taxnotes federal

Volume 172, Number 5 ■ August 2, 2021

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Reprinted from *Tax Notes Federal*, Aug. 2, 2021, p. 731

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Curtail U.S. PTEP Reporting Complexity: Know Your P's and Q's

by Lewis J. Greenwald, Brainard L. Patton, and Brendan Sinnott

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In this article, Greenwald, Patton, and Sinnott consider changes to the U.S. compliance requirements for previously taxed earnings and profits and suggest how to simplify the burden.

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There is much for U.S. international tax practitioners to grapple with these days, especially with the changes wrought by the Tax Cuts and Jobs Act. This article focuses on just one element of those changes: those that relate to previously taxed earnings and profits (PTEP)[1] and the extraordinary complexity of PTEP-related information now required by Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations." We review those changes and suggest options for greatly simplifying that compliance burden.

I. Background

Before the TCJA, Form 5471 could be viewed as a reasonable balance of the government's need for, and taxpayers' effort to provide, information on earnings and profits and related foreign income taxes of controlled foreign corporations. All the required information for E&P and related foreign tax credits was included on three Form 5471 schedules: Schedule E, "Income, War Profits, and Excess Taxes Paid or Accrued"; Schedule H, "Current Earnings and Profits"; and Schedule J, "Accumulated Earnings & Profits (E&P) of Controlled Foreign Corporation." Taxpayers were able to provide all the required information for each CFC on less than two full pages!

Those days are gone. Because of the complexity and incompleteness of the TCJA's international provisions, along with congressional failure to pass a technical corrections act to remedy the well-known errors of those provisions, Treasury and the IRS were left to bridge the gap and forced to promulgate new regulations (which can safely be called extremely complex) and a grossly expanded Form 5471 that could not have been imagined four years ago. Besides adding pages and complexity to the above-mentioned schedules, Schedule G, "Other Information," was expanded from eight questions to 22 (including a new line 19 that leads to 22 additional questions). Further, four new schedules have been added to Form 5471: Schedule I-1, "Information for Global Intangible Low-Taxed Income"; Schedule P, "Previously Taxed Earnings and Profits of U.S. Shareholders of Certain Foreign Corporations"; Schedule Q, "CFC Income by CFC Income Groups"; and Schedule R, "Distributions From a Foreign Corporation."

Before addressing the TCJA's changes to international provisions, it is worthwhile to note that the provisions on PTEP that taxpayers and their advisers were familiar with had changed very little since the Tax Reform Act of 1986. For example, PTEP distributions by CFCs to U.S. shareholders were exempt from U.S. income tax,[2] corporate U.S. shareholders were entitled to a credit for foreign taxes related to PTEP distributions (to the extent not previously claimed

[1] Referred to as previously taxed income, or PTI, before the TCJA.

[2] Section 959(a).

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as a credit),[3] and U.S. corporate shareholders that reported additional foreign taxes for PTEP distributions were entitled to an additional FTC limitation under section 904 (to facilitate absorption of those additional foreign taxes on the distributions).[4] Also, before the TCJA, most CFCs had very little PTEP — all of which arose by virtue of subpart F and section 956 inclusions.

A. The TCJA and PTEP

The TCJA made several changes to the rules for FTCs on CFC income that have created significant complexity and have indirectly led to unnecessary U.S. tax reporting when PTEP is repatriated. The first and most significant of those changes was the creation of a 100 percent dividends received deduction under new section 245A and the related repeal of section 902.[5] Besides the obvious impact of disallowing FTCs on what are now nontaxable dividends, that action also terminated the rule that had been in effect for over 30 years by which deemed-paid credits for income inclusions related to E&P of CFCs were calculated by pooling the E&P and related taxes of each CFC (for all years from 1986 through the date of distribution).[6] The TCJA simultaneously modified section 960(a) to require calculating indirect credits on subpart F inclusions (including inclusions under new section 951A for GILTI) on a current-year basis.[7]

A second set of changes involves the GILTI provisions of new section 951A. The TCJA created a special 10.5 percent tax rate on GILTI (13.125 percent after 2025), a new section 904 basket for GILTI, a 20 percent haircut for the foreign taxes for a GILTI inclusion, and, most significantly, a disallowance of a carryover for excess FTCs on a GILTI inclusion. The combination of limiting FTCs to current-year taxes and disallowing excess FTCs on only one of the four post-TCJA FTC categories or baskets is at the root of the complexity concerns discussed herein.

Rather than provide specific guidance, section 960(a) provides that deemed-paid credits shall be those foreign income taxes properly attributable to the included income,[8] thus obligating Treasury to provide regulations for determining creditable taxes and allocating those taxes to specific baskets. As will be discussed, Treasury and the IRS interpreted those changes as requiring taxpayers to keep track of E&P and related creditable taxes by year, by basket, and by PTEP group based on the principles of reg. section 1.904-6 — calculations that are exponentially more complicated than the rules in effect before the TCJA.

Unfortunately, at the same time that PTEP reporting became more complex, the TCJA led to an exponential increase in the amount of PTEP generated by CFCs. Our post-TCJA experience is that, as a result of GILTI and subpart F, virtually all CFC E&P is now PTEP, with very little untaxed section 959(c)(3) E&P, or E&P that has not been previously taxed.[9] Despite that, other than the potential additional creditable foreign income taxes that may come with a distribution of PTEP, there is little in the post-TCJA environment that should make the U.S. international tax aspects of PTEP distributions more complicated than before the TCJA.

With a view to assisting taxpayers in efficiently meeting their U.S. international tax compliance obligations and encouraging Treasury and the IRS to take action to reduce the extremely inefficient filing requirements spawned by the TCJA, the remainder of this article looks at the

[3] Section 960(b)(1), formerly section 960(a)(3). Individual shareholders electing to report income from CFCs under section 962 are also entitled to the indirect credit under section 962(a)(2). A discussion of that is beyond the scope of this article.

[4] Section 960(c), formerly section 960(b).

[5] Section 902 is deemed no longer necessary because post-TCJA dividends from CFCs are entitled to the 100 percent deduction under section 245A and foreign income taxes related to those dividends are no longer creditable.

[6] Those of us who were U.S. international tax practitioners before 1986 will recall the difficult calculations and lost FTCs that resulted from the year-by-year deemed-paid FTC rule in effect before TRA 1986.

[7] In what was either a veiled attempt to cover a complex wolf in simple sheep's clothing or evidence of a profound misunderstanding of what was being enacted, the accompanying committee report said that "offering deemed paid FTCs on a current year basis under section 960 reflects what the Committee believes to be a simpler and more appropriate application of the foreign tax credit regime in a 100 percent participation exemption system." H.R. Rep. 115-409, at 312 (2017).

[8] The indirect credit under pre-TCJA section 960(a) (for inclusions under section 951(a)) was calculated as if the section 951(a) inclusion were a dividend, governed by section 902.

[9] Post-TCJA untaxed E&P generally consists of the return on qualified business asset investment under section 250(b)(2)(B) and income excluded from GILTI by virtue of the high-tax exclusion of section 954(b)(4).

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PTEP-related law and expanded reporting requirements.

II. Discussion

As evidence of the difficulty in interpreting the impact of the law's changes on PTEP calculations and related reporting obligations, nearly four years after enactment of the TCJA, Treasury and the IRS have been unable to issue formal PTEP guidance. We attempt to fill in the gaps by reviewing the applicable code sections and related guidance provided to date.

A. New Section 960(b)

Whereas section 960(a) allows for an FTC for income inclusions under section 951(a)(1), new section 960(b)[10] provides updated post-TCJA rules for foreign taxes attributable to PTEP distributions that are excluded from gross income under section 959(a), including distributions made through tiered CFCs.

New section 960(b)(1) generally provides that if any portion of a distribution from a CFC to a domestic corporation (that is also a U.S. shareholder of that CFC) is excluded from gross income under section 959(a), the domestic corporation will be deemed to have paid the foreign corporation's foreign taxes that are properly attributable to that portion and have not been deemed previously paid by the domestic corporation under section 960 for that tax year or any prior tax year.[11] For this discussion, section 960(b)(2) is key: A CFC's deemed-paid foreign income taxes must include income taxes attributable to a PTEP distribution from another CFC as described in section 959(b). In those cases, additional FTCs on a PTEP distribution (described in section 960(b)(1)) include any additional taxes attributable to the section 959(b) PTEP distribution.

For example, if a U.S. shareholder excludes under section 959(a) any part of a distribution received from a lower-tier CFC through a chain of CFCs as PTEP, that shareholder will be deemed to have paid any withholding or other taxes paid by an upper-tier CFC that are properly attributable to distributions of the PTEP by the lower-tier CFC.[12]

Unfortunately for Treasury, section 960(f) directs the secretary to prescribe regulations and other guidance "as may be appropriate to carry out the purposes of section 960."

B. Section 959

Before reviewing the section 960 regulations and guidance, it is helpful to revisit how section 959 operates. Section 959(c) specifies that E&P distributions from a foreign corporation are first attributable to PTEP described in section 959(c)(1),[13] then to PTEP described in section 959(c)(2),[14] and then to other E&P described in section 959(c)(3).[15]

Treasury and the IRS determined that adherence to reg. section 1.904-6 principles created the need to track and account for several new groups of PTEP because section 959(c)(2) PTEP (and related deemed-paid FTCs) may arise by reason of income inclusions under sections 951(a)(1)(A), 245A(e)(2), 951A(f)(1), 959(e), 964(e)(4), and 965(a), or by reason of the application of section 965(b)(4)(A).

Also, because section 959(c)(2) PTEP may be reclassified as section 959(c)(1) PTEP as a result of sections 956 and 959(a)(2), Treasury and the IRS determined that mirror PTEP groups for section 959(c)(1) PTEP must be maintained. Finally, PTEP subaccounts must be maintained for each section 904 FTC category.

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[10] Successor code section to former section 960(a)(3).

[11] Post-TCJA section 960(b)(2) provides a similar rule for tiered foreign corporations.

[12] Joint Committee on Taxation, "General Explanation of Public Law 115-97," JCS-1-18 (Dec. 2018).

[13] Section 959(c)(1) PTEP is E&P attributable to amounts previously included in income under section 951(a)(1)(B) — that is, amounts determined under section 956 — and E&P attributable to amounts previously included in income under section 951(a)(1)(C) — that is, amounts determined under now-repealed section 956A.

[14] Section 959(c)(2) PTEP is E&P attributable to amounts previously included in income under section 951(a)(1)(A) — that is, subpart F income.

[15] Changes made by the TCJA slightly modified the section 959 ordering rules. Now, starting with section 959(c)(1) PTEP, as an exception to the last-in, first-out approach, distributions are sourced first from reclassified section 965(a) PTEP and then from reclassified section 965(b) PTEP. Once those PTEP groups have been exhausted, under LIFO, distributions are sourced pro rata from the remaining section 959(c)(1) PTEP groups in each annual PTEP account, starting with the most recent. Once the PTEP groups relating to section 959(c)(1) PTEP are exhausted, distributions are sourced from section 959(c)(2) PTEP. Finally, once all the PTEP groups have been exhausted, the remaining amount of any distributions are sourced from section 959(c)(3) "live" E&P.

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C. The Proposed Section 960(b) Regulations

On December 7, 2018, Treasury and the IRS issued proposed regulations under section 960(b) (REG-105600-18).

1. Annual PTEP accounts and associated taxes.

The proposed regs require a CFC to establish a separate, annual account for its E&P for each current tax year to which subpart F or GILTI inclusions of U.S. shareholders of the CFC are attributable. Each account must correspond to the inclusion year of the PTEP and to the section 904 category of the inclusions at the U.S. shareholder level.

The PTEP in each annual account is assigned to one of 10 possible PTEP groups.[16] The PTEP groups serve a similar function to the subpart F income groups and tested income groups — they are a mechanism for associating foreign taxes paid or accrued, or deemed paid, by a CFC with section 959 PTEP distributions.

A CFC accounts for a section 959(b) distribution that it receives by adding the distribution amount to an annual PTEP account and PTEP group that corresponds to the account and group from which the distributing CFC made the distribution. A CFC that makes a section 959 distribution must similarly reduce the annual PTEP account and related PTEP group from which the distribution is made by the distribution amount. A CFC must also reduce PTEP groups that relate to section 959(c)(2) PTEP to account for reclassifications of amounts into those groups as section 959(c)(1) PTEP (reclassified PTEP) and increase the PTEP group that corresponds to the reclassified amount.[17]

2. Associating foreign taxes with PTEP groups.

Under the proposed regs, PTEP group taxes consist of: (1) foreign income taxes deemed paid by the CFC under section 960(a) for a current-year income inclusion in a PTEP group; (2) the foreign income taxes paid or accrued by the CFC as a result of its receipt of a section 959(b) distribution that are allocated and apportioned to the PTEP group; and (3) for a reclassified PTEP group, foreign income taxes that were paid, accrued, or deemed paid for an amount that was initially included in a section 959(c)(2) PTEP group and later added to a corresponding reclassified section 959(c)(1) PTEP group.

PTEP group taxes are reduced by the amount of foreign income taxes in the group that are deemed paid by a U.S. shareholder under section 960(b)(1) or by another CFC under section 960(b)(2), as well as foreign income taxes relating to amounts in a PTEP group that have been reclassified to a section 959(c)(1) PTEP group.

Under the proposed regulations, a CFC's current-year taxes are associated with a PTEP group for section 960(b) purposes only if the receipt of a section 959(b) distribution causes an increase in a PTEP group. The increased PTEP group is treated as an income group to which current-year taxes are imposed solely by reason of that section 959(b) distribution. Taxes that are allocated and apportioned to a PTEP group by reason of a CFC's receipt of a section 959 distribution are allocated and apportioned to the PTEP group under reg. section 1.904-6 principles.[18] For example, a withholding tax imposed on a section 959(b) distribution received by an upper-tier CFC is allocated and apportioned to the PTEP group and relevant tax year, as well as to the section 904 category that was increased by the section 959(b) distribution. The withholding tax also reduces (as a distribution) the amount in the same PTEP group, year, and section 904 category.

3. Computational rules.

A domestic corporation that receives a section 959(a) distribution is deemed to have paid the foreign income taxes properly attributable to the distribution from the distributing CFC's PTEP group if the PTEP group taxes have not already been deemed paid in the current tax year or any prior tax year. The amount of foreign income taxes properly attributable to a domestic corporation's receipt of a section 959(a) distribution from a PTEP group in a section 904 category is its proportionate share of PTEP taxes associated with the PTEP group. The domestic corporation's proportionate share of foreign income taxes

[16] Technically, one of only five PTEP groups, as will be discussed below.

[17] Prop. reg. section 1.960-3(c)(4).

[18] Prop. reg. section 1.960-1(d)(3)(ii)(B).

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associated with a section 959(a) distribution from a PTEP group is determined by a fraction equal to the amount of the section 959(a) distribution attributable to the PTEP group over the total amount of PTEP in the PTEP group.[19]

D. Notice 2019-1

Immediately after issuing the proposed regulations, Treasury and the IRS released Notice 2019-1, 2019-3 IRB 275, announcing their intention to issue regulations on foreign corporations with PTEP. Notice 2019-1 affirmed the requirement to maintain annual PTEP accounts but expanded the number of PTEP groups from 10 to 16 and provided that the rules would be coordinated with prop. reg. section 1.960-1 and -3.

1. The final section 960(b) regulations.

Both the preamble to the proposed regulations and Notice 2019-1 requested comments on possible ways to simplify the PTEP groups. While no comments suggested how to combine or consolidate PTEP groups, one noted that the rules were complex and questioned whether tracking all the PTEP groups was necessary.

On December 17, 2019, Treasury and the IRS issued final regulations under section 960(b) (T.D. 9882) that finalized the proposed regulations with some modifications.

After evaluating the various limitations on the creditability of some foreign income taxes and the application of the section 986(c) foreign currency rules to PTEP groups, the final regulations still permit the application of the relevant FTC and foreign currency provisions but consolidate the PTEP groups into five under section 959(c)(2)[20]: PTEP arising under sections 965(a), 965(b)(4)(A), 951A(f)(2), 245A(d),[21] and 951(a)(1)(A).

Although section 956 has virtually no significance following the availability of the 100 percent dividends received deduction of section 245A, the final regulations implicitly acknowledge that the distribution-ordering rule of section 959(c) requires that U.S. taxpayers reclassify section 959(c)(2) PTEP as section 959(c)(1) PTEP whenever the CFC has a section 956 investment in U.S. property that was included in the U.S. shareholder's gross income under section 951(a)(1)(A), or would have been included except for section 959(a)(2).

In that case, the section 959(c)(2) PTEP group is reduced by the functional currency amount of the reclassified PTEP, which is added to the corresponding section 959(c)(1) PTEP group described in the same section 904 category and same annual PTEP account as the reduced section 959(c)(2) PTEP group. That tracking requirement adds extreme complexity without any corresponding FTC value.

III. New Form 5471 Reporting Requirements

Reg. section 1.960-3 detailed what CFCs must do to calculate the taxes properly attributable to items of income under the principles of reg. section 1.904-6. As a result, the IRS has determined that U.S. shareholders must complete and include as part of the annual Form 5471 for each CFC several schedules (essentially workpapers) to disclose how they calculated the current-year FTC on income inclusions, as well as the various PTEP categories and related foreign taxes, even though that information is largely irrelevant for the calculation of the current-year tax liability.

The new and expanded Form 5471 schedules that implement those rules are briefly described below.

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[19] A single section 959(a) distribution could be attributable to multiple PTEP groups of the distributing CFC for multiple inclusion years. The proposed regulations, including their order of PTEP groups, do not provide rules for allocating distributions among different kinds of PTEP under section 959(c). Treasury and the IRS anticipate that future regulations under section 959 will provide ordering rules for determining the annual PTEP account and PTEP group to which a section 959 distribution is attributable.

[20] The regulations list 10 PTEP groups, but five are duplicated under section 959(c)(1)-(2).

[21] Reg. section 1.960-3(c)(2)(ix)(A) is E&P described in section 959(c)(2) by reason of section 254A(e)(2), reg. section 1.960-3(c)(2)(ix)(B) is E&P described in section 959(c)(2) by reason of section 959(e), and reg. section 1.960-3(c)(2)(ix)(C) is E&P described in section 959(c)(2) by reason of section 964(e)(4).

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A. Schedule J

Before the TCJA, Schedule J merely rolled beginning-of-year E&P to end-of-year E&P, reflecting the impact of current earnings, current reclassifications of E&P under section 959(c)(3) and the two PTEP categories under section 959(c)(2) and (1), and distributions of E&P. For taxpayers taking advantage of the pre-TCJA deferral regime, Schedule J might take only a few minutes to complete.

Simplicity, however, is a foreign concept for the new Schedule J. At the highest level, the post-TCJA version of Schedule J serves the same purpose as before: rolling E&P from the beginning of the year to the end. However, it expanded the amount of detail on how E&P rolls and the number of section 959(c)(2) PTEP categories to be reported from one to five. It also expanded section 959(c)(1) into the same five PTEP categories.

Beyond merely reflecting current E&P, section 959(c) reclassifications, and distributions, the new Schedule J requires that several other drivers of untaxed E&P be tracked, including E&P subject to the section 909 anti-splitter rules, E&P carried over in nonrecognition transactions, and hovering E&P deficits — and that relates just to untaxed E&P under section 959(c)(3).[22]

While those details can prove problematic, the real trouble begins with the expanded categories of PTEP resulting from the section 1.960-3 regulations discussed above. The new Schedule J requires taxpayers to show PTEP attributable to section 965(a) inclusions, section 965(b) deficit offsets, section 956 investments in U.S. property, GILTI inclusions, subpart F inclusions, section 245A hybrid dividends, and section 1248 amounts. Within those categories, taxpayers must report whether the PTEP is section 959(c)(2) or (c)(1) PTEP. Taxpayers must also separately track each PTEP according to its FTC category, as well as track movements of PTEP between section 959(c)(2) and (c)(1) groupings for the five new PTEP groups.

As a result, a taxpayer can easily have many different PTEP categories reported on a single Form 5471, with no practical benefit to that level of detail outside the application of sections 960(b) and 986(c).

B. Schedule P

Form 5471 was expanded to require additional detail on PTEP at the U.S. shareholder level. While similar to Schedule J in organization and purpose, new Schedule P requires several additional levels of detail to be tracked.

Most notably, Schedule P must be prepared for each U.S. shareholder of a CFC, tracking the shareholder's portion of the CFC's PTEP balances in each group and FTC basket. For 100 percent owned CFCs, that information may be readily available after completing Schedule J. However, complexities inevitably arise when CFCs have multiple U.S. shareholders. For example, a taxpayer filing for a 90 percent owned CFC with an unrelated 10 percent minority U.S. shareholder cannot reasonably be expected to know the minority shareholder's section 951A PTEP balance, which is a function of the tested income and losses of any other CFCs owned by that shareholder. Despite that impracticality, taxpayers are expected to track and report not only their tax attributes but also those of unrelated taxpayers — an obligation with no known comparable in U.S. federal tax compliance.

Schedule P also diverges from Schedule J in requiring that the PTEP balances be reported in both functional currency and U.S. dollars. The clear implication here is that Schedule P serves as a roadmap for the IRS to audit section 986(c) calculations with no effect on the current-year U.S. tax liability of the reporting U.S. shareholder.

As similarly observed with Schedule J, Schedule P creates a degree of impracticality to accommodate a narrow range of transactions. Absent actual distributions of PTEP, Schedule P provides no meaningful information to justify the effort it requires.

C. Schedule E-1

For any taxpayers uncertain why the expanded reporting on schedules J and P was necessary, Schedule E-1 serves to clarify the matter. As discussed above, the relevance of expanded PTEP reporting is largely a function of accommodating section 960(b) and (c), in which

[22]As indicated above, despite the additional reporting complexity, most CFCs report small amounts of untaxed section 959(c)(3) E&P.

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distributions of PTEP may carry the opportunity for claiming FTCs.

Schedule E-1 supports that function. Mirroring schedules J and P in organization, Schedule E-1 traces foreign taxes paid that are associated with PTEP (for example, when a CFC-to-CFC section 959(b) distribution of PTEP is subject to non-U.S. income or withholding tax). When that PTEP is ultimately distributed to a U.S. shareholder, those foreign taxes may be available as an FTC, subject to the rules of sections 960 and 904. However, that should apply only when the reporting CFC receives from a lower-level CFC a PTEP distribution subject to local withholding tax in the country of payment or income tax in the country of the receiving entity.

Schedule E-1 therefore stands somewhat in contrast to schedules J and P: Its complexity is borne out of actual, rather than potential, necessity. A taxpayer must disclose a level of detail on Schedule E-1 only if its PTEP balances are subjected to foreign tax (for example, by reason of a taxable distribution). A taxpayer without that fact pattern leaves the vast majority of Schedule E-1 blank. By contrast, schedules J and P must be fully reported, regardless of the relevancy of much of the detail.

D. Schedule Q

Schedule Q amounts to a worksheet by which the preparer of the other schedules must show the underlying calculations.

Taxpayers who have already disclosed their subpart F amounts on Schedule I and shown their calculations of tested income on Schedule I-1 must go into even greater detail. Schedule Q requires that a taxpayer report the gross income and deductions allocable and apportionable to that gross income for the various subpart F income groups, tested income, and residual income. Again, the net income in those income groups is already reflected elsewhere on Form 5471; nothing reported on Schedule Q alters a taxpayer's taxable income. Therefore, Schedule Q merely follows a similar pattern of the IRS requiring that taxpayers put their workpapers directly into their U.S. tax returns.

IV. Conclusion and Recommendation

Based on the foregoing, we can safely say that the section 960 regulations and the related reporting requirements scrupulously adhere to the "principles of section 1.904-6" as directed by the House Ways and Means Committee. Those principles in turn are driven solely by U.S. FTC considerations and are designed to ensure that U.S. corporate taxpayers that include income under section 951(a)(1) — whether under the subpart F, GILTI, or section 956 provisions — will claim credit only for deemed-paid foreign income taxes that are properly attributable to the section 904(d)(1) FTC category of income being reported.

Only after that income has been included and taxed on a U.S. return does it become PTEP under section 959(c)(2). Under section 959(a), PTEP distributions by a CFC to its U.S. shareholders are not again included in gross income. In that case, under section 960(b)(1), the foreign income taxes claimed as a credit on the original income inclusion are not allowable as a deemed-paid credit at the time of the PTEP distribution. In fact, the only time a U.S. corporate shareholder might be entitled under section 960(b) to a deemed-paid FTC for taxes related to PTEP distributions is when the CFC is redistributing PTEP that it received via a section 959(b) distribution of PTEP from a lower-level CFC and the distribution was subject to foreign income taxes that were not claimed as a deemed-paid credit under section 960(a) at the time of the original inclusion.

In our view, the availability of an additional FTC on PTEP distributions and the related requirements to track and report the PTEP and related FTC have no relevance or benefit if the CFC making a PTEP distribution to its U.S. shareholders has no CFC subsidiaries making section 959(b) distributions or the U.S. shareholder is an individual (because individuals are not entitled to deemed-paid taxes under section 960).

A. Section 960(b) Election

To address the vastly disproportionate effort-to-value problem and reduce the burden on U.S. shareholders of reporting unnecessary information, we propose that reg. section 1.960-3 be revised to allow the U.S. shareholders of a CFC to make an annual election to forgo the benefit of

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any deemed-paid credit under section 960(b) for distributions by that CFC of PTEP arising in that year. If later section 959(b) distributions of that PTEP to an upper-level CFC are subject to withholding taxes in the paying country or to additional income taxes in the recipient country, those taxes would not be allowable as a credit under section 960(b) on eventual distribution to a U.S. shareholder and would also not reduce E&P of the recipient CFC.

CFCs for which all U.S. shareholders have made that election would file a simplified Schedule J for each section 904(d)(1) category, with four columns to report E&P in that category under section 959(c)(1)-(3) and total E&P (similar to the format for Schedule J) as of December 2012. In that case, the Form 5471 for the CFC would not be required to include the post-TCJA schedule J, P, or Q.

Although we find them unnecessarily burdensome, schedules E and E-1 would still be required for U.S. shareholders claiming a current-year FTC under section 960(a).

B. PTEP Purge

Even if Treasury and the IRS view as untenable the proposed election to forgo section 960(b) FTCs, U.S. shareholders of a CFC can still engage in self-help. They can significantly reduce the burden of tracking the annual amounts of E&P and related foreign income taxes in each PTEP group by causing the CFC to purge its PTEP by repatriating all PTEP, reducing the end-of-year E&P balances in each PTEP group to as close to zero as possible. However, U.S. taxpayers with minimum tax basis in the shares of the CFCs should be mindful of a potential exposure to capital gain under section 961(b)(2).[23] The conundrum is that the distribution of PTEP in excess of basis can generate capital gain while the distribution of less than all PTEP leaves the U.S. shareholders with the burden of completing and filing Form 5471 attachments that have no relevance.

Unless Treasury and the IRS relax the requirement that U.S. shareholders of CFCs fastidiously track PTEP and related foreign taxes by PTEP group, FTC basket, and year, U.S. taxpayers are in for a frustratingly difficult and costly exercise to timely complete Form 5471 and related schedules J, P, and Q — while knowing that their efforts will likely have little or no impact on their current or future FTC calculations. ■

[23]Under reg. section 1.961-2(a)(1), PTEP distributions that are excluded from gross income under section 959(a) reduce the adjusted tax basis in the stock of the distributing CFC at the time of distribution, whereas an inclusion of income under section 951(a) increases the U.S. shareholder's basis in the stock of that CFC only at the end of the CFC's tax year. The IRS is well aware of this problem and has promised guidance over the last several years to address it.

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