

# **Cash Measurement Dates Under Section 965**

**Avishai Shachar  
Mario Verdolini  
Bill Curran  
Christopher Baratta**

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# **Davis Polk**

**Davis Polk & Wardwell LLP**

# Overview

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- Proposed Regulations under Section 965 published in the Federal Register on August 9, 2018
  - Proposed Regulations are inconsistent with statute and broader than necessary to address specific concerns identified by Treasury in meeting with Davis Polk on October 31
  - Proposed Regulations materially and adversely affect taxpayers who engaged in transactions outside the scope of potentially abusive transactions and Congress' policy goals
  - Proposed Regulations result in retroactive effect broader than authorized by Congress
- Davis Polk has provided Treasury with proposals that would address concerns in an appropriate and narrowly tailored fashion
- Proposed final regulations under section 965 were submitted to OIRA on December 6, 2018
  - We presume for purposes of discussion that the submitted regulations are identical to the Proposed Regulations in all relevant respects

## Section 965 Taxation of E&P as of November 2, 2017 or December 31, 2017

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- Section 965 requires U.S. shareholders to include in income all previously untaxed E&P held by a “deferred foreign income corporation” (“DFIC”)
  - A DFIC is any “specified foreign corporation” that has accumulated post-1986 deferred income as of November 2, 2017 or December 31, 2017
  - A specified foreign corporation (“SFC”) is, in relevant part, any controlled foreign corporation or any foreign corporation with respect to which one or more domestic corporations is a U.S. shareholder
- U.S. shareholder’s inclusion is greater of E&P as of two dates:
  - November 2, 2017 (date House of Representatives bill was first introduced) or
  - December 31, 2017
- U.S. shareholder is taxed at higher rate on “aggregate foreign cash position”
  - 15.5% rate on untaxed E&P equal to its “aggregate foreign cash position” in its foreign subsidiaries and
  - 8% rate on remaining untaxed E&P



## Aggregate Foreign Cash Position – Same Corporations Measured on Each Date

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- Text of Section 965(c)(3)(A)

(3) *Aggregate foreign cash position.* For purposes of this subsection—

(A) *In general.* The term “aggregate foreign cash position” means, with respect to any United States shareholder, the greater of—

(i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the last taxable year of such specified foreign corporation which begins before January 1, 2018, or

(ii) one half of the sum of—

(I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation which ends before November 2, 2017, plus

(II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I).

- Notably, “each such” specified foreign corporation measured on two earlier dates must be the same specified foreign corporation measured on first date

# Proposed Rule, However, Includes Different Corporations on Earlier Dates

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- Under the Proposed Regulations, an SFC's cash position may be measured even if it was not in existence on final measurement date
  - "the final cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018 and ends on or after November 2, 2017, if any"
  - "the second cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any"
  - "the first cash measurement date of a specified foreign corporation is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any"

--Proposed Treas. Reg. Sections 1.965-1(f)(8), (24), (25), (31)

- De-linking of SFCs measured on earlier dates from those measured on final date is expressly acknowledged
  - SFC's cash position as of any measurement date is determined "without regard to whether the 958(a) U.S. shareholder is a section 958(a) shareholder of the specified foreign corporation as of any other cash measurement date of the specified foreign corporation, including the final cash measurement date." Proposed Treas. Reg. Section 1.965-f(3)(iii).



# Preamble to the Proposed Regulations Highlights This Inconsistency with Statute

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→ ■ Preamble does not explain departure from statute

- Rather, it omits word “such” before “specified foreign corporation” in its presentation of statutory rule (comparison of preamble against statute):

“aggregate foreign cash position” means, with respect to any United States shareholder, the greater of

(i) the aggregate of such United States shareholder’s pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the last taxable year of ~~such~~ the specified foreign corporation which begins before January 1, 2018, or

(ii) one half of the sum of (A) the aggregate described in clause (i) determined as of the close of the last taxable year of each ~~such~~ specified foreign corporation which ends before November 2, 2017, plus (B) the aggregate described in clause (i) determined as of the close of the taxable year of each ~~such~~ specified foreign corporation which precedes the taxable year referred to in subclause (A).

# Proposed Rule Transforms the Look-Back Rule into Operative Rule

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- By testing same entity in each year, statute is smoothing volatility of year-to-year cash and minimizing a taxpayer's ability to engage in tax-planning post-enactment
- By de-linking entities in prior years, Proposed Rule goes beyond look-back rule and operates to impose increased tax burden on completed transactions
- Example
  - First-tier CFC is liquidated into its U.S. shareholder prior to November 2, 2017
  - CFC's cash was already transferred to U.S. shareholder, and U.S. shareholder will have already paid tax at 35% rate on liquidated CFC's E&P
  - Proposed Rule would impose another 7.5% tax on section 965(a) inclusion to the extent of cash in liquidated CFC
- Anti-abuse rule available for aggressive transactions, without imposing double-tax on previously repatriated cash

## Treasury's Concerns Underlying Proposed Rule

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- In 2017, U.S. shareholder in control of two foreign corporations, Corporations A and B
  - U.S. shareholder causes Corporation A to merge with and into Corporation B on November 1, 2017, with Corporation B surviving
  - Corporation A had modest amount of cash at time of merger and significantly more cash as of each of two earlier measurement dates
  - Treasury concerned that cash held by Corporation A at the time of the earlier measurement dates would not be taken into account
  - But Proposed Rule overly broad and thus captures transactions outside the scope of Treasury concern—e.g., example on prior slide
    - 42.5% effective tax rate on earnings in stark contrast with intent of Congress



# Reference to SFC's Predecessor Resolves Treasury's Concern

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- Title 1 chapter 1 of the U.S. Code includes general rules of construction applicable to “any Act of Congress”
- 1 U.S.C. § 5 provides guidance on the use of “company” or “association”
  - “when used in reference to a corporation, shall be deemed to embrace the words ‘successors and assigns of such company or association,’ in like manner as if these last-name words, or words of similar import, were expressed”
  - Logic demands that a corporation’s predecessors are also captured when Congress uses the word corporation
- Rule that requires an SFC to have a final cash measurement date for its cash position to be measured on prior dates, but which references the cash positions of its predecessor corporations, would thus be consistent with the statute

# Narrowly Tailored Exception to Proposed Rule Mitigates Concerns with Statutory Conflict

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- In our November 2, 2017 letter addressed to Treasury
- Revision to Section 1.965-1(f)(45):

(45) *Specified foreign corporation*—

(i) *General rule.* Except as provided in ~~paragraph~~ paragraphs (f)(45)(iii) or (f)(45)(iv) of this section, the term *specified foreign corporation* means—

(A) A controlled foreign corporation, or

(B) A foreign corporation of which one or more domestic corporations is a United States shareholder.

(iv) *Certain repatriated foreign corporations.* For purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder under paragraph (f)(8) of this section and the consolidated group aggregate foreign cash position (as defined in § 1.965-8(f)(4)) of the consolidated group of which such section 958(a) U.S. shareholder is a member, a foreign corporation the assets of which were, prior to November 2, 2017, acquired by such section 958(a) U.S. shareholder in a transaction described in § 1.367(b)-3(a) is not a specified foreign corporation.