corp merges into L Corp in a reorganization described in section 368(a)(1)(A).
- In 2021, L Corp acquires Equipment from K Corp.

Analysis:

- L Corp's acquisition is not eligible for expensing under section 168(k).
- Because J Corp is the predecessor of L Corp and J Corp previously had a depreciable interest in Equipment, L Corp's acquisition of Equipment does not satisfy the requirement that the property was not used by the taxpayer or its predecessor prior to the acquisition.

Used Property – Interaction with Consolidated Groups

General Rule:

- If a member of a consolidated group acquires depreciable property in which the consolidated group had a depreciable interest at any time prior to the member's acquisition of the property, the member will be treated as having a depreciable interest in the property prior to the acquisition.
- Consolidated group is treated as having a depreciable interest in property during the time any current or previous member of the group had a depreciable interest in the property while a member of the group.

Stock and Asset Acquisition Rule:

- A member will be treated as having a prohibited depreciable interest in property where, as part of a “series of related transactions,” a member of a consolidated group acquires the property and a corporation that previously used that property becomes a member of the same consolidated group.
- For purposes of the General Rule and the Stock and Asset Acquisition Rule, where as part of a “series of related transactions” a member of a consolidated group both acquires property and the transferee ceases to be a member of the consolidated group, the taxpayer’s membership in the consolidated group is tested immediately after the last transaction in the series.

Used Property – Consolidated Group Rules

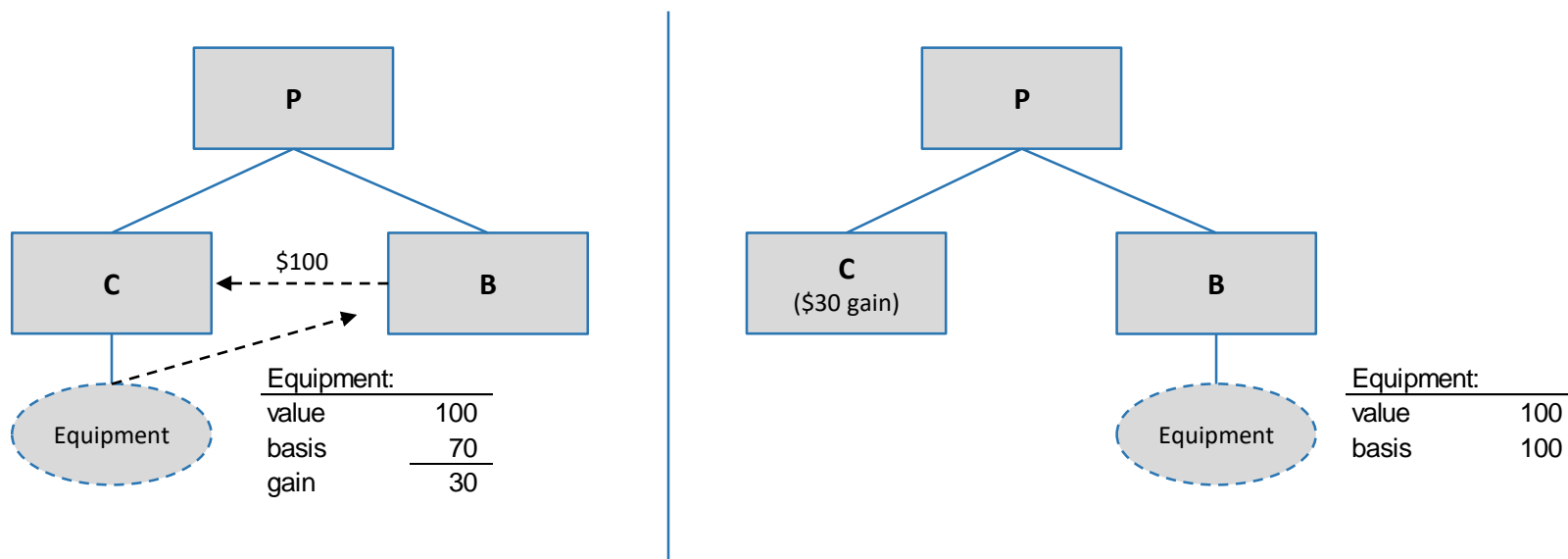
Section 168(i)(7):

- Section 168(i)(7) provides that if property is transferred in certain tax-free transactions (sections 332, 351, 361, 721, or 731) or in an intercompany transaction, the transferee is treated as the transferor for purposes of computing the depreciation deduction to the extent of the basis in the hands of the transferor.
- “Step in the shoes” treatment.

Intercompany Transaction:

- A transaction between corporations that are members of the same consolidated group immediately after the transaction.
- If a transaction occurs in part while S and B are members of the consolidated group and in part while they are not members, the transaction is treated as occurring upon the earliest of:
 - When performance by either S or B takes place, or
 - When payment for performance would be taken into account under the intercompany transaction rules.

Prop. Reg. §1.168(k)-2(b)(3)(v), Example 19



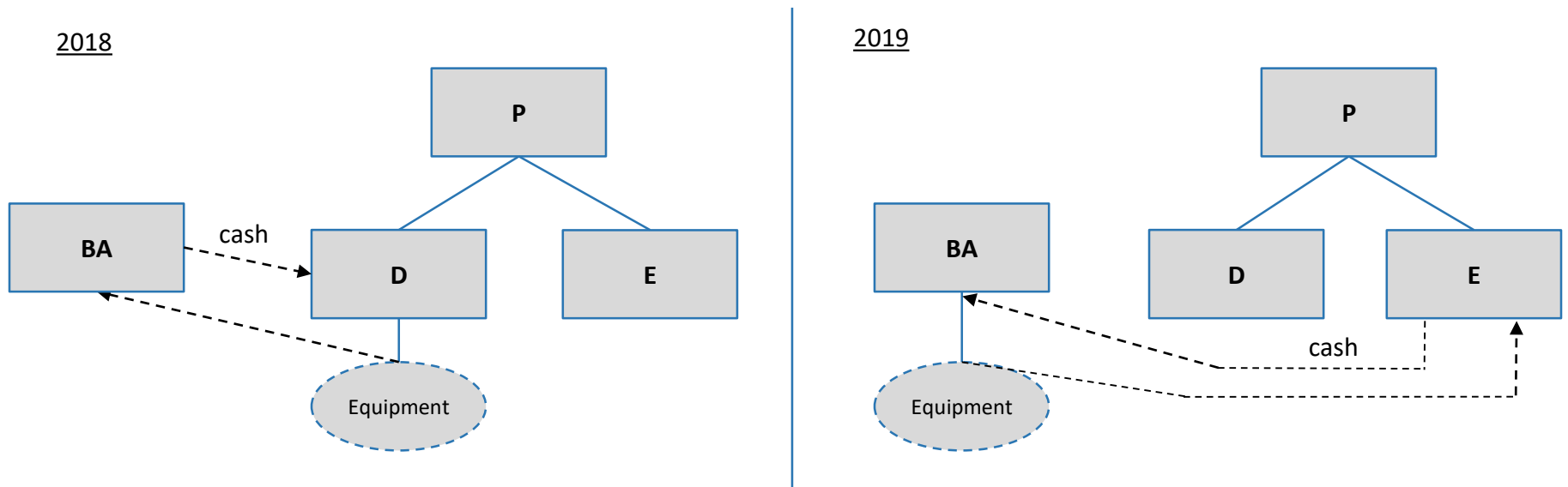
Facts:

- P corporation owns all of the stock of B and C corporations, each of which is a member of the P consolidated group.
- C has a depreciable interest in Equipment.
- During 2018, C sells Equipment to B. Prior to this acquisition, B never had a depreciable interest in Equipment.

Analysis:

- B's acquisition of Equipment does not satisfy the used property acquisition requirements for two reasons:
- First, B and C are related parties within the meaning of section 179(d)(2)(B) and Reg. § 1.179-4(c)(2)(iii).
- Second, under Prop. Reg. § 1.168(k)-2(b)(3)(iii)(B)(3)(i) (the General Rule), B is treated as previously having a depreciable interest in Equipment because B is a member of the P consolidated group and C, while a member of the P group, had a depreciable interest in Equipment.
- Accordingly, B's acquisition of Equipment is not eligible for the additional first year depreciation deduction.

Prop. Reg. §1.168(k)-2(b)(3)(v), Example 20



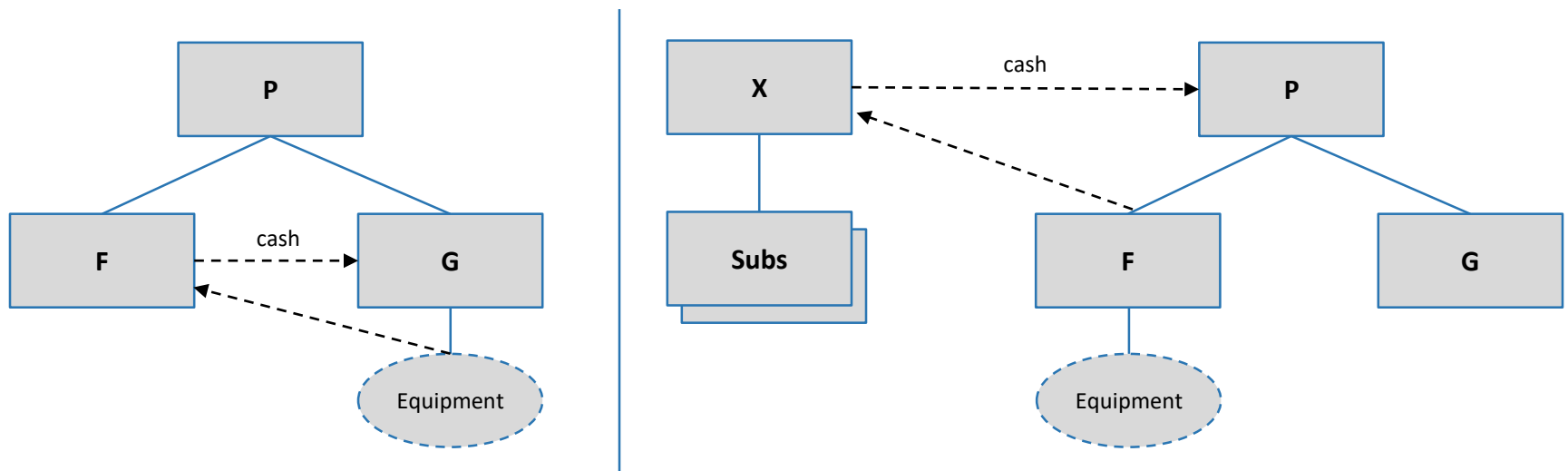
Facts:

- P corporation owns all of the stock of D and E corporations, each of which is a member of the P consolidated group.
- D has a depreciable interest in Equipment; no other members of the P group ever had a depreciable interest in Equipment.
- During 2018, D sells Equipment to BA, a person not related, within the meaning of section 179(d)(2)(A) or (B) and Reg. § 1.179-4(c), to any member of the P group.
- In an unrelated transaction in 2019, E acquires Equipment from BA (or another unrelated person).

Analysis:

- Under the General Rule, E is treated as previously having a depreciable interest in Equipment because E is a member of the P group, and D, while a member of the P group, had a depreciable interest in Equipment.
- As a result, E Corporation's acquisition of Equipment does not satisfy the used property acquisition requirements.
- Thus, E's acquisition of Equipment is not eligible for the additional first year depreciation deduction.
- Same if D had ceased to be a member of the P group prior to E's acquisition of Equipment.

Prop. Reg. §1.168(k)-2(b)(3)(v), Example 21



Facts:

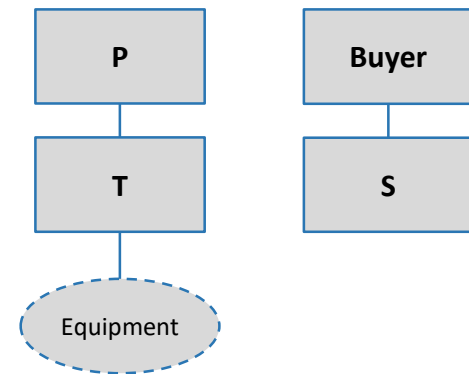
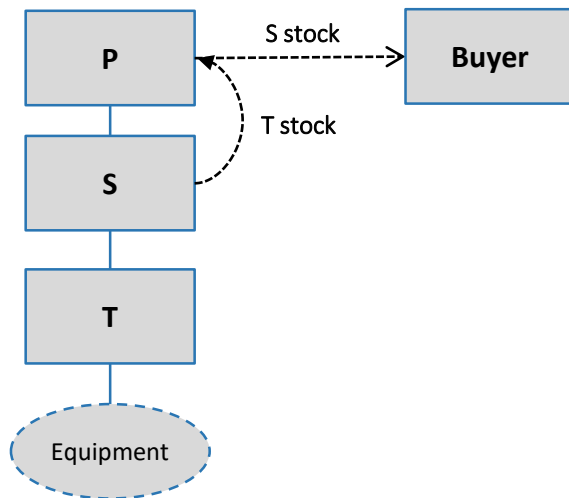
- P corporation owns all of the stock of F and G corporations, each of which is a member of the P consolidated group. G has a depreciable interest in Equipment.
- X corporation is the common parent of a consolidated group and is not related, within the meaning of section 179(d)(2)(A) or (B) and Reg. § 1.179-4(c), to any member of the P consolidated group. No member of the X consolidated group ever had a depreciable interest in Equipment.
- In related transactions, G sells Equipment to F, and P sells all of the stock of F to X.

Analysis:

- Because there is a series of related transactions that includes the acquisition of Equipment and a transaction in which F, the transferee of the property, leaves the P group and joins the X group, the time to test whether F is a member of the P group for purposes of the General Rule is met is immediately after the last transaction in the series (i.e., the sale of the F stock to X).
- Because F is not a member of the P group after the last transaction of the series, F is not treated as previously having a depreciable interest in Equipment by virtue of G's depreciable interest in Equipment.

Which group is entitled to the section 168(k) deduction? How does section 168(i)(7) apply?

Expensing With Taxable Distribution



Facts:

Pursuant to a single plan, on Day 1, S distributes all of the stock of T to P in a taxable distribution and P sells all of the stock of S to unrelated Buyer for cash on Day 3.

P and S make a section 336(e) election with respect to T.

P and S are unrelated at the end of the transaction.

Can the P group expense T's tangible assets under section 168(k)? If P, S, and T were members of the same consolidated group, is the P group treated as having a prior use that precludes the deduction? See Prop. Reg. § 1.168(k)-2(b)(3)(iii)(B)(3)(i) (treating a consolidated us member of the group had a depreciable interest).

Section 245A Foreign-Source Dividends Received Deduction

Section 245A - Generally

A U.S. corporation is permitted a deduction equal to the foreign source portion of any dividend received from a specified 10-percent owned foreign corporation if the U.S. corporation is a U.S. shareholder with respect to such foreign corporation.

- **U.S. Corporation:** Statutory language applies to “domestic corporations” that are not RICs or REITs.
- **Foreign Corporation:** Legislative history indicates a CFC may be eligible for the deduction.
 - Footnote 1486 of the Conference Report indicates that the provision is also meant to apply to “a controlled foreign corporation treated as a domestic corporation for purposes of computing the taxable income thereof.” See Reg. § 1.952-2(b)(1) (“Except as provided in subparagraph (2) of this paragraph [dealing with insurance income], the taxable income of a foreign corporation for any taxable year shall, subject to the special rules of paragraph (c) of this section, be determined by treating such foreign corporation as a domestic corporation taxable under section 11 and by applying the principles of section 63.”).
 - Section 245A(e)(2)(B) (requiring US shareholders to include as subpart F income hybrid dividends received by one CFC from another CFC) suggests that the deduction would otherwise be available. But the preamble to proposed regulations under section 951A request comments as to whether the deduction should be available for purposes of computing tested income.

Section 245A - Generally

- **Specified 10-percent Owned Foreign Corporation:** Excludes passive foreign investment companies that are not also CFCs.
- **Dividends Received:** Includes actual and deemed dividends (e.g., under section 1248 or 964(e)) and a U.S. corporation's distributive share of such dividends received by a partnership that owns stock of a foreign corporation.
- **Foreign Source Portion:** Amount that bears the same ratio to the dividend as the undistributed foreign earnings of the specified 10-percent owned foreign corporation bears to the total undistributed earnings of the foreign corporation.
 - Undistributed earnings → E&P of the foreign corporation as of the close of the taxable year in which the dividend is distributed, without diminution for dividends distributed during the year.
 - Undistributed foreign earnings → Portion of undistributed earnings attributable to income other than ECI or dividends from 80% owned U.S. corporations.

Section 245A – Holding Period

Deduction under section 245A is only available to U.S. corporate shareholders that have held the shares in the specified 10-percent owned foreign corporation **for at least 366 days** during the 731 day period beginning 365 days before the date on which the shares “become[] ex-dividend” with respect to the dividend. See section 246(c)(1), (c)(5)(A).

- **Days that Count:** Day of disposition but not day of acquisition counts in holding period. See section 246(c)(3).
- **Maintenance of Status:** U.S. shareholder and specified 10-percent owned foreign corporation status must be maintained at all times during the required holding period. See section 246(c)(5)(B).
- **Ex-dividend date:** Generally, the first date on which the transferee of stock would not be entitled to receive the dividend.

Section 245A – Holding Period

- **Diminished Risk of Loss:** Holding period is reduced for periods during which risk of loss is diminished, generally where:
 - The taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities;
 - The taxpayer is the grantor of an option to buy substantially identical stock or securities; or
 - Under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more positions with respect to substantially similar or related property. *See* section 246(c)(4).

Section 245A – Limitations

Foreign tax credit disallowance: No foreign tax credit or deduction for taxes paid or accrued with respect to any dividend for which a deduction is allowed under section 245A.

Hybrid dividends: The deduction under section 245A is not available if the dividend is a hybrid dividend.

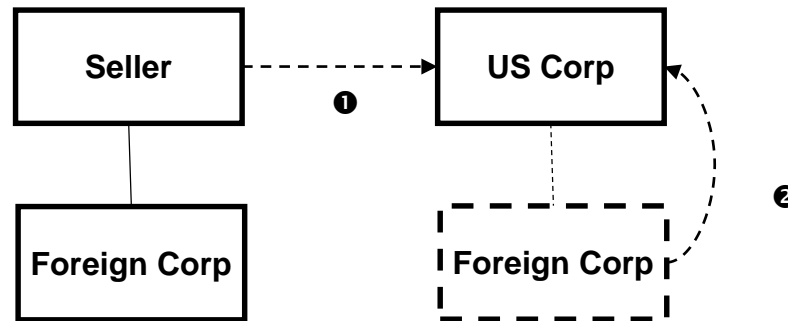
- A hybrid dividend is an amount received from a CFC for which a deduction would be allowed under section 245A, and for which the CFC received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by a foreign country or possession of the U.S.
- The denial of foreign tax credits (and deductions for foreign taxes) still applies.
- If a CFC receives a hybrid dividend from a lower-tier CFC, the dividend is treated as subpart F income and must be included in the income of the U.S. shareholder under the rules of section 951. *See* section 245A(e)(2).

Section 245A – Limitations

Stock Losses: Under section 961(d), in determining loss on a disposition of stock of a specified 10-percent owned foreign corporation by a U.S. corporation that received a dividend with respect to which a deduction under section 245A was allowed, the U.S. corporation's basis in the stock of the foreign corporation is reduced (but not below zero) by the amount of the deduction under section 245A, except to the extent such basis was reduced under section 1059 by reason of a dividend for which such a deduction was allowable.

- Section 964(e)(4)(b) applies basis adjustment rules similar to section 961(d) to a sale/exchange by a CFC of stock in another foreign corporation.

Example 1 – Acquisition Date Distribution

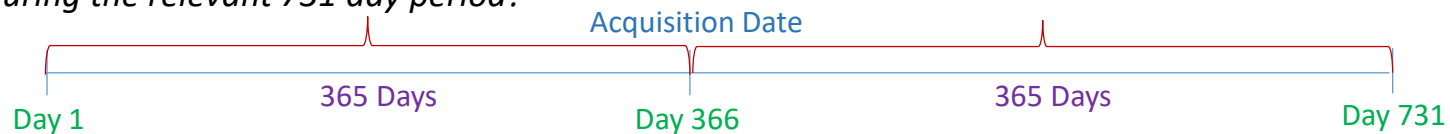


Facts:

US Corp acquires Foreign Corp stock from Seller in exchange for cash. Foreign Corp distributes a note to US Corp on the acquisition date.

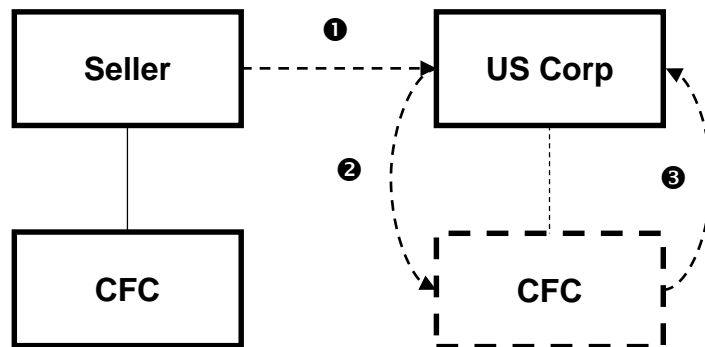
Analysis:

- *What is the ex-dividend date? If the ex-dividend date is the distribution date, can the holding period requirement of section 245A be satisfied as there are only 365 days after the ex-dividend date that are during the relevant 731 day period?*



- *What if a section 338(g) election were made with respect to US Corp's acquisition of Foreign Corp?*
 - Under Reg. § 1.338-9, Seller is treated as owning the Foreign Corp stock through the acquisition date. *For purposes of section 245A, does US Corp's holding period begin on the day after the legal acquisition date or two days after the legal acquisition date (because its acquisition date for US tax purposes is the day after the legal acquisition date)?*
 - The "next day rule" of Reg. § 1.338-1(d) pushes the note distribution to the day after the acquisition. *What is the ex-dividend date?*

Example 2 – Multiple Holding Periods



Facts:

On January 1, Year 1, US Corp acquires the stock of CFC from Seller for cash. On July 1, Year 1, US Corp contributes cash to CFC and does not receive additional stock of CFC. On December 31, Year 1, CFC declares and pays a dividend to US Corp in an unrelated transaction. On March 1, Year 2, US Corp disposes of CFC stock.

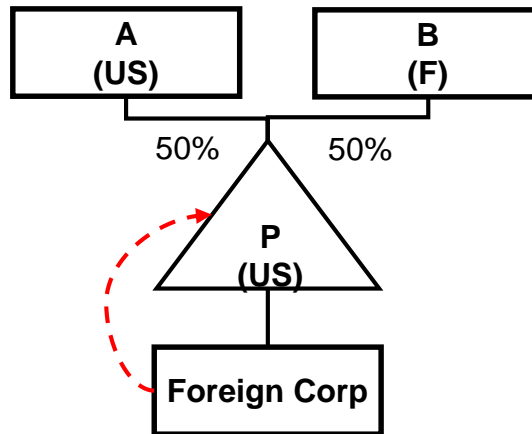
Analysis:

- *Is the section 245A holding period satisfied with respect to the entire distribution?*
- *What if US Corp receives additional stock of CFC in respect of the contribution?*
- *What if, instead of contributing cash, US Corp contributed property with a holding period of greater than one year?*

Authorities:

Rev. Rul. 75-524 (basis in real estate was allocable between the portion of the building constructed within the six-month period and after the six-month period for purposes of determining long-term or short-term gain or loss on the sale); Rev. Rul. 85-164 (aggregate bases of assets is allocated to stock and securities received in a section 351 transaction in proportion to FMV of assets transferred, and stock and securities have split holding periods for purposes of determining long-term and short-term gain or loss (citing Rev. Rul. 62-140)); Reg. § 1.1223-3(a) (split holding period for partnership interests where portions acquired at different times); *see also Lessinger v. Comm’r*, 85 T.C. 824, *rev’d on other grounds*, 872 F.2d 519 (2d Cir. 1989); Rev. Rul. 64-155, 1964-1 C.B. 138; Prop. Reg. § 1.358-2(g)(3).

Example 3 – Application to “specified 10-percent owned foreign corporation” held through partnerships



Facts:

On December 31, Year 1, Foreign Corp declares and pays a \$100 dividend to P. Foreign Corp has \$200 of undistributed foreign earnings and \$200 of total undistributed earnings.

Analysis:

- *Is A entitled to a section 245A deduction?*
- *Is B entitled to a section 245A deduction?*

Authorities:

- Section 702(a)(5) provides that dividends received by a partnership retain their character as dividends to the partners.
- H.R. Rep. No. 115-466 at 599 states “if a domestic corporation indirectly owns stock of a foreign corporation through a foreign partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the partnership’s dividend from the foreign corporation.”
- Rev. Rul. 71-141 (providing that 50/50 corporate partners in a partnership that owned a 40 percent interest in a foreign corporation that paid foreign taxes was each treated as owning a 20% interest in the foreign corporation’s stock, and therefore each met the 10% ownership test of section 902(a)).

Deemed Dividends – Section 1248

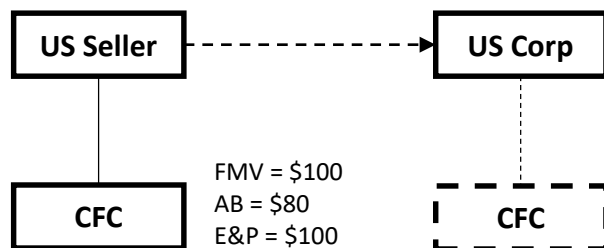
If a US person owning 10% or more of the voting power of all classes of stock entitled to vote sells or exchanges stock in a foreign corporation, then the gain recognized on the sale or exchange is included in gross income of such person as a dividend to the extent of the earnings and profits of the foreign corporation which accumulated during the period the stock was held by such person while the foreign corporation was a CFC.

- Applies to all U.S. persons owning 10 percent or more (by vote) of the stock of the CFC during the 5 year period ending on the date of the sale or exchange.
- Deemed dividend applies to disposition of CFC stock in certain non-recognition transactions as well. (Section 1248(f).)
- Where the U.S. person is a domestic corporation that held the stock in the CFC **for one year or more**, then any amount that is treated as a dividend by reason of section 1248 is treated as a dividend for purposes of applying section 245A. (Section 1248(j).)

Section 1059 – Extraordinary Dividends

- A corporation that receives (and is allowed to deduct any part of) an “extraordinary dividend” is required to: (i) reduce stock basis by the amount of the DRD, and (ii) recognize gain to the extent the DRD exceeds its stock basis.
- Section 1059(a) applies with respect to the non-taxed portion of a dividend (*i.e.*, the DRD under sections 243, 245, and 245A).
- Generally, an extraordinary dividend:
 - is paid on stock ***held by a corporation for less than 2 years*** (exception for stock held the entire existence of the dividend-paying corporation, unless E&P inherited from another corporation), and
 - equals or exceeds:
 - 5% of the taxpayer’s basis in preferred stock, or
 - 10% of the taxpayer’s basis in any non-preferred stock
 - Note: dividends paid within one year can be aggregated for this determination.
- Section 1059(e) creates a *per se* list of extraordinary dividends (*i.e.*, extraordinary without regard to holding period or amount), including dividends arising from:
 - Non-pro rata redemptions (including non-pro rata section 356(a)(2) boot dividends)
 - Dividend-equivalent section 304 transactions.

Example 4 – Interaction of Sections 245A, 1059, and 1248



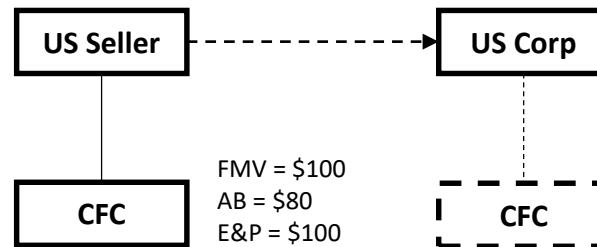
Facts:

On December 31, 2017, US Seller acquired the stock of CFC. On December 1, 2018, US Seller and US Corp enter into a binding contract to sell and purchase the stock of CFC for \$100. The sale is executed on January 1, 2019. No election under §338(g) is made with respect to the purchase. At the time of the sale, CFC has \$100 of accumulated earnings and profits attributable to the period during which US Seller held the CFC stock.

Analysis:

- US Seller recognizes \$20 of gain that is recharacterized as a dividend under §1248. Given that US Seller held the stock of CFC for more than one year, under section 1248(j), the gain is treated as a dividend for purposes of applying section 245A.
 - *Does section 1248(j) mean that the section 245A deduction is available without regard to the other requirements of section 245A? Or, does it simply confirm dividend treatment with all the other requirements for the section 245A deduction applying?*
 - *Under section 246(c)(1), has US Seller held the CFC stock for at least 366 days during the period beginning 365 days before the date on which the shares became ex-dividend? On what date did the CFC shares become ex-dividend? December 1, 2018? January 1, 2019?*
 - *If section 245A applies, will section 1059 also apply as the deemed dividend is an extraordinary dividend? Is stock gain recharacterized as a dividend the receipt of a dividend for purposes of section 1059?*

Example 4 – Interaction of Sections 245A, 1059, and 1248 (Cont.)



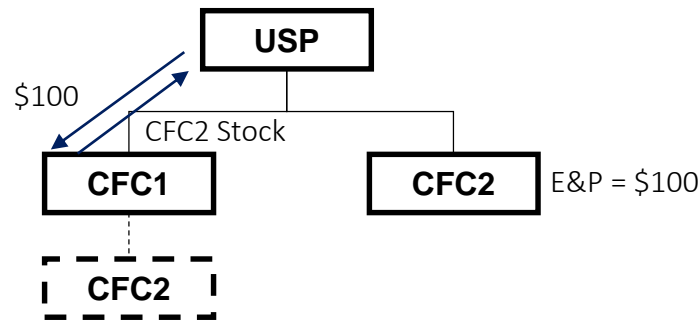
Analysis (cont.):

- If sections 245A and 1059 apply, US Seller reduces its basis in CFC immediately before the sale by the dividend amount (basis reduced by \$20 to \$60), which increases US Seller's gain on CFC stock to \$40. Then, section 1248 applies to recharacterize the additional gain as a dividend, which increases the non-taxed dividend under section 245A such that US Seller further reduces its basis in CFC stock, which increases the amount of gain recognized, which increases the dividend amount, etc., until all of CFC's earnings and profits have been exhausted and there is no further application of sections 245A, 1059, and 1248. Ultimately, US Seller has dividend income of \$100, a DRD of \$100 and capital gain of \$20.
 - *Should a transaction with only \$20 gain realized produce gross amounts of gain/income in excess of that amount? Should US Seller's capital gain be treated as a dividend with respect to which a DRD is allowed? Is it intended that this transaction would convert all of CFC's earnings and profits to PTI?*

Deemed Dividends - Section 964(e)

- If a CFC sells or exchanges stock in another foreign corporation, the gain is recharacterized as a dividend to the same extent it would have been if the selling CFC were a section 1248 shareholder of the target foreign corporation. See section 964(e)(1).
- The same-country exception is not available for a section 964(e)(1) dividend, *however*, there is no similar restriction on the application of section 954(c)(6) (providing that dividends received from related CFCs are not treated as foreign personal holding company income to the extent attributable to the distributing CFC's income that is neither subpart F income nor income effectively connected with a U.S. trade or business).
- If the selling CFC held the stock in the target CFC for more than one year, then the foreign source portion of the deemed dividend recognized by the selling CFC is treated as subpart F income.
- The US Shareholder of the selling CFC includes its pro rata share of this subpart F income as it would any other amount of subpart F income.
- For purposes of applying section 245A, the subpart F income of the selling CFC is treated by the U.S. Shareholder as a dividend received from the selling CFC.
- If the other requirements of section 245A are satisfied (e.g., section 246(c) holding period), the section 245A deduction should be available for the subpart F income inclusion resulting by reason of section 964(e).

Example 5 – Section 304 Transaction



Facts:

USP sells CFC2 to CFC1 for \$100, recognizing \$100 of gain. At the time of the sale, CFC2 has \$100 of earnings and profits at the end of the taxable year of the sale, all of which is attributable to the period during which USP has held the stock of CFC2.

Analysis:

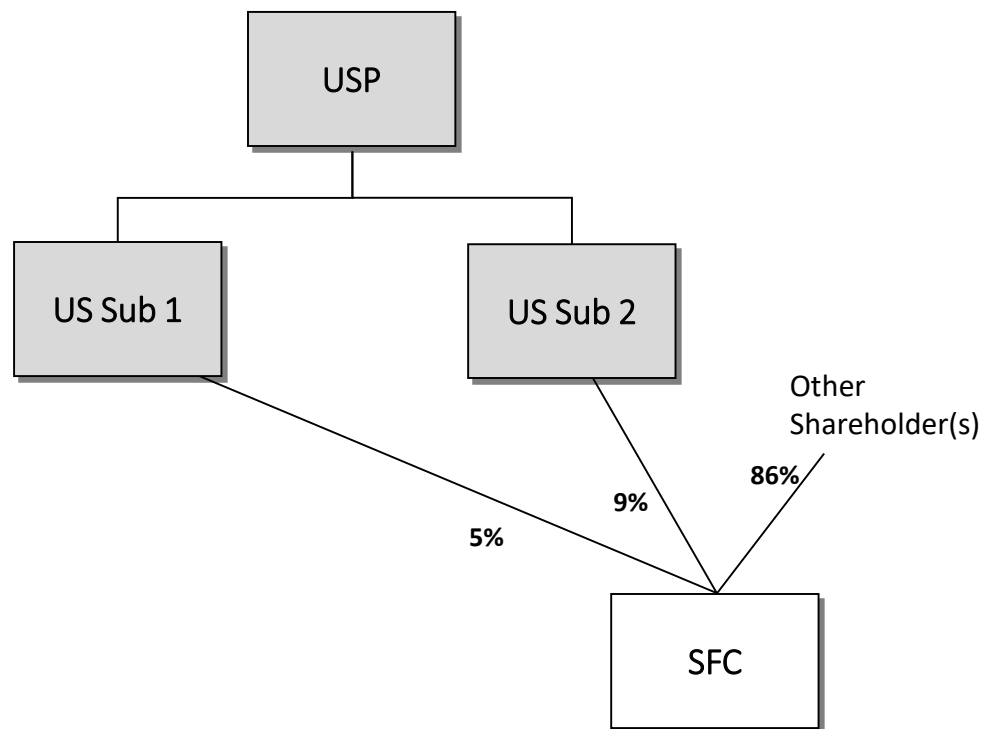
Under section 304(a)(1),

1. USP is treated as transferring CFC2 to CFC1 in exchange for CFC1 shares in a transaction to which §351 applies (potential overlapping applications of section 367(a) and (b); GRA requirement (see Notice 2012-15)); and
 2. CFC1 is treated as redeeming the shares deemed issued to USP for cash; the deemed redemption is treated as a dividend to which section 301 applies.
- *Can section 245A apply to USP's deemed dividend? Can USP meet the holding period requirement of §245A with respect to the shares deemed issued and redeemed?*
 - *Section 1059(e) treats the deemed dividend as "per se" extraordinary if the redemption would not have been treated (in whole or in part) as a dividend if section 304(a) had not applied. If section 304 had not applied, then section 1248 would have applied to treat USP's gain as a dividend. *Does section 1059(e) apply (assuming section 245A applies)?**

Section 245A – Consolidated Group Issues

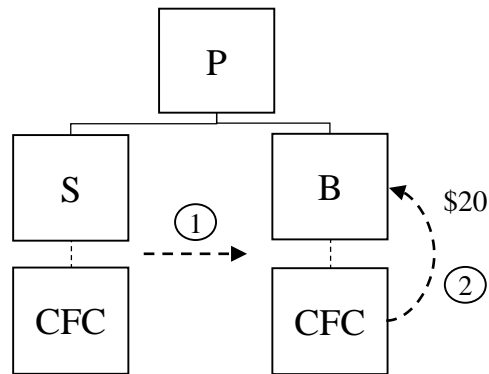
- Uncertain whether group member ownership is aggregated for purposes of the 10-percent ownership and holding period rules. Reg. §§ 1.1502-11(a)(7), -12(n), -26 provide that DRDs are determined on a consolidated basis, but they do not include a reference to section 245A.
- See also Reg. § 1.1502-80(a) (Internal Revenue Code, and regulations, generally applicable “to the group”).

Example 6: Consolidated Issues—US Shareholder Determinations

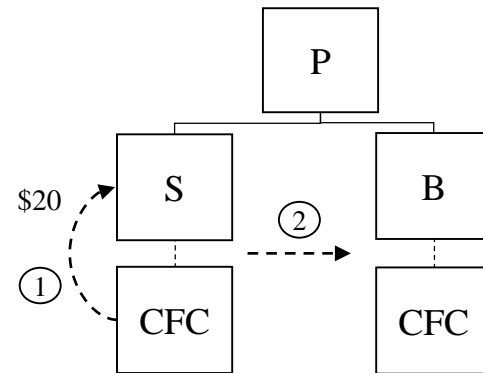


- Section 245A generally applies to a domestic corporation that is a “United States shareholder” of a specified 10-percent owned foreign corporation.
 - Section 951(b): 10% of voting power or value of the stock of the foreign corporation.
- Note that, both US Sub 1 and US Sub 2 are “United States shareholders” under Section 951A(e)(2) and Section 958(a), even though neither directly owns 10% of the CFC stock.
- This is true whether the US Parent affiliated group files a consolidated return, or alternatively, each affiliated corporation files its own separate return.

Example 7: Consolidated Issues—Intercompany Transactions

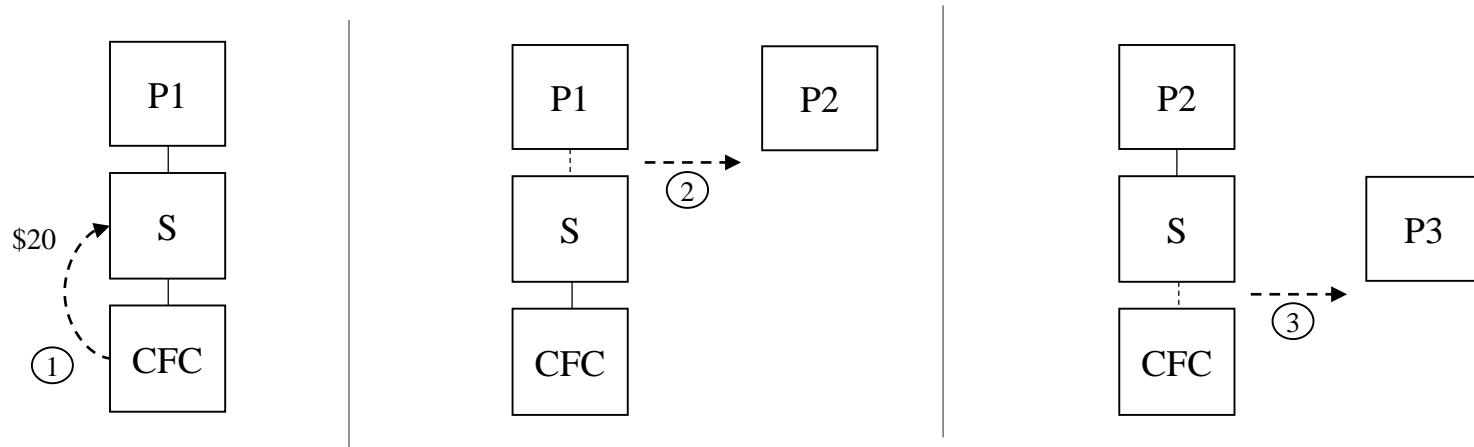


- P, S and B compose a consolidated group, and on January 1, Year 1, S acquired the stock of CFC from an unrelated seller.
- On July 1, Year 1, S sold the stock of CFC to B in a -13 intercompany transaction.
- On February 1, Year 2, CFC paid a section 301 dividend to B.
- On March 1, Year 2, B sold the CFC stock to an unrelated buyer.
- *Should B be able to satisfy the section 245A holding period requirement with respect to the dividend by including S's holding period under -13(c)(1)(ii)? Is any new rule required to achieve this result?*



- *What if, instead CFC's dividend being to B following the intercompany transaction, CFC paid its dividend to S before the intercompany transaction—should S be able to satisfy the section 245A holding period requirement with respect to the dividend by including B's holding period under -13(c)(1)(ii)? Is any new rule required to achieve this result?*

Example 8: Consolidated Issues—Investment Adjustments



- P1 and S compose a consolidated group, S historically owned CFC, and on January 1, Year 1, CFC distributed \$20 to S as a section 301 dividend with respect to which section 245A applies.
- On July 1, Year 1, P1 sold S to P2, resulting in S becoming a member of the P2 consolidated group.
- On January 1, Year 2, S sold CFC to P3 for an amount \$20 less than the existing CFC stock basis.
- *Should section 961(d) require S to reduce its pre-sale basis, resulting in S recognizing zero gain or loss on the sale of CFC (i.e., should S or the P1 group be treated as the domestic corporation that received a dividend and applied section 245A for purposes of section 961(d))?*
- *If section 961(d) applies to S in the P2 group, should P2 be required to reduce its basis in S under -32(b)(3)(iii)(B), to reflect the \$20 reduction to S's CFC stock basis, with the result that P2 would subsequently recognize uneconomic gain or loss on a subsequent taxable sale of the S stock (i.e., is this the -32 analysis for section 961(d) different from the analysis of other built-in loss that is taken into account under -32 by the P2 group)?*

Qualified Opportunity Zones

Qualified Opportunity Zones – Background

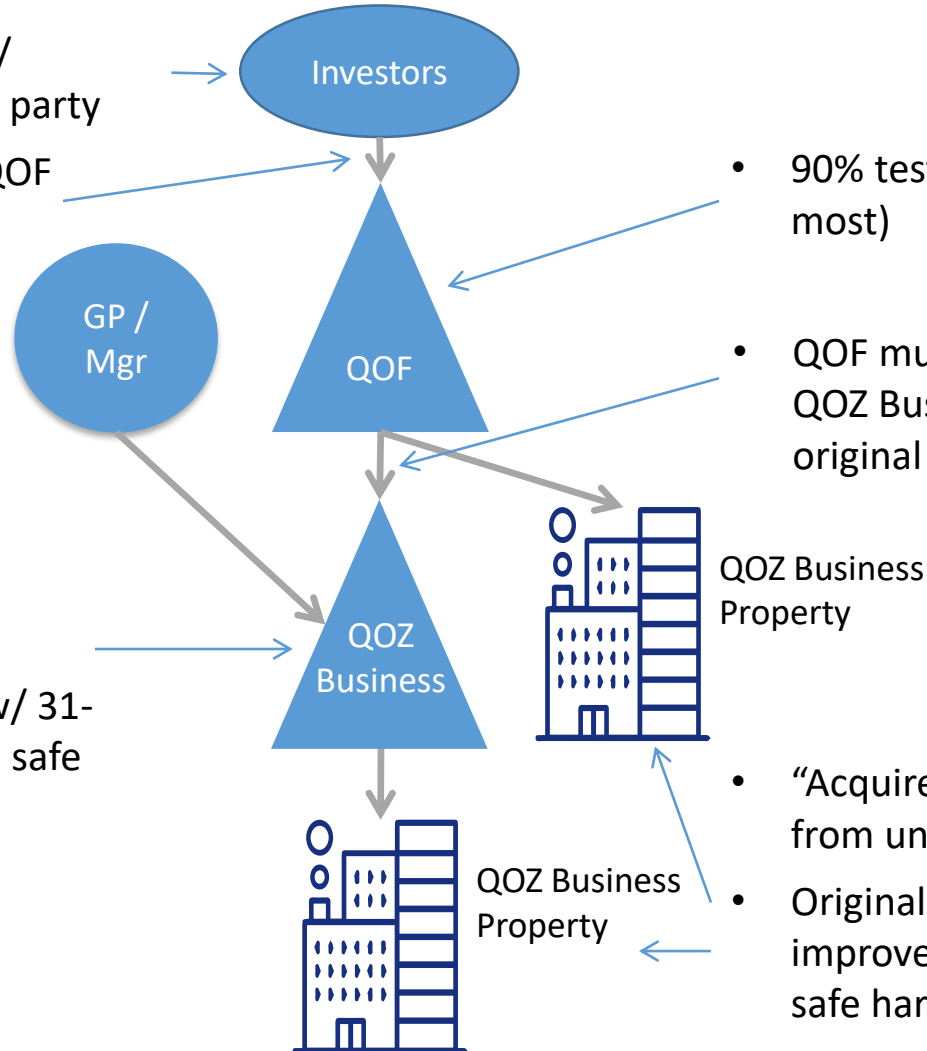
- Established under the Tax Cuts and Jobs Act of 2017, section 1400Z-1 and 1400Z-2.
- Allows taxpayers to defer capital gains incurred from a sale or exchange of an asset to an unrelated third party by investing the amount of such gains in Qualified Opportunity Funds (“QOFs”) which, in turn, invest in “Qualified Opportunity Zone Businesses” or “Qualified Opportunity Zone Business Property.”
- Intended to encourage investment in areas designated as Qualified Opportunity Zones (“QOZs”).
- QOZs were designated in all 50 states, the District of Columbia, and several possessions during the first half of 2018; designations last until December 31, 2028.
- Proposed Regulations were issued on October 19, 2018; additional guidance is forthcoming.

Benefits to Investors

- **Deferral** of current capital gain.
 - Defer gain to the extent invested in QOF within 180 days.
 - Include in income earlier of year QOF interest is sold/exchanged **OR** December 31, 2026.
- **Increase in basis** used for determining amount of deferred gain included in income over time.
 - If QOF interest is held for 5 years, basis is increased by 10% of amount of gain deferred (reducing deferred gain inclusion to 90%).
 - If QOF interest is held for 7 years, basis is increased by an additional 5% of amount of gain deferred (reducing deferred gain inclusion to 85%).
- If QOF interest is held for 10 years and an election is made, **basis is equal to fair market value** of QOF interest on the date the interest is sold or exchanged (eliminating or reducing gain from sale/exchange).

Qualified Opportunity Zones – Summary of Requirements

- Capital gain from sale / exchange to unrelated party
- 180 days to invest in QOF



- 70% test
- Active conduct / nonqualified financial property limitations (w/ 31-month working capital safe harbor)
- No sin businesses

- 90% test (w/in 6 months, at most)
- QOF must acquire interest in QOZ Business for cash at original issue
- “Acquired by purchase” from unrelated seller
- Original use / substantial improvement (w/ 30-month safe harbor)
- Substantially all use in QOZ

QOZ Terms

- Qualified Opportunity Zone (QOZ) – A population census tract that is a low-income community and has been designated as a QOZ by the state executive.
- Qualified Opportunity Fund (QOF) – Corporation or tax partnership organized for making investments in QOZ businesses and property.
- QOZ Property – QOZ Business or QOZ Business Property.
 - QOZ Business – A business operating in a QOZ that meets certain requirements (may be a corporation or partnership).
 - QOZ Business Property – Tangible property used in a QOZ that meets certain requirements.

Eligible Gains

- QOZ benefits are available to “**eligible taxpayers**” that invest “**eligible gains**” into one or more QOFs within a 180-day investment period.
- An eligible taxpayer is any taxpayer that recognizes gain for tax purposes.
- Gain is treated as “eligible gain” if:
 - The gain is treated as capital gain,
 - The gain is gain that would otherwise be recognized no later than December 31, 2026,
 - The gain is not recognized as a result of a sale or exchange engaged in by the taxpayer with a related person (i.e., a person whose constructive or actual ownership overlaps more than 20% with the taxpayer),
 - The gain is not already subject to a QOZ election, and
 - The gain is not from a position that is or has been part of an “offsetting-positions transaction.”
 - An “offsetting-positions transaction” is any transaction in which a taxpayer has substantially diminished its risk of loss in one position by holding one or more other positions (regardless of whether either of the positions is with respect to actively traded personal property).

QOF Requirements

- A QOF is an investment vehicle organized as a corporation or a partnership (including an LLC) for the purpose of investing in QOZ Property.
 - One QOF may not be formed for the purpose of investing in another QOF (no multi-tiered QOFs).
- A QOF must hold at least 90% of its assets in **QOZ Property**, calculated by taking the average of the percentage of QOZ Property held in the fund.
 - Measured on the last day of the first 6-month period of the taxable year of the fund, and on the last day of the taxable year of the fund.
 - If fail for year, penalty imposed on a monthly basis (e.g., 0.5% of the shortfall at the end of each month).
 - 90% determination based on applicable financial statement values or, if none, cost.
- An investment entity must self-certify its QOF status on its federal income tax return (no approval by the IRS required).
 - To self-certify, a taxpayer must complete a form and attach it to the taxpayer's federal income tax return for the taxable year. The return must be filed timely, taking extensions into account.

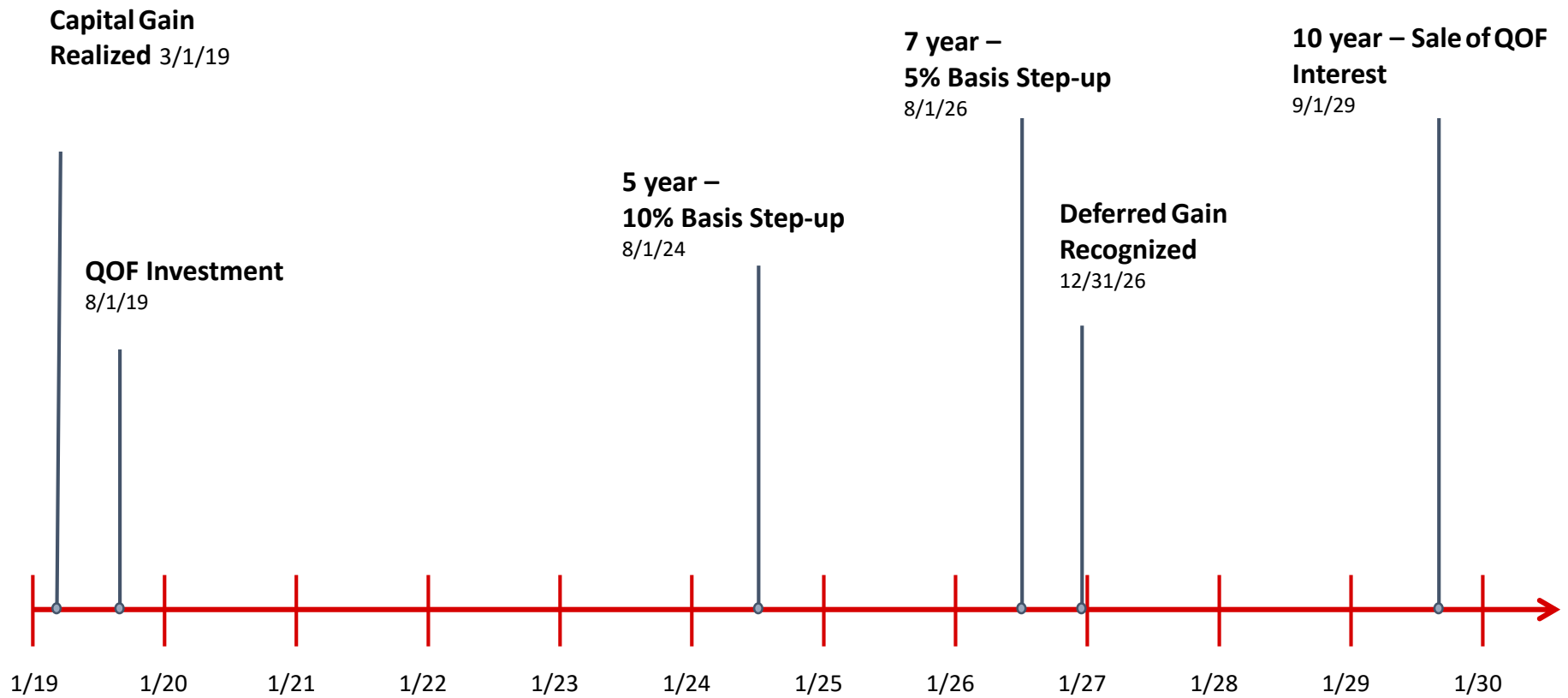
QOZ Property Requirements

- QOZ Business Interests – QOZ stock or QOZ partnership interest
 - Must be acquired by QOF after 12/31/17, at original issue, solely in exchange for cash.
 - Entity generally must qualify as a **QOZ Business** at the time the QOF acquires the stock or partnership interest and for substantially all of the QOF's holding period.
- QOZ Business Property
 - Tangible property acquired by purchase (as defined in section 179(d)(2)) after 12/31/17.
 - Must be acquired from an unrelated party (i.e., not related under section 267 or 707(b), determined by substituting 20% for 50%, and not component member of a controlled group).
 - Must be acquired by purchase (i.e., basis of property in acquirer's hands is not determined in whole or in part by reference to the adjusted basis of such property in the hands of the transferor, or under section 1014).
 - **“Original use”** commences with the QOF/QOZ Business **OR** property is **“substantially improved”** by the QOF/QOZ Business
 - Safe harbor for substantial improvement - 100% basis additions within any 30-month period beginning after the date of acquisition, not including land (see Rev. Rul. 2018-29).
 - Substantially all of the use of the property is in the QOZ for substantially all of the QOF's/QOZ Business's holding period.

QOZ Business Requirements

- **Substantially all (>70%)** of tangible property owned or leased by the business is QOZ Business Property (and so must be acquired by purchase after 12/31/17 from an unrelated party and satisfy the original use or substantial improvement requirements).
 - Similar to 90% test for QOFs, 70% determination based on applicable financial statement values or, if none, cost.
- Requirements of section 1397C(b)(2), (4), and (8) are satisfied:
 - At least 50% of total gross income of the business is derived from the active conduct of the business in the QOZ.
 - A substantial portion of intangible property of the business is used in the active conduct of the business in the QOZ.
 - Less than 5% of the aggregate unadjusted bases of the property of the business is nonqualified financial property.
 - 31-month safe harbors for working capital held for the acquisition, construction, or substantial improvement of QOZ Business Property in accordance with a written schedule.
- Business cannot be a golf course, liquor store, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling.

Investor Timeline



Investment Timeline

Initial Investment in QOZ Business
6/1/19

Additional Investment in QOZ Business
12/1/21

QOF Asset Test Date
6/30/19

QOF Asset Test Date
12/31/21

31-Month Working
Capital Safe Harbors

30-Month Substantial Improvement Safe Harbor

Active Conduct of
QOZ Business?

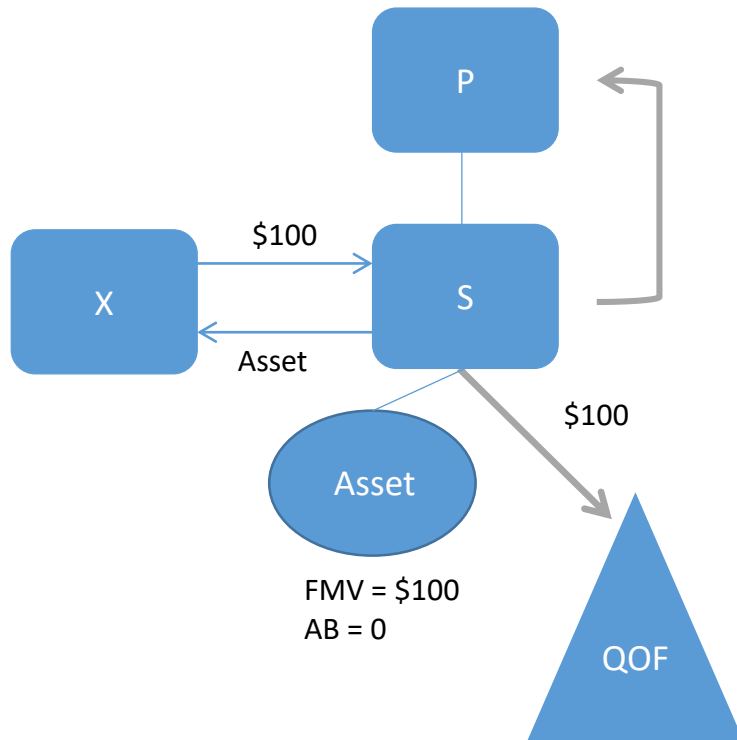
Purchase QOZ Business Property
6/15/19

Initial Investment in QOF
1/15/19

Additional Investment in QOF
10/1/21

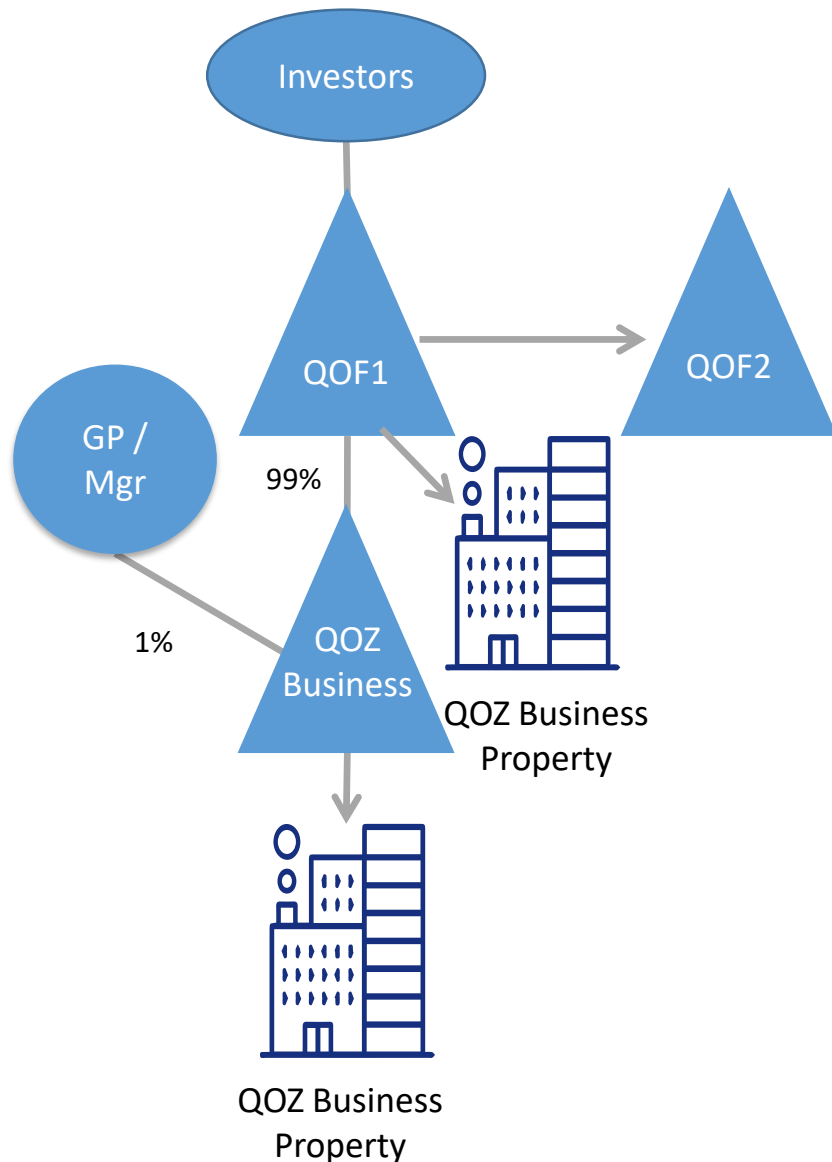


QOZ Issues – Nonrecognition Transactions by Eligible Taxpayer



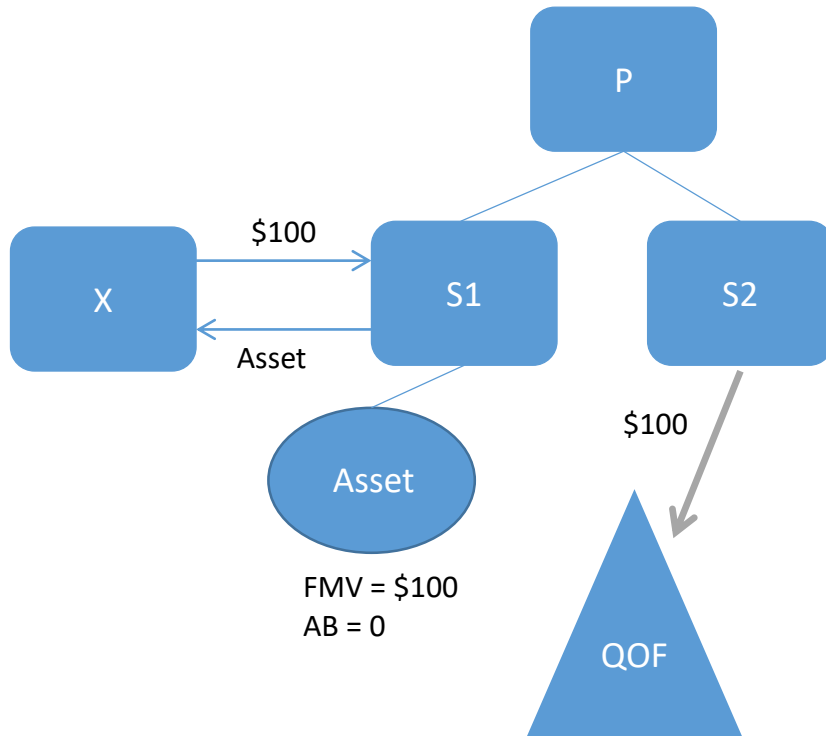
- S owns Asset A with a basis of \$0. During Year 1, S sells Asset A to X, an unrelated party, for \$100. S uses the proceeds from the sale of Asset A to invest \$100 in a QOF and makes an election under section 1400Z-2(a)(2) to defer the gain.
- At the end of Year 6, S liquidates into P in a section 332 liquidation, and P continues to hold QOF through the end of Year 11, at which time it sells the QOF interest to a third party for \$200.
- S's initial basis in its interest in the QOF is \$0. In Year 6, after S held the QOF interest for 5 years, the basis in the QOF is increased by 10% of the original gain deferred.
- Does the holding period of the QOF continue with P, or is S's gain triggered under section 1400Z-2(b)(1)(A)?

QOZ Issues – Nonrecognition Transactions by QOF



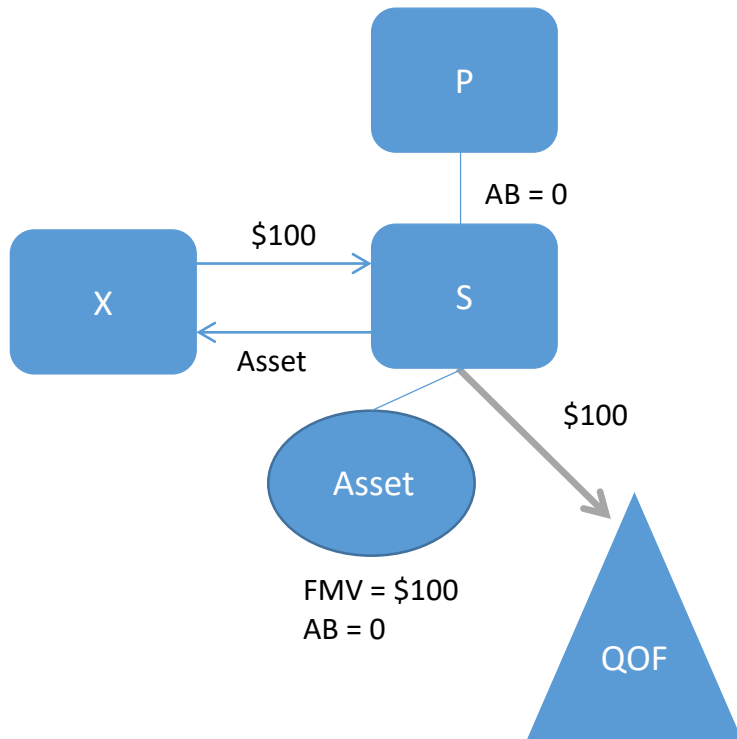
- QOF1 owns 99% of the partnership interests in QOZ Business and separately owns QOZ Business Property. Assume that QOF1 satisfies the 90% test.
- QOF 1 wants to separate its QOZ Business Property from its QOZ Business, so it engages in an assets-over division, transferring its interests in the QOZ Business to QOF2 and distributing the interests in QOF2 pro rata to the investors.
- Because all of the investors continue to be partners in QOF2, QOF2 is treated as a continuation of QOF1. Reg. § 1.708-1(d)(1).
- Are the investors' holding periods in QOF1 tacked onto their holding periods in QOF2, or does the holding period start over? Will the interests in the QOZ Business fail to meet the "solely in exchange for cash" requirement of section 1400Z-2(d)(2)(C)(i) in the hands of QOF2? Will the deemed partial liquidation of the investors' interests in QOF1 trigger a partial end of deferral?
- What if QOF1 transferred the QOZ Business Property instead of the QOZ Business interests to QOF2? Are the original use or substantial improvement requirements satisfied?

QOZ Consolidated Group Issues – Eligible Taxpayer



- P, S1, and S2 comprise a consolidated group. S1 owns Asset A with a basis of \$0.
- In Year 1, S1 sells Asset A to X, an unrelated party, for \$100, and the \$100 capital gain is included in the P group's consolidated taxable income. Three months later, S2 invests \$100 in a QOF, and the P group makes an election under section 1400Z-2(a)(2) to defer the gain.
- Is the P consolidated group able to defer the \$100 gain on S1's property sale as a result of such election?
- Assume that, instead, S1 invests \$100 in a QOF. What effect if P sells all of the stock of S1 to an unrelated person in 2020, but S1 continues to hold its QOF investment?
 - Alternatively, what if, instead of a sale of S1 in 2020, S1 distributes all of its assets to P in complete liquidation of S1 under section 332?

QOZ Consolidated Group Issues – Investment Adjustments



- S owns Asset A with a basis of \$0. P’s adjusted basis in S is also \$0. During Year 1, S sells Asset A to X, an unrelated party, for \$100.
- S uses the proceeds from the sale of Asset A to invest \$100 in a QOF, and the P group makes an election under section 1400Z-2(a)(2) to defer the gain. S holds QOF through the end of Year 11 at which time it makes an election under section 1400Z-2(c) to adjust its basis to fair market value, and it sells its QOF interest to a third party for \$200.
- S’s initial basis in its interest in the QOF is \$0.
 - If S holds for 5 years, the basis in the QOF is increased by 10% of the original gain deferred.
 - If S holds for 7 years, the basis in the QOF is increased by 5% of the original gain deferred (or 15% total).
 - If S holds for 10 years, S may elect to adjust its basis in the QOF to an amount that equals the investment’s FMV on the date that the investment is sold or exchanged (or \$200).
- When is P’s basis in S adjusted under Reg. § 1.1502-32(b)(3)(i) (taxable income) and (ii) (tax-exempt income)? Tax-exempt income must be “permanently excluded” from gross income.