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Global Tax Perspectives

From 951A to 954(d) by Way of 338(g): The TCJA, Subpart F, and Post-Acquisition IP Integration

By Ethan Kroll and David de Ruig*

Introduction

In this column, we discuss a relatively novel element of the post-acquisition integration calculus: whether to make a Code Sec. 338(g) election with respect to stock of a foreign target so that a post-acquisition sale of the target's assets gives rise to subpart F income under Code Sec. 954(d)—*i.e.*, foreign base company sales income ("FBCSI"). We describe this element as novel because, before U.S. tax reform, companies typically tried to minimize subpart F income and to achieve deferral in post-acquisition integration transactions. Now that deferral is off the table for many companies, except in limited instances, the choice is generally between current U.S. tax in one form or another—*i.e.*, on subpart F income or global intangible low-taxed income ("GILTI"). This column addresses a few of the key considerations that companies should weigh in deciding whether to make a Code Sec. 338(g) election in this context.

Subpart F or GILTI: A Distinction with a Difference

We start from the premise that a U.S. company that holds part of its intangible property ("IP") offshore purchases, either directly or through a controlled foreign corporation ("CFC"), the stock of a foreign target. The foreign target and its foreign affiliates become CFCs of the U.S. company. For simplicity, we refer to the foreign target and its foreign affiliates as the "target."

There are three main ways to integrate the target's IP into the acquiring company's foreign structure—license, sale, or some form of joint development arrangement. Under current law as of the time of writing, an intercompany license between CFCs can be largely U.S.-tax neutral because the royalties do not give rise to subpart F income under Code Sec. 954(c)(6), and the GILTI rules effectively allow companies to net the royalty expense against the royalty income in computing the U.S. shareholder's ultimate GILTI inclusion.[1]

Despite the apparent simplicity of the license alternative, companies often prefer to move IP out of the target structure shortly after the acquisition closes to minimize controversy surrounding the IP value in the target jurisdictions by tying the IP value to the target's purchase price. Companies may therefore forgo the potential benefits of a license or a joint development arrangement in favor of a taxable sale. In this case, the critical question is whether to structure the sale in a manner that generates subpart F income or GILTI. The answer to this question is binary because, in the post-TCJA world, income of a CFC falls under either the subpart F regime or the GILTI regime, not both.[2]

As a threshold matter, subpart F income that a CFC earns is subject to tax at the U.S. corporate headline rate of 21%.[3] In contrast to the GILTI regime, there is no specific statutory deduction available to reduce a U.S. shareholder's subpart F inclusion.[4] By the same token, if the U.S. shareholder has NOLs, the U.S. shareholder is likely to be indifferent. In this case, the U.S. shareholder must apply its NOLs to the gross amount of the GILTI inclusion.[5] A U.S. shareholder in an NOL position is therefore effectively subject to a tax rate of 21% on both GILTI and subpart F inclusions because the U.S. shareholder must apply an attribute that could otherwise reduce U.S. taxable income subject to the 21% rate to income that would otherwise be subject to U.S. federal income tax at a rate of 10.5% by operation of the Code Sec. 250 deduction.

Now that deferral is off the table for many companies, except in limited instances, the choice is generally between current U.S. tax in one form or another—i.e., on subpart F income or global intangible low-taxed income ("GILTI").

From a foreign tax credit perspective, however, there is a clear distinction between the GILTI and subpart F regimes. First, only 80% of the foreign taxes that are attributable to a U.S. shareholder's annual GILTI inclusion are creditable, subject to applicable Code Sec. 904 limitations.[6] Importantly, the 80% cap on creditable foreign taxes in the GILTI basket does not apply to taxes that a "tested loss" CFC incurs, which are not eligible for a foreign tax credit at all.[7]

In addition, expenses that the Code Sec. 861 rules allocate to the U.S. shareholder's Code Sec. 904(d) GILTI basket further complicate matters. These expenses reduce the shareholder's foreign tax credit limitation and, as a result, the foreign effective tax rate above which the U.S. shareholder no longer pays any incremental U.S. tax on GILTI may be much higher than the 13.125% ceiling that the TCJA Conference Report suggested.[8] Finally, and perhaps most importantly, foreign taxes on "tested income" are available as a credit only in the year in which the U.S. shareholder is deemed to pay those taxes.[9] Accordingly, if the U.S. shareholder is deemed to pay more in taxes than the U.S. shareholder is able to claim as a credit against its GILTI inclusion, those excess taxes are effectively lost for U.S. foreign tax credit purposes.

Furthermore, the GILTI rules limit the U.S. shareholder's credit with respect to foreign taxes that U.S. shareholder's tested-income CFCs pay or accrue to the U.S. shareholder's "inclusion percentage." The inclusion percentage is expressed as the ratio of the U.S. shareholder's GILTI inclusion to the U.S. shareholder's *pro-rata* share of the aggregate tested income of the U.S. shareholder's CFCs.[10] Thus, if a U.S. shareholder's CFCs have a material amount of qualified business asset investment or tested losses that create a disparity between the U.S. shareholder's aggregate tested income and its actual GILTI inclusion, those attributes may also limit the U.S. shareholder's ability to access and monetize the foreign taxes that its tested income CFCs pay.

In contrast to the foreign tax credit rules for GILTI, the foreign tax credit rules for subpart F inclusions seem downright generous. Under these rules, a U.S. shareholder is entitled to a credit for 100% of the foreign taxes it is deemed to pay with respect to a subpart F income inclusion and may carry any credits that it cannot use in a given year first to the year immediately before the year in question and then to each succeeding year, for another 10 years.[11]

Of course, appearances can be deceiving. Taking a step back, it is important to remember that, in many instances, the benefit of a 50% deduction makes GILTI far more attractive than subpart F income, despite the 20% foreign tax credit "haircut" under the GILTI regime. Oversimplifying, if a CFC pays $25 foreign tax on $100 of tested income, the U.S. shareholder is notionally able to use $20 of the tax to offset $10.50 in U.S. federal income tax on its $50 GILTI inclusion. Thus, the U.S. shareholder has $9.50 in excess GILTI credits to potentially use to offset U.S. federal income tax on lower taxed tested income, setting aside expense allocation and apportionment. In contrast, if that $100 constitutes subpart F income, the U.S. shareholder is notionally able to use the full $25 in foreign tax, but the U.S. federal income tax burden in this case is $21—*i.e.*, 21% of the full $100. In this case, the U.S. shareholder only has $4 of excess credits that it may use against other income in the same Code Sec. 904 category. Nonetheless, if a company typically has other income in the same basket and income group as a potential subpart F inclusion, and that inclusion has the potential to generate foreign tax credits that would be lost if the inclusion were instead treated as GILTI, subpart F income could become more attractive than GILTI. Getting to the "right" answer typically involves extensive modeling, as the acquiring company begins to identify, understand, and integrate into the model key aspects of the target's profile.

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For a company that wants to maximize the amount of subpart F income that an IP sale generates, a Code Sec. 338(g) election could seem like a clean, technical solution.[12]

Under the tax fiction of Code Sec. 338, the "old" target is deemed to transfer its assets and liabilities at the close of the acquisition date to an unrelated "new" target, with the new target's purchase and assumption of those assets and liabilities treated as occurring effective as of the day following the acquisition date.[13] The assets, including IP, that the new target holds are deemed to be purchased for U.S. federal income tax purposes, including for purposes of the FBCSI rules under Code Sec. 954(d). The deemed purchase results in a step-up in the basis of the target's assets to fair market value for U.S. federal income tax purposes only. The Code Sec. 338(g) election therefore creates a difference in the U.S. and foreign tax basis in the target's assets.

As a result, if a target that is the subject of Code Sec. 338(g) election sells IP that it uses solely in its trade or business[14] to an affiliate shortly after the transaction closes, that sale falls within the scope of the FBCSI rules because it represents a sale of property to a related person that the target was deemed to have purchased.[15] To that end, a Code Sec. 338(g) election, followed by a sale of the target's IP, provides a fairly straightforward mechanism for triggering subpart F income, should the acquiring company wish to do so.

From a foreign tax credit perspective, however, a Code Sec. 338(g) election poses two significant challenges. The first challenge, which is well known, relates to Code Sec. 901(m). Code Sec. 901(m) permanently disallows a foreign tax credit, including a deemed paid credit under Code Sec. 960, for the "disqualified portion" of foreign taxes associated with the basis difference that the Code Sec. 338(g) election creates.[16] At a high level, Code Sec. 901(m) requires a taxpayer to multiply the amount of foreign tax by a fraction equal to the difference between the U.S. and foreign tax basis in an asset over the amount of foreign income on which the foreign government imposes the tax. For example, if a company were to acquire a target with IP with a foreign tax basis of $0 and a fair market value of $500, and if the sale were to result in $100 of foreign tax, Code Sec. 901(m) would ostensibly disallow the entire amount—*i.e.*, $100 foreign tax × $500 basis difference/$500 foreign income from the sale.

If a company were able to effect a sale of the IP in one U.S. tax year, and have foreign taxes on the gain on the sale accrue in a different U.S. tax year, the company might allocate the basis difference entirely to the first tax year for purposes of Code Sec. 901(m) and, as a result, no portion of the foreign taxes that accrue in the subsequent year would be associated with that basis difference.[17] In this way, the company might be able to mitigate the impact of Code Sec. 901(m). Alternatively, depending on the amount of the basis difference, the company might determine that generating FBCSI, and deemed paid credits under Code Sec. 960(a), yields a sufficient benefit even with the "haircut" that Code Sec. 901(m) imposes.

> *We live in a different world now. All companies and their advisors must wrestle, and ultimately come to terms, with the new, intricate framework of the properly attributable standard of Code Sec. 960.*

The second, subtler challenge, and the one we wish to discuss, relates to Code Sec. 960 as amended by the TCJA. The regulations under Code Sec. 960(a) provide that a U.S. shareholder may only be treated as paying foreign taxes that are "properly attributable" to a subpart F income inclusion. It is this second requirement, a subpart F income inclusion, that may prove the most challenging in the context of a Code Sec. 338(g) election.

The Code Sec. 960 regulations contain rules implementing amended Code Sec. 960's transition to an annual, properly attributable approach from the former pooling regime for deemed paid taxes.[18] Generally speaking, a U.S.

shareholder that has a subpart F inclusion is only deemed to pay foreign taxes of its CFC to the extent those taxes are properly attributable to the CFC's items of income that gave rise to the subpart F inclusion in the first instance.[19] For these purposes, the amount of foreign taxes treated as properly attributable to an item of income equals the U.S. shareholder's "proportionate share" of the CFC's current year taxes that are allocated and apportioned to the specific subpart F income group (here, FBCSI) to which the income is attributable.[20]

The proposed regulations under Code Sec. 861, the regulations under Code Sec. 904, and the regulations under Code Sec. 960 govern the allocation and apportionment of taxes for this purpose. Specifically, regardless of whether the CFC recognizes income on the IP sale (1) from a U.S. federal income tax perspective or (2) in a different year from the year in which the foreign tax accrues, the proposed Code Sec. 861 regulations appear to assign the foreign taxable income that the CFC recognizes to the statutory grouping that would apply if the CFC had recognized the income for U.S. federal income tax purposes (*i.e.*, general category income) in the U.S. tax year in which the taxes are paid or accrued.[21] The proposed Code Sec. 861 regulations and the final regulations under Code Sec. 904 allocate and apportion all the foreign taxes to that income because the income on which the foreign government imposes tax falls solely in that statutory grouping.[22]

The regulations under Code Sec. 960 further allocate and apportion the taxes among income groups (as defined in Reg. §1.960-1(d)(2)) within the general category based on the relative foreign taxable income in each group, by providing that a "current year tax that is allocated and apportioned to a section 904 category is then allocated and apportioned among the income groups within the section 904 category under the principles of §1.904-6(a)(1) *based on the portion of the foreign taxable income (as characterized under Federal income tax principles) that is assigned to a particular income group*."[23] Importantly, this italicized portion does not appear in the initial proposed Code Sec. 960 regulations that were published in the Federal Register in December 2018. At the same time, the example in those proposed regulations, which purports to demonstrate the application of Proposed Reg. §1.960-1(d)(3)(ii), is virtually identical to the example contained in the final regulations under Code Sec. 960.[24] This example appears to both allocate and apportion taxes based on relative income in each income group.[25] Therefore, it appears that Treasury intended the final version of the regulation to clarify the approach that the example in the 2018 proposed regulations suggests.[26]

Nevertheless, current Proposed Reg. §1.960-1(d)(3)(ii), which, if finalized in its current form, would apply to taxable years of a foreign corporation beginning after December 31, 2019, seems to articulate a different rule. This regulation allocates and apportions current year taxes among income groups under the new framework in Proposed Reg. §1.861-20 by treating each income group within a Code Sec. 904 category as a statutory grouping.[27] This regulation therefore presumably would require taxpayers to allocate taxes to an income group based on a factual relationship between the tax and the income, including in situations where foreign law applies a specific tax rate to a certain type of income, or permits a credit against tax on particular items or types of income.[28]

Thus, the current, final regulations, at least as they stand at the time of writing, appear to require taxpayers to spread taxes that are allocable to the general category among the income groups within that category *pro rata*, based on the relative amounts of foreign taxable income in each group. As noted above, the regulations could be construed to not require—or allow, for that matter—taxpayers to allocate taxes solely to the income group that, as a factual matter, includes the foreign taxable income on which the foreign government imposed the taxes.

By way of illustration, under this construction, if a CFC were to recognize $20 of foreign taxable income, $10 of which constitutes foreign base company services income ("FBCSvI") under Code Sec. 954(e) and $10 of which constitutes FBCSI, the regulations under Code Sec. 960 ostensibly would apportion general category taxes ratably between the CFC's FBCSI and its foreign base company services income, regardless of what percentage of the taxes actually relates to each income group. Furthermore, if that $10 of FBCSvI were instead to constitute $10 of very low taxed general category tested income, the regulations could apportion some portion of the foreign taxes on the amount of foreign taxable income that constitutes FBCSI to the $10 of tested income. In this case, the allocation and apportionment rule discussed above could erode the amount of taxes that are available for a U.S. shareholder to be deemed to pay on subpart F income pursuant to Code Sec. 960.

It is of course entirely possible that Treasury intended all three instances of the regulation to articulate a consistent rule. After all, in the example, the country in which the CFC conducts business appears to impose tax uniformly on the CFC's general category income, without regard to the nature of the income in that category. Therefore, the example ostensibly implements the 2018 proposed regulation, the 2019 final regulation, and the 2019 proposed regulation correctly by allocating and the apportioning the tax based on relative income. Put another way, where a tax does not definitely relate to income in a particular group, the regulations rightly require the taxpayer to spread that tax among the various income groups in proportion to the relative amount of income in each group. Where, however, a country taxes different types of income differently—*e.g.*, under certain incentive regimes—then the 2018 proposed regulation and the 2019 final regulation appear to ignore the factual relationship of the tax and the income in directing the taxpayer to nonetheless ratably allocate and apportion the tax. The 2019 proposed regulation appears to close the gap by expressly directing taxpayers to treat each income group as a statutory grouping for purposes of allocating and apportioning the tax.

Turning back to the mechanics of the proportionate share rule, the Code Sec. 960 regulations determine the U.S. shareholder's proportionate share of taxes for each specific subpart F income group by multiplying the current year taxes that the regulations allocate and apportion to the specific income group within a Code Sec. 904 category by a fraction, the numerator of which is the portion of the U.S. shareholder's subpart F inclusion that is attributable to the specific subpart F income group and the denominator of which is the total net income in that subpart F income group.[29] If the numerator is zero because the U.S. shareholder does not have a subpart F inclusion in the relevant group, then the shareholder's proportionate share of the relevant taxes also is zero.

In sum, in the fact pattern we are discussing, if a U.S. shareholder does not recognize net subpart F income in the specific group—here, FBCSI—the U.S. shareholder is not deemed to pay taxes arising from the intercompany sale of the IP following the Code Sec. 338(g) election that are allocated and apportioned to that income group in the year in which the taxes accrue. Moreover, the U.S. shareholder is not deemed to pay, in a subsequent year, taxes that it is not deemed to pay in the year in which the taxes accrue, because the proportionate share calculation, detailed above, operates on a current-year-only basis.

There are a number of ways in which a company could easily find itself with no net foreign-base-company income in the context of a Code Sec. 338(g) election that is followed by a sale of IP. First, under the Code Sec. 338 fiction, as noted above, the assets receive a stepped-up basis for U.S. federal income tax purposes. The Code Sec. 338(g) election does not affect the foreign tax basis, with the result that an IP sale typically results in a material amount of foreign tax. Assume that U.S. and foreign income and foreign tax all accrue in the same U.S. tax year. If the IP does not appreciate materially between the date on which the company acquires the target and the date on which the IP sale occurs, gross gain on the sale from a U.S. federal income tax perspective will be limited. In this case, the foreign taxes on a much larger base may eliminate this gain, or convert it to a loss, on a net basis.[30] Worse, the IP may have even declined in value during this time period, resulting in a loss from a U.S. federal income tax perspective, irrespective of the foreign tax burden.

If the CFC has other assets that appreciate between the date on which the acquisition closes and the year in which the sale occurs, the CFC could sell these assets to capture at least some of the taxes from the IP. In this case, the foreign taxable income that the asset sale generates would presumably attract some portion of the taxes from the IP sale under Reg. §1.960-1(d). Likewise, if some portion of the CFC's income were to constitute foreign base company services income under Code Sec. 954(e), and that income was not subject to the same tax rate in the CFC's country of organization as other taxable income of the CFC (*e.g.*, income from the IP sale giving rise to FBCSI), that additional foreign taxable income also might attract some portion of the taxes from the IP sale. Given the relative magnitude of the IP sale and these other transactions, neither approach is likely to represent a meaningful strategy to ensure that the U.S. shareholder is deemed to pay tax on the gain from the IP pursuant to Code Sec. 960(a).[31]

Furthermore, foreign tax will reduce the CFC's current year earnings and profits ("E&P"). In addition, the basis step-up results in U.S. tax amortization that may further erode the CFC's current year E&P. Even if the sale were to generate net gain, the sale would not give rise to subpart F income unless the CFC had positive current-year E&P. Moreover, additional income that the CFC generates from selling other assets or engaging in other subpart F income-generating activities still may not bring with it sufficient current-year E&P to make up for the negative E&P impact of both the foreign taxes and the U.S. amortization deductions discussed above. Of course, there are strategies that a company can employ to increase E&P. These strategies typically involve accelerating income or deferring deductions—*e.g.*, through prepayments or Code Sec. 59(e) elections. Yet, E&P reflects a company's economic position and therefore can be difficult to predict with certainty. A company likely will not know at the time an IP sale takes place precisely what a CFC's E&P will be as of the close of the year of the sale. The prospect of losing 100% of the foreign taxes on the IP sale due to the potential absence of current-year E&P may be enough to discourage many taxpayers from pursuing a Code Sec. 338(g) election.

Assume, in the alternative, that the foreign taxes on the gain accrue in the year following the year in which the gain arises from a U.S. federal income tax perspective. The issues in this scenario appear to be largely the same as in the scenario above. The proposed regulations under Code Sec. 861 and the regulations under Code Sec. 904 appear to assign the foreign taxable income, and allocate the foreign taxes, to general category income in the year in which the taxes accrue.[32] The Code Sec. 960 regulations then largely apportion those taxes to FBCSI, under the assumption that foreign taxable income from the IP likely remains by far the largest source of general category income that the CFC recognizes. On the theory that the CFC's income is generally taxed uniformly, and that tax does not have a definite factual relationship to any income type, unless the CFC generates (i) net FBCSI (*i.e.*, FBSCI in excess of the foreign taxes), or (ii) additional foreign taxable income that can attract the taxes on the IP sale away from the FBCSI group, and (iii) can maintain a positive current-year E&P position, the U.S. shareholder is not likely to be deemed to pay a material amount of the tax on the IP sale under Code Sec. 960(a). The U.S. shareholder either will not recognize net FBCSI, the relevant subpart F income group, or will recognize income in a subpart F income group that is not sufficient to bring with it a significant portion of the taxes on the sale. In this regard, the proposed Code Sec. 861 regulations and the regulations under Code Secs. 904 and 960 appear to largely frustrate at least one approach to mitigating the impact of Code Sec. 901(m).

Conclusion

Is Code Sec. 338(g) off the table entirely in light of guidance under Code Secs. 861, 904, and 960? Of course not. As companies consider their unique facts and model the various possible outcomes under a range of plausible scenarios, we expect that at least some will find that a Code Sec. 338(g) election yields tangible benefits in connection with post-acquisition integration transactions. Our objective in this column is simply to alert companies to the complexities of the new regime so that they can make informed decisions. Furthermore, the rules discussed above are relevant outside the Code Sec. 338(g) context. All companies and their advisors must wrestle, and ultimately come to terms, with the new, intricate framework of the properly attributable standard of Code Sec. 960. We expect that they will.

ENDNOTES

* The views expressed are those of the authors and do not necessarily reflect the views of Ernst & Young LLP or other member firms of the global Ernst & Young organization. In addition, the authors would like to thank Marjorie Rollinson, Deputy Director of National Tax, Ernst & Young LLP, for her helpful input.

1 *See, e.g.*, Code Sec. 951A(c).

2 *See* Code Sec. 951A(c)(2)(A)(i)(II). Of course, the portion of a CFC's income that is excluded from subpart F income and is otherwise attributable to a 10% fixed return on depreciable assets is neither subpart F, nor GILTI.

3 This assumes that the CFC has current year earnings and profits ("E&P") sufficient to support a subpart F inclusion. Taxpayers with current-year E&P deficit CFCs must pay careful attention to the recapture rules and their overlap with the new GILTI regime. *See* Reg. §1.951A-2(c)(4)(iii)(B); Reg. §1.951A-2(c)(4)(iv)(A), Example 1.

4 *See, e.g.*, Code Sec. 250.

5 Code Sec. 250(a)(2).

6 Code Sec. 960(d). Fortunately, the entire Code Sec. 78 gross-up is eligible for the Code Sec. 250 deduction. Code Sec. 250(a)(1)(B)(ii).

7 Code Sec. 960(d). The GILTI limit on creditable foreign taxes is also a function of how much of the U.S. acquirer's overall GILTI inclusion is attributable to the CFC generating creditable foreign taxes. Code Sec. 960(d)(2).

8 H.R. Rep. No. 115–466, at 498–499 (2017) (the "Conference Report").

9 Code Sec. 904(c).

10 Code Sec. 960(d).

11 Code Sec. 904(c).

12 There have been many articles on the relative merits of a Code Sec. 338(g) election post-TJCA. Our focus is limited to the implications of the election for the affirmative subpart F planning that is the subject of this column.

13 Code Sec. 338(a).

14 The sale therefore does not generate foreign personal holding company income under Code Sec. 954(c). *See* Reg. §1.954-2(e)(3)(iv). If the sale were to generate foreign personal holding company income, the sale would not be treated as generating FBCSI. *See* Reg. §1.954-1(e)(4).

15 It is the authors' view that IP likely qualifies as personal property for Code Sec. 954(d) purposes.

16 Code Sec. 901(m)(2)(A).

17 *See* Code Sec. 901(m)(3)(B)(ii); *see also* Temporary Reg. §1.901(m)-5T(c); Proposed Reg. §1.901(m)-5(c), (h), Example 1.

18 Reg. §1.960-2.

19 Reg. §1.960-2(b)(2).

20 Reg. §1.960-2(b)(3).

21 Proposed Reg. §1.861-20(d)(2)(i)-(ii)(A).

22 Reg. §1.904-6(a)(1)(i), (iv), (b)(1); Proposed Reg. §1.861-20(e)–(f). *See also* Proposed Reg. §1.861-20(g), Example 3.

23 Reg. §1.960-1(b)(7), (d)(2), (3)(ii). *See also* Reg. §1.960-1(f).

24 *See* Proposed Reg. §1.960-1(f).

25 *See* Proposed Reg. §1.960-1(f) ("Under paragraph (d)(3)(ii) of this section, 600,000u (3,000,000u/4,500,000u x 900,000u) of the 900,000u current year taxes paid by CFC1 are related to the PTEP group within the general category, and 300,000u (1,500,000u/4,500,000u x 900,000u) are related to the residual income group within the general category.").

26 *See, e.g.*, Code Sec. 863.

27 Proposed Reg. §1.960-1(d)(3)(ii)(A). Proposed Reg. §1.861-20 likewise applies to taxable years beginning after December 31, 2019.

28 *Accord* Proposed Reg. §1.861-20(f).

29 Reg. §1.960-2(b)(3). Further, the numerator (the portion of the U.S. corporate shareholder's subpart F income attributable to FBCSI, in our example) is further reduced by the CFC's *pro rata* share of a prior year qualified deficit. Reg. §1.960-2(b)(3)(ii).

30 *See* Reg. §1.954-1(a)(4).

31 In fact, it is probably much more likely that the CFC will generate material tested income, and that this tested income will attract some portion of the tax on the gain under Reg. §1.960-1(d). In this way, the U.S. shareholder may be deemed to pay some portion of the tax after all, albeit pursuant to Code Sec. 960(d) and not Code Sec. 960(a).

32 *See* Proposed Reg. §1.861-20(d)(2)(i), (g), Example 3.