PTEP and Partnerships: A Study

*By Chadwick Rowland**

It is 9:59 again. My clock always seems to read 9:59. Those numbers bear a striking—indeed, exact—resemblance to a cherished section of the Internal Revenue Code. Perhaps after enough repetition, numbers have a way of appearing in odd places.[1] What follows are some reflections on previously taxed earnings and profits ("PTEP"). Recent years have transformed PTEP from a relative niche to a pervasive feature of the U.S. international tax system. After setting out several basic concepts and principles, this article turns to a particular source of difficulty: the intersection of the PTEP rules with Subchapter K. This crossroads remains largely unsettled. The discussion then examines the 2024 proposed rules relating to PTEP and partnerships, before concluding with several observations on those rules, including areas left unresolved and possible paths forward.

I. Background

A. In General

Among cross-border provisions, Code Secs. 959 and 961 are as venerable as any, entering the Code with the advent of the subpart F regime (Code Sec. 951 *et seq.*).[2] The subpart F rules provide an inclusion mechanism that requires a United States shareholder ("U.S. Shareholder") of a controlled foreign corporation ("CFC") to include in gross income its *pro-rata* share of certain income earned by the CFC. These rules thus apply passthrough-type concepts within the corporate form.[3] Subpart F primarily operates through an interlocking set of provisions: Code Sec. 951(a) provides for inclusions, Code Sec. 951(b) defines U.S. Shareholder, Code Sec. 952 defines subpart F income, Code Sec. 957(a) defines CFC, and Code Sec. 958 provides rules for determining stock ownership.

In keeping with principles of corporate separateness, a U.S. owner of a CFC remains liable for U.S. tax on the CFC's non-subpart F earnings—the earnings not subject to immediate U.S. tax—when those earnings are repatriated as a dividend or invested in U.S. property.[4] Code Sec. 1248, a provision enacted with the subpart F regime, provides that a U.S. person, in the case of a sale or exchange of stock in a CFC or former CFC, includes in income as a dividend certain foreign earnings attributable to the stock sold or exchanged. As described in Part II.C, this framework created the so-called "lock-out effect" under which

CHADWICK ROWLAND is Counsel at Miller & Chevalier Chartered in Washington, DC.

U.S. persons would indefinitely defer repatriating foreign earnings to avoid residual U.S. tax.

B. Foundation: Code Secs. 959 and 961, 960(b), and 986(c)

Once a CFC's earnings have been subject to U.S. taxation through the subpart F rules, Code Secs. 959 and 961 operate together to form a U.S. Shareholder-centric anti-double tax regime that primarily operates through two channels: a gross income exclusion for repatriations and related basis adjustments for value attributable to certain undistributed earnings. These rules provide the basic plumbing for the U.S. cross-border framework, particularly for provisions related to earnings and profits ("E&P"), the foreign tax credit, and foreign currency gain or loss ("FX gain or loss").

Code Sec. 959 provides the exclusionary rule: when a U.S. Shareholder includes amounts in gross income with respect to a CFC's E&P, the E&P gains a special character—as PTEP—that is not taxed again upon actual or deemed repatriation.[5] Code Sec. 959 includes successor rules for U.S. persons that acquire stock in a foreign corporation from a U.S. Shareholder that initially included an amount in gross income with respect to a CFC, in which case the acquirer succeeds to the PTEP. PTEP, as E&P, is a corporate-level attribute, but a corporate-level attribute that takes on a U.S. Shareholder-specific nature to prevent sharing the PTEP benefit among shareholders.[6] Once included in a U.S. Shareholder's gross income, PTEP is placed within a category—Code Sec. 959(c)(1)[7] or 959(c)(2)[8]—which regulations then break into specific groupings based on the particular provision giving rise to the inclusion.

In the case of an actual repatriation (*i.e.*, a dividend distribution to a U.S. Shareholder under Code Sec. 316(a)), PTEP status follows from attributing the distributed E&P to three consecutive buckets: Code Secs. 959(c)(1), 959(c)(2), and 959(c)(3) ("Section 959(c)(3) E&P").[9] E&P attributed to the first two buckets qualifies for the Code Sec. 959(a)(1) exclusion as a PTEP distribution; E&P attributed to the last bucket, Code Sec. 959(c)(3), is not eligible for the Code Sec. 959(a)(1) exclusion, but may be eligible for the dividends-received deduction under Code Sec. 245A, as discussed below.[10] For an effective repatriation through an investment in U.S. property under Code Sec. 956, Code Sec. 959(a)(2) first attributes the Code Sec. 956 amount to Code Sec. 959(c)(2) PTEP, before allocating the Code Sec. 956 amount to Code Sec. 959(c)(3) E&P, as reduced for distributions made by the CFC during the year.[11] The statutory structure, therefore, provides that a CFC's E&P for a taxable year is first classified as PTEP to account for any inclusions of the U.S. Shareholder with respect to the CFC for the year under Code Sec. 951(a)(1)(A) or 951A(a), which PTEP is available to characterize dividends distributed by the CFC during the year as distributions of PTEP.[12] Next, any Code Sec. 956 amount with respect to the CFC for the taxable year is allocated to Code Sec. 959(c)(2) PTEP—thereby qualifying for the Code Sec. 959(a)(2) exclusion and reclassifying such PTEP as Code Sec. 959(c)(1) PTEP—and any excess gives rise to an inclusion for the U.S. Shareholder under Code Sec. 951(a)(1)(B). The Code Sec. 956 amount, once included under Code Sec. 951(a)(1)(B), becomes Code Sec. 959(c)(1) PTEP.

Code Sec. 961 provides rules for PTEP-related basis adjustments "[u]nder regulations prescribed by the Secretary[.]"[13] Code Sec. 961(a) provides basis increases for directly held property (stock or other property) through which a U.S. Shareholder includes an amount in gross income with respect to a CFC, and Code Sec. 961(b) provides basis decreases (and gain recognition where distributions exceed basis) for PTEP distributions received by a U.S. Shareholder (or successor) with respect to such directly held property.[14] Code Sec. 961(a), by increasing basis for inclusions, prevents value attributable to undistributed PTEP from giving rise to gain and additional U.S. tax for a U.S. Shareholder in a sale or exchange of stock of the foreign corporation or property through which such stock is owned.[15] Relatedly, basis reductions and gain recognition under Code Sec. 961(b) prevent double benefits that could otherwise arise if basis were not decreased for distributed PTEP. This concept—basis reductions, with potential gain recognition for insufficient basis—has analogs in other parts of the Code (*e.g.*, Code Sec. 301(c) for general corporate distributions, Code Sec. 731(a) for partnership distributions, and Code Sec. 1368(b) for S corporation distributions).[16] For tiered structures, Code Sec. 961(c) provides that, if a U.S. Shareholder owns stock in a CFC that is owned by another CFC, adjustments similar to the adjustments provided by Code Secs. 961(a) and (b) are made to the basis of such lower-tier stock, and the basis of stock in any other CFC through which the U.S. Shareholder owns the stock of the first mentioned CFC, but only for purposes of determining amounts included under Code Sec. 951.[17]

Code Secs. 959 and 961 thus provide the backbone of the PTEP system. To round out the picture, however, it is worth noting two additional aspects: Code Secs. 960(b) and 986(c). Code Sec. 960(b) generally provides a deemed-paid foreign tax credit for foreign income taxes properly attributable to PTEP distributions. Code Sec. 904(d)(1) imposes a limitation on the foreign tax credit, including the deemed paid credit under Code Sec. 960, that applies separately with respect to certain categories of income. In the case of a distribution of PTEP between CFCs, the imposition of foreign income taxes decreases the recipient CFC's E&P, so Code Sec. 960(b) credits effectively replace any PTEP eliminated by the imposition of foreign taxes as that PTEP moves up the ownership chain.[18] Current Reg. §1.960-3 implements Code Sec. 960(b) by establishing, in relevant part, CFC-level accounts for tracking PTEP and PTEP taxes based on inclusion year, Code Sec. 904 category, and PTEP group.[19] Finally, PTEP, as E&P, is maintained in a foreign corporation's functional currency under Code Sec. 986(b). Code Sec. 986(c) requires FX gain or loss to track the movement in exchange rates between when the E&P were included in gross income and when those E&P, as PTEP, are repatriated directly (as a dividend) or indirectly (through a disposition). As with Code Sec. 960(b), special rules apply to FX gain or loss from certain types of PTEP.[20]

C. TCJA-Related Changes

1. In General

The Tax Cuts and Jobs Act, P.L. 115-97 (2017) ("TCJA") fundamentally reshaped the rules applicable to cross-border E&P, diminishing historical issues and creating new ones. For U.S.-parented multinationals, the primary evil addressed by the TCJA was the "lock-out" effect under prior law, which permitted the possibility of indefinite deferral of U.S. residual tax on foreign earnings.[21] In broad outline, the TCJA's solution was threefold: (i) lower the U.S. corporate tax rate from 35% to 21%, which had previously been among the highest statutory rates for developed economies[22]; (ii) move the United States toward a quasi-territorial system through a participation exemption, primarily embodied in the dividends-received deduction under Code Sec. 245A (the "Code Sec. 245A DRD")[23]; and (iii) encourage "onshoring" by enacting provisions intended to neutralize the role of U.S. tax considerations in the decision of where to earn foreign income (directly or indirectly through a CFC).[24]

As part of these changes, Congress enacted a one-time repatriation tax under Code Sec. 965, imposed at a reduced rate, which functioned as the toll charge for the new covenant represented by the quasi-territorial system.[25] The TCJA also introduced a new CFC regime under Code Sec. 951A, imposed at a reduced rate for corporate U.S. Shareholders (and U.S. individuals making a Code Sec. 962 election), that effectively operates as a minimum tax on certain foreign earnings, determined on an aggregate basis across all of a U.S. Shareholder's CFCs. These changes substantially increased the amount of PTEP in the U.S. system, both by reason of the one-time tax under Code Sec. 965 and the ongoing effects of Code Sec. 951A.

While the TCJA's direct impact on Code Secs. 959 and 961 was modest—the only direct statutory changes involved striking a cross reference from Code Secs. 959(d) and (e) and adding new Code Sec. 961(d)—it fundamentally altered the historical benefits and detriments associated with PTEP and non-PTEP (*i.e.*, Code Sec. 959(c)(3) E&P). Before the TCJA, Code Sec. 959(c)(3) E&P were generally subject to U.S. tax when repatriated, but the Code Sec. 245A DRD now allows those amounts to be repatriated free of residual U.S. tax when its requirements are met. The ordering rule in Code Sec. 959(c), by sourcing a distribution first to PTEP (*i.e.*, E&P described in Code Sec. 959(c)(1) or (c)(2)) before Code Sec. 959(c)(3) E&P, ensures that a distribution is first comprised of PTEP, to the extent thereof, before reaching Code Sec. 959(c)(3) E&P. Code Sec. 959(d)—by providing that a PTEP distribution is not treated as a dividend—ensures that Code Secs. 959(a) and 245A do not apply to the same E&P.[26]

The distinction between PTEP and non-PTEP implicates different U.S. tax results. Taking Code Sec. 959 first, a PTEP distribution (i) requires a basis reduction under Code Sec. 961(b) on the property with respect to which the distribution is received; (ii) may trigger FX gain or loss recognition (if the PTEP is denominated in a non-U.S. dollar functional currency); and (iii) may permit Code Sec. 960(b) deemed-paid credits properly attributable to the distribution of PTEP. A distribution of Code Sec. 245A-eligible E&P, on the other hand, (i) does not require an automatic basis reduction; (ii) Code Sec. 245A(d) disallows a credit or deduction for foreign income taxes imposed on a distribution to which the Code Sec. 245A DRD is allowed; and (iii) FX gain or loss is inapposite with respect to Code Sec. 959(c)(3) E&P, as such amounts have not been previously included in a U.S. Shareholder's gross income.[27] Because the traditional downside of repatriation for non-PTEP (*i.e.*, residual U.S. tax) has been significantly reduced through Code Sec. 245A, and the U.S. tax consequences of a dividend distribution may vary significantly depending on the character of the distributed E&P, PTEP thus has an additional function post-TCJA: PTEP continues to facilitate repatriations of previously taxed amounts, but it also seeks to preserve PTEP character.[28]

2. Code Sec. 958(a) Regulations—From Entity to Aggregate

In connection with implementing Code Sec. 951A, Treasury and the Internal Revenue Service ("IRS") changed their historical approach to domestic partnership-owned CFCs by adopting, for certain purposes, aggregate treatment. Historically, an entity approach governed domestic partnerships, under which the partnership was treated as owning CFC stock for subpart F purposes, and an aggregate approach applied to foreign partnerships, under which the partners of the foreign partnership were treated as owning their proportionate share of CFC stock.[29] Thus, a domestic partnership would include amounts in income under Code Sec. 951(a), for which it would receive PTEP and basis, while any partner of a foreign partnership that was a U.S. Shareholder would include amounts in income under Code Sec. 951(a), for which the partner would receive PTEP and basis in its partnership interest. Under that approach, however, there were no rules providing basis adjustments for the CFC stock indirectly owned through the foreign partnership by the partner.

Treasury and the IRS released final regulations in 2019 that adopted an aggregate approach for purposes of Code Sec. 951A, and Code Sec. 951 followed suit in 2022.[30] Thus, for purposes of Code Secs. 951, 951A, and 956(a) (and any provision that specifically applies by reference to those sections), a domestic partnership is generally not treated as owning stock of a foreign corporation under Code Sec. 958(a); such stock is instead treated in the same manner as stock owned by a foreign partnership under Code Sec. 958(a)(2) and Reg. §1.958-1(b).[31] Because Code Sec. 959 and 961 apply by reference to Code Secs. 951 and 951A, this aggregate approach to domestic partnerships applies for PTEP and basis purposes.[32] Entity treatment remains, however, for certain purposes, including for applying Code Sec. 1248, and for determining whether any U.S. person is a U.S. Shareholder and whether any foreign corporation is a CFC.[33] After these regulations were issued, the historical question of whether a foreign partnership received basis adjustments under Code Sec. 961 for CFC stock indirectly owned through the partnership became applicable to all partnerships.[34]

Guidance under Code Sec. 965 offered an initial glimpse of a potential solution to this issue. Reg. §1.965-2(h)(5)(ii) adopted a mechanism to ensure that basis adjustments attributable to Code Sec. 965 amounts were preserved through "foreign passthrough entities", including foreign partnerships and certain domestic partnerships treated as such.[35] Under this rule, if a U.S. Shareholder owns the relevant property through a foreign partnership, the partnership's basis in the underlying CFC stock is adjusted as if the stock were owned directly by the U.S. Shareholder. In effect, Reg. §1.965-2(h)(5)(ii) permits a shareholder-level Code Sec. 961-type basis adjustment to be pushed down to the foreign partnership's inside basis, solely with respect to that shareholder's interest, without addressing how that adjustment interacts with other partners, transactions, or dispositions.[36]

D. Current and Former PTEP Regulations

Current regulations under Code Secs. 959 and 961, which date back largely to the initial statutory scheme, provide a set of basic rules that have not been comprehensively updated to reflect subsequent legislation.[37] The government first attempted to modernize the PTEP system in 2006 through proposed regulations addressing legislative developments, like Code Secs. 304(b)(6) and 961(c).[38] Notably, the 2006 Proposed Regulations did not address certain partnership-related issues, including whether a foreign partnership could maintain Code Sec. 961 basis in stock of a CFC. The 2006 Proposed Regulations generally employed a share-specific model for both PTEP and basis adjustments, which would have allowed PTEP and basis sharing across shares of stock owned by a U.S. Shareholder (and with members of a U.S. consolidated group).[39]

After the TCJA, the government announced its intent to withdraw the 2006 Proposed Regulations in Notice 2019-01,[40] as part of a broader effort to issue new proposed regulations. That withdrawal occurred in 2022—spurred by the potential for basis sharing under the 2006 Proposed Regulations—before the recent proposed regulations were issued, and without the 2006 Proposed Regulations ever having been finalized.[41]

II. 2024 Proposed Regulations

A. In General

In late 2024, Treasury and the IRS released long-awaited proposed PTEP regulations that would establish the foundational layer for a new PTEP system (the "2024 Proposed Regulations").[42] The 2024 Proposed Regulations would be effective upon finalization, with an early-application option subject to consistency requirements.[43] The early-application option, however, is itself contingent on finalization—the 2024 Proposed Regulations, therefore, do not allow immediate reliance as a technical matter.

The 2024 Proposed Regulations, in heralding this new system, address partnership-owned CFCs, including the long-standing issue of whether a partnership maintains Code Sec. 961-type basis on behalf of its partners in CFC stock or other property through which such stock is owned. The central innovation in this regard is the so-called "derived basis" rules, which borrow from Code Sec. 743(b) to track partner-specific basis at the partnership level. Some pressing questions, however, remain unaddressed. For example, the proposed regulations do not provide rules for maintaining and adjusting Code Sec. 961 basis for partnerships that are owned by foreign corporations.[44] The derived basis rules do not address the application of derived basis to certain partnership distributions.[45] Finally, the rules do not address the effect of derived basis on the dividend recharacterization rules under Code Sec. 1248, nor do they address broader questions surrounding the application of Code Sec. 1248 to partnerships.[46]

The remainder of this Part describes the proposed rules that are relevant to partnership-owned CFCs, and Part III reflects on the open issues, along with other topics.

B. Relevant Rules for Partnership-Owned CFCs

1. PTEP

The 2024 Proposed Regulations would establish an accounting system for PTEP, comprised of covered shareholder-level and foreign-corporation-level components, that form the base layer of the framework.[47] The central definition is "covered shareholder," which the regulations define as a U.S. person, other than a domestic partnership.[48] For this purpose, S corporations are treated as domestic partnerships, except where an S corporation has made an election under Proposed Reg. §1.958-1(e)[49] or section 3.02 of Notice 2020-69[50] to be treated as an entity separate from its owners.[51]

There are three types of covered shareholder accounts, each implementing an aspect of the PTEP system: annual PTEP accounts, which determine the exclusions under Code Secs. 959(a) and (b) by tracking a foreign corporation's PTEP with respect to a covered shareholder; dollar basis pools, which determine FX gain or loss under Code Sec. 986(c); and PTEP tax pools, which determine the amount of foreign income taxes properly attributable to PTEP under Code Sec. 960(b).[52] Dollar basis pools and PTEP tax pools also determine basis reductions under Code Sec. 961(b) for distributions of PTEP. These accounts are generally specific to a covered shareholder, Code Sec. 904 category, and taxable year.[53] A foreign corporation maintains simplified covered shareholder-specific PTEP accounts and PTEP tax pools that are not taxable-year specific (in contrast to covered-shareholder accounts), but it does not maintain dollar basis pools.[54] Thus, for a partnership-owned CFC, annual PTEP accounts, dollar basis pools, and PTEP tax pools are maintained, as a general matter, at the partner level because a partnership, whether foreign or domestic, cannot be a covered shareholder if Reg. §1.958-1(d) applies. To accommodate the aggregate approach embodied in Reg. §1.958-1(d), the regulations provide transition rules that "push out" to the partners certain items previously maintained at the partnership level—like annual PTEP accounts and certain basis—as of the first taxable year of the domestic partnership to which both Reg. §1.958-1(d) and the 2024 Proposed Regulations apply.[55]

Proposed Reg. §1.959-3 includes detailed adjustment rules to account for income inclusions, distributions of PTEP, and transactions related to PTEP occurring during the taxable year of a foreign corporation.[56] The proposed regulations apply Code Secs. 959(a)(1) and (b) based on the balance of a covered shareholder's annual PTEP accounts with respect to a distributing foreign corporation. The annual PTEP accounts, therefore, take primacy: adjustments to dollar basis pools and PTEP tax pools follow the adjustments to annual PTEP accounts. Increases to annual PTEP accounts are generally made at the earliest point at which the PTEP is available for distribution based on the inclusion provision,[57] and decreases occur when a foreign corporation distributes PTEP or a covered shareholder otherwise loses dominion over undistributed PTEP (*e.g.*, through a sale or exchange).[58]

A covered shareholder determines whether it receives a PTEP distribution by applying its annual PTEP accounts to its portion of a "covered distribution" made by a foreign corporation.[59] A "covered distribution" means a dividend as described in Code Sec. 316, determined without regard to Code Sec. 959(d).[60] A covered distribution excludes amounts treated as a dividend under Code Sec. 78, 367(b), 964(e)(1), or 1248—a Code Sec. 78 amount is determined without regard to E&P, and the latter three generally represent amounts definitionally excluding PTEP.[61] If a covered distribution is characterized as a PTEP distribution, the proposed regulations determine the composition of the PTEP distribution by reference to the relevant PTEP groupings within the annual PTEP accounts and determine the dollar basis of, and PTEP taxes associated with, distributed PTEP by applying a *pro-rata* rule to the relevant dollar basis and PTEP tax pools.[62] For a covered distribution made to a partnership, Proposed Reg. §1.959-4(c)(3) treats a partner's distributive share of the covered distribution made (or treated as made) to the partnership as made directly to the partner.[63] However, for periods before Reg. §1.958-1(d) applies, the partnership is treated as a covered shareholder, in which case both it and its partners could have taken inclusions with respect to a partnership-owned CFC before the 2024 Proposed Regulations apply. In such a case, Proposed Reg. §1.959-11(d) first applies the rules regarding PTEP distributions to the partnership, before applying to its partners.[64]

To implement Code Sec. 959's successor concepts, Proposed Reg. §1.959-7 provides rules for "general successor transactions" ("GSTs"), which essentially means a taxable disposition between covered shareholders of stock in a foreign corporation with undistributed PTEP.[65] A GST excludes, in relevant part, an acquisition of stock in a foreign corporation from (i) an issuance of a partnership interest; (ii) a liquidating distribution of a partnership interest,[66] or (iii) a transfer of a partnership interest if the interest would be substituted basis property for the successor.[67] When the GST rules apply, Proposed Reg. §1.959-7(c) automatically transfers annual PTEP accounts, dollar basis pools, and PTEP tax pools from the transferor covered shareholder to the successor covered shareholder using a hypothetical distribution model.[68] Finally, because Code Sec. 959 allows a U.S. person to succeed to PTEP of a foreign corporation acquired "from any person," the guidance includes rules that treat all foreign ownership of a foreign corporation's stock as held by a single hypothetical covered shareholder to ensure that PTEP transfers, irrespective of periods of intervening foreign ownership.[69] These "deemed covered shareholder" rules operate as an accounting construct, treating the deemed covered shareholder as a covered shareholder for purposes of determining the amount of PTEP transferred to a successor covered shareholder after a period of offshore ownership.[70]

2. Code Sec. 961

a) in general. The proposed rules under Code Sec. 961 are built around three related constructs: property units, basis types, and basis utility. Regardless of the type of property unit at issue, Code Sec. 961 basis is specific to a particular share of stock or item of property (like a partnership interest) under the 2024 Proposed Regulations.[71] A "property unit" can be a Code Sec. 961(a) ownership unit, a derivative ownership unit, or a Code Sec. 961(c) ownership unit, each of which is maintained in U.S. dollars and depends on the direct owner of the property.[72] For example, if a covered shareholder directly owns an interest in a partnership, and that partnership owns stock in a CFC, the partnership interest is a Code Sec. 961(a) ownership unit for which the covered shareholder maintains adjusted basis.[73] Continuing the example, each share of stock of the CFC owned by the partnership is a "derivative ownership unit."[74] A partnership maintains "derived basis" in a derivative ownership unit as a partnership-level attribute that is specific to each covered shareholder that owns the derivative ownership unit, as described further below.[75] For tiered partnerships, a derivative ownership unit includes a partnership interest directly owned by another partnership, provided that a covered shareholder indirectly owns stock of a foreign corporation through that partnership in a partnership-only chain between the covered shareholder and the foreign corporation.[76] Thus, if in the example above, the covered shareholder directly owns an interest in a partnership ("UTP"), which directly owns an interest in another partnership ("LTP") that owns stock in a CFC, the UTP interest is a Code Sec. 961(a) ownership unit, UTP's interest in LTP is a derivative ownership unit, and each share of stock of the CFC owned by the LTP is a derivative ownership unit.

Finally, a share of stock of a foreign corporation directly owned by a CFC and owned indirectly by one or more covered shareholders is a "section 961(c) ownership unit" for which the CFC maintains Code Sec. 961(c) basis.[77] Like derived basis, Code Sec. 961(c) basis is specific to each covered shareholder that owns a Code Sec. 961(c) ownership unit.[78]

b) adjustment rules for inclusions and distributions. The 2024 Proposed Regulations generally match the timing of basis adjustments with the corresponding adjustment to annual PTEP accounts. As with basis in other property units, the derived basis in a derivative ownership unit increases for the covered shareholder inclusions taken into account through the property unit.[79] The basis is generally available at the beginning of the taxable year—when the associated PTEP is first available for distribution—which resolves historical uncertainty regarding distributions of current-year PTEP before year end.[80] The basis gets allocated to and among property units using a hypothetical-distribution model that aims to forecast how the PTEP would ultimately be distributed to the covered shareholder in an actual repatriation, based on the ownership structure existing at the time of inclusion.[81]

The proposed regulations implement Code Sec. 961(b) by reducing basis in a property unit for the dollar basis of, and foreign income taxes associated with, the PTEP received with respect to the property unit under the Code Sec. 959 rules.[82] This amount—the dollar basis and foreign income tax associated with PTEP—represents the original increase under Code Sec. 961(a) for the PTEP. When a partnership receives a PTEP distribution, Proposed Reg. §1.961-4(e)(2) provides that adjustments under Code Sec. 705 for the distribution are concurrent with the reduction to derived basis in the derivative ownership unit. This adjustment facilitates the actual movements of the funds from the partnership to the partner without creating gain under Code Sec. 731(a). Finally, the reduction for distributed PTEP occurs at the time of distribution.[83]

Given that Code Sec. 961 adjustments follow adjustments to annual PTEP accounts, PTEP and basis should, in principle, move in harmony; however, PTEP and basis separation may occur in relatively routine transactions.[84] If the basis reduction for a distribution of PTEP would otherwise reduce basis in the property unit below zero, the proposed regulations cause gain recognition under Code Sec. 961(b)(2), regardless of whether excess basis exists on other property units owned by the covered shareholder at the same tier of ownership. Such gain recognition follows from an infusion of the property-specific approach to basis, as described above, with anti-basis sharing principles, as embodied in the withdrawal of the 2006 Proposed Regulations.[85] The government cites *Johnson*,[86] which addresses uneven basis in the Code Sec. 301(c) context, for the proposition that excess basis on one share of stock does not prevent Code Sec. 961(b)(2) gain from occurring on a share of stock with deficient basis.[87] This issue does not extend to an interest in a partnership as such, because a partner is generally treated as having a single adjusted basis in all of its interests in a partnership.[88]

For PTEP distributions received by a partnership in excess of derived basis, the partnership is treated as recognizing gain with respect to the derivative ownership unit, subject to the limitation described in the following paragraph.[89] That gain is allocated solely to the relevant covered shareholder as a distributive share with respect to the partnership, thus giving rise to basis for the covered shareholder in the partnership interest under Code Sec. 705, but the gain itself otherwise has no impact on any partnership-level computation under Code Sec. 703 or allocation under Code Sec. 704 or on the covered shareholder's capital account.[90] A similar approach applies to tiered PTEP distributions in excess of Code Sec. 961(c) basis received by a CFC.[91]

Before moving on, it is worth noting a special feature of derivative ownership units and Code Sec. 961(c) ownership units related to Code Sec. 961(b)(2): negative basis.[92] On one hand, the 2024 Proposed Regulations interpret Code Secs. 961(b)(2) and 961(c) to allow gain recognition for a distribution of PTEP in excess of basis to occur at any level of a covered shareholder's ownership chain with respect to a foreign corporation. On the other hand, derived basis and Code Sec. 961(c) basis represent special-purpose basis tied to a particular covered shareholder, leaving the possibility that a partnership or CFC, as applicable, could have "other" basis—*i.e.*, non-derived or Code Sec. 961(c) basis—in the relevant property unit. If there is other basis available in the same property unit, immediate gain recognition would be economically distortive, arising solely from the lack of the proper "type" of basis to support the PTEP distribution.[93] To address this issue, Proposed. Reg. §§1.961-4(c)(3) and (d)(3) allow derived basis or Code Sec. 961(c) basis to go "negative" in certain cases.

For a derivative ownership unit, if a PTEP distribution exceeds derived basis with respect to a covered shareholder, the excess first reduces any Code Sec. 743(b) adjustment as to the covered shareholder in the derivative ownership unit to zero before creating negative derived basis.[94] Negative derived basis can only arise, however, if the partnership has other common basis in the derivative ownership unit; any excess reduction simply gives rise to gain recognition under Proposed Reg. §1.961-4.[95] A covered shareholder determines its share of available common basis in the derivative ownership unit through a *pro-rata* rule.[96] Negative Code Sec. 961(c) basis generally follows the same approach.[97] In this manner, the amount of negative basis represents an early use of "other" basis in the property unit, which the proposed regulations would recapture when basis later becomes relevant in determining taxable income regarding the property unit (*e.g.*, upon a sale or distribution, or if the derivative ownership unit or Code Sec. 961(c) ownership unit loses its status as such).[98]

Finally, to implement Code Sec. 961's successor concepts, Proposed Reg. §1.961-5(c) provides rules for the successor basis. These rules, as with their PTEP counterpart in Proposed Reg. §1.959-7, apply by reference to a GST and address foreign ownership through the deemed covered shareholder rules, while automatically transferring derived basis in an acquired partnership, or Code Sec. 961(c) basis in an acquired foreign corporation, from the transferor covered shareholder to the successor covered shareholder.[99] If an acquired partnership has a Code Sec. 754 election in effect, or if there would be a substantial built-in loss in the partnership after the acquisition under Code Sec. 743(d), Proposed Reg. §1.961-5(d) provides that a successor covered shareholder treats acquired derived basis in a derivative ownership unit as basis for purposes of making Code Sec. 743(b) adjustments. It is worth emphasizing that these rules do not convert basis of one type to another.[100] For example, if a successor covered shareholder is a partner in a partnership that acquires what was a CFC directly owned by a transferor covered shareholder, the successor covered shareholder would succeed to undistributed PTEP of the acquired CFC, but the partnership would not have derived basis tied to the acquired PTEP in the derivative ownership unit represented by the CFC stock. In such a case, the negative basis rules could address this mismatch by preventing immediate Code Sec. 961(b)(2) gain recognition for PTEP distributions to the extent of the partnership's cost basis in the acquired CFC.

c) derived basis mechanics. Proposed Reg. §1.961-8 describes how positive derived basis applies in a disposition of a derivative ownership unit. These rules aim to replicate the result that would obtain if, in a disposition of a derivative ownership unit, derived basis were treated as an additional amount of adjusted basis taken into account in allocating gain or loss to a covered shareholder.[101] Consistent with the approach in Reg. §1.743-1(j), the proposed rules provide that, for a sale, exchange, or other disposition by a partnership of one or more derivative ownership units, the partnership first determines each partner's distributive share of gain or loss under Code Sec. 704 without regard to positive derived basis, taking into account any Code Sec. 743(b) adjustment.[102] Positive derived basis then applies as a covered shareholder-level adjustment to its distributive share of gain or loss, which can either reduce the amount of gain, increase the amount of loss, or convert a share of gain into a loss.[103] The application of positive derived basis, however, is not limitless: positive derived basis can create or increase a distributive share of a loss, for example, only if the partnership recognizes (or would recognize) loss on the disposition and the loss would give rise to a current deduction.[104]

A covered shareholder adjusts its interest in the transferring partnership under Code Sec. 705 by taking into account the derived basis applied to the disposition.[105] In tiered structures, this adjustment applies only at the level of the top-tier partnership (*i.e.*, the partnership in which the covered shareholder directly owns an interest).[106] An upper-tier partnership, therefore, adjusts its common basis in a lower-tier partnership interest under Code Sec. 705 without regard to the application of derived basis at the covered shareholder level.[107] Instead, the derived basis in each derivative ownership unit down the partnership ownership chain is, in effect, simultaneously replaced by common basis under Code Sec. 705.[108]

d) Code Sec. 961(c) basis as relevant to partnership-owned CFCs. Before moving on, we pause on Code Sec. 961(c) basis, because it informs the resolution of whether a CFC partner should maintain basis with respect to a partnership-owned CFC. Proposed Reg. §1.961-9 provides rules for the use of Code Sec. 961(c) basis upon the disposition of a Code Sec. 961(c) ownership unit. Like derived basis, Code Sec. 961(c) basis is covered shareholder-specific—so the rules ensure that the benefit of Code Sec. 961(c) basis is not spread between shareholders of an upper-tier CFC—and Code Sec. 961(c) basis may be positive or negative.[109] Code Sec. 961(c) basis is also a special-purpose basis: it does not affect the amount of the selling CFC's gross income or E&P, but exists only for purposes of applying Code Secs. 951 and 951A to a covered shareholder.[110] This feature ultimately informs the utility of Code Sec. 961(c) basis. That is, instead of directly offsetting gain at the level of the selling CFC, Proposed Reg. §1.961-9(b) treats a portion of the gain from the disposition of a Code Sec. 961(c) ownership unit (termed "covered gain") as exempt income, meaning the E&P attributable to the gain is treated as PTEP that is excluded from the CFC's gross income for purposes of determining the CFC's subpart F income and tested income or tested loss.[111] In this respect, Code Sec. 961(c) basis differs from derived basis by recharacterizing stock gain as PTEP at the CFC level, rather than by adjusting gain or loss.[112]

Proposed Reg. §1.961-9(c) coordinates with dividend recharacterization provisions, like Code Sec. 964(e), by providing, first, that the portion of covered gain treated as Code Sec. 961(c) PTEP is carved out before rules like Code Sec. 964(e) apply, reflecting that Code Sec. 961(c) basis operates like adjusted basis in that it effectively reduces the amount of gain subject to dividend recharacterization. The proposed regulations further provide rules for allocating Code Sec. 961(c) PTEP to shares of stock for purposes of applicable dividend-recharacterization provisions.[113]

III. Open Issues and Other Thoughts

Several commentators provided insightful comments on the partnership-related aspects of the 2024 Proposed Regulations, which will be incorporated into the following discussion.[114]

The concepts and detailed mechanics provided for derived basis are not clear from the face of the statute but instead follow from a proposed use of regulatory authority. Consider a simple example in which a U.S. Shareholder owns an interest in a partnership that owns stock in a CFC. Assume also that the CFC has PTEP with respect to the U.S. Shareholder and a positive amount of Code Sec. 959(c)(3) E&P. If the partnership were to sell stock in the CFC, what are the U.S. tax consequences? Recall that, after Reg. §1.958-1(d)(1), these questions are now universal for partnership-owned CFCs. Section 32.1.1.2.2 of the Chief Counsel Directives Manual ("CCDM") provides generally that, if there are no relevant final or temporary regulations, the government "ordinarily should not take any position in litigation or advice that would yield a result that would be harsher to the taxpayer than what the taxpayer would be allowed under the proposed regulation." The CCDM may provide some certainty to taxpayers on the application and use of derived basis—thus ensuring that PTEP value is not subject to double inclusion—but that certainty is limited and, more importantly, the 2024 Proposed Regulations do not address the application of other provisions, like Code Sec. 1248, to these fact patterns.[115] Thus, even if the government would not take a position contrary to the result obtained under the proposed rules, a routine disposition like the one illustrated would nevertheless implicate significant issues without a clear solution—the taxpayer is still operating in the space between principle and finalized mechanism.[116]

A. Basis for CFC-Owned Partnerships

The 2024 Proposed Regulations do not provide rules for maintaining Code Sec. 961 basis with respect to a CFC in a CFC-owned partnership.[117] Resolution of this issue hinges on three questions, the first of which is whether basis should exist in such structures. From a normative perspective, the answer is yes: if the anti-double-taxation premise underlying Code Secs. 959 and 961 is taken seriously, it is difficult to justify a result in which PTEP is effectively taxed a second time merely because lower-tier CFC stock is held through a partnership rather than directly through a chain of CFCs.

Accepting that normative conclusion, we next ask whether the statute permits basis in these structures. Consider, for example, a covered shareholder that owns stock in a CFC (CFC1), where CFC1 is a partner in a partnership (PRS), and PRS owns sufficient stock in a lower-tier CFC (CFC2) such that the covered shareholder takes inclusions with respect to CFC2. Turning to Code Sec. 961(c), several features of the statutory language are notable. First, after providing regulatory authority, the lead-in language refers to a U.S. shareholder's ownership under Code Sec. 958(a)(2) of stock in a lower-tier CFC owned by another CFC.[118] When such ownership is met, Code Sec. 961(c) provides adjustments similar to those under Code Secs. 961(a) and (b) to "the basis of such stock [in the lower-tier CFC]," and "the basis of stock in any other [CFC] by reason of which the [U.S. Shareholder] is considered under section 958(a)(2) as owning [the stock in the lower-tier CFC.]" Notably, in contrast to Code Secs. 961(a) and (b), Code Sec. 961(c) contains no reference to property other than stock as a potential object of adjustments.[119] Referring to our facts, this raises the question whether Code Sec. 961(c) authorizes basis solely in the stock of CFC2, or whether it can be read to reach the PRS interest held by CFC1. The question is not whether Code Sec. 961(c) expresses the right policy analog—it surely does—but whether the statutory words "the basis of such stock" and "the basis of stock in any other [CFC]" leave enough room to create basis in an intervening partnership interest. The answer will likely turn on the strength of the phrase "[u]nder regulations prescribed by the Secretary[.]"[120]

Assuming a CFC-owned partnership could maintain some form of Code Sec. 961(c) basis in a lower-tier CFC, the final question concerns the nature of that basis. The preamble asks whether such a basis should resemble a derived basis, Code Sec. 961(c) basis, or some combination of the two.[121] A sensible approach, grounded in both the statutory framework and the proposed rules, would allow it to have characteristics of each. Mechanically, the basis could operate under a derived-basis model—akin to a Code Sec. 743(b) adjustment—but in substance it would retain the character of Code Sec. 961(c) basis, converting the CFC partner's share of gain into Code Sec. 961(c) PTEP rather than directly reducing gain or increasing loss. Because a CFC maintains Code Sec. 961(c) basis in a lower-tier CFC, an approach that would allow the interposition of a partnership between CFCs to fundamentally change the nature and use of the Code Sec. 961 basis would run counter to the parity principles that undergird various aspects of the 2024 Proposed Regulations.[122] The principal difficulty with this approach, however, would be administrability and taxpayer burden. For example, would the partnership be required to maintain basis separately for each combination of CFC partner and covered shareholder that indirectly owns the lower-tier CFC? While that result seems implicit, it is easy to foresee how that would create a matrix of accounting in more complex ownership structures, placing tension on bedrock Subchapter K principles.[123] Perhaps simplifying conventions could be available for certain structures, like those in which the partnership is a controlling domestic shareholder under Reg. §1.964-1(c)(5).[124]

B. Partnership Distributions and Derived Basis

The 2024 Proposed Regulations do not address the application of derived basis in certain partnership distributions (Code Secs. 731, 732, and 734), instead requesting comments.[125] These provisions are informed by the general theme underlying Subchapter K: "simplicity, flexibility, and equity[.]"[126] The distribution rules thus reflect a general policy of nonrecognition, which allows property to freely move into and out of partnership solution, causing recognition only upon certain distributions.[127] This nonrecognition framework, however, creates potential tension with the government's concern over "basis shifting" in the international context, as reflected both in the 2024 Proposed Regulations and in the withdrawal of the 2006 Proposed Regulations.[128] This tension provides context for the partnership distribution issues to follow.

In general, Code Sec. 731(a)(1) requires a partner to recognize gain on a distribution only to the extent the partner receives money (including marketable securities) in excess of the partner's adjusted basis in its partnership interest immediately prior to the distribution; the partnership itself recognizes neither gain nor loss on a distribution under Code Sec. 731(b).[129] Within this nonrecognition regime, Code Secs. 732 and 733 play a central role by allocating the partner's outside basis between the distributed property and any retained partnership interest, thereby preserving any pre-existing gain or loss in the distributee's partnership interest, either in the property distributed or in the partner's continuing interest. Under Code Sec. 732(a)(2), a partner's basis in distributed property (other than money) is limited to its basis in the partnership interest immediately before the distribution, reduced by any money distributed in the same transaction, and Code Sec. 732(b) applies a comparable limitation in the case of a liquidating distribution. Where multiple properties are distributed in cases where these limitations apply, Code Sec. 732(c) allocates basis among the distributed assets based on asset type.

Partnership distributions, as a general matter, do not alter the partnership's basis in its remaining assets under Code Sec. 734(a). That general rule, however, gives way in circumstances where a distribution risks creating or exacerbating a mismatch between the partnership's inside basis and the partners' outside bases—*e.g.*, where the distribution results in gain or loss recognition or where the partner's basis in the distributed property diverges from the partnership's basis immediately prior to the distribution. To address these potential distortions, Code Sec. 734 authorizes adjustments to the partnership's basis in retained property if a Code Sec. 754 election is in effect or if the distribution gives rise to a substantial basis reduction (as defined in Code Sec. 734(d)). In contrast to Code Sec. 743(b) adjustments, which are specific to a transferee partner, Code Sec. 734(b) adjustments impact the common basis of partnership property. Specifically, under Code Sec. 734(b), the partnership (i) increases basis of its remaining property to the extent the distributee partner recognizes gain or receives distributed property with a basis lower than the partnership's pre-distribution basis (if Code Sec. 732(a)(2) or (b) apply to the distribution) and (ii) decreases basis to the extent the partner recognizes loss in a liquidating distribution or receives property with a basis exceeding the partnership's pre-distribution basis. In computing these adjustments, any special basis adjustments under Code Sec. 743(b) (or Code Sec. 732(d)) are taken into account under Reg. §§1.734-1(b)(1)(ii) and (b)(2)(ii) and 1.734-2.

Code Sec. 743(a), like Code Sec. 734(a), generally provides that the basis of partnership property is not adjusted due to a transfer of an interest in a partnership unless a Code Sec. 754 election is in effect or there is a substantial built-in loss (as defined in Code Sec. 743(d)) immediately after such transfer.[130] Where applicable, Code Sec. 743(b)—which supplies the conceptual model for the derived-basis rules—authorizes a partner-specific adjustment equal to the difference between the transferee partner's basis in its partnership interest and the partner's allocable share of the partnership's adjusted basis in its assets; thus, this mechanism produces an upward adjustment where the transferee's outside basis exceeds its share of inside basis and a downward adjustment where the reverse is true. Reg. §1.743-1(d) determines a partner's share of partnership inside basis by reference to "previously taxed capital," which parallels capital account principles under Code Sec. 704(b). Finally, as with Code Sec. 734(b), Code Sec. 755 allocates the basis adjustment among the partnership's properties.[131]

The regulations specify how special basis adjustments are treated in partnership distributions. Under Reg. §§1.743-1(g)(1) and 1.732-2(b), a partner's Code Sec. 743(b) adjustment is included in determining the partner's basis in distributed property under Code Sec. 732, but only with respect to property to which that adjustment relates. Where property subject to a Code Sec. 743(b) adjustment is distributed to a different partner, the distributee does not succeed to that adjustment under Reg. §1.743-1(g)(2); instead, the adjustment is reallocated to the partnership's remaining property under Reg. §1.755-1(c). For a liquidating distribution in which a partner gives up an interest in partnership property to which a Code Sec. 743(b) adjustment relates, Reg. §1.743-1(g)(3) provides that the adjustment carries over to the basis of property distributed to the partner, reallocated among the distributed assets under Reg. §1.755-1(c). To the extent the partner receives property or money that does not fully absorb the Code Sec. 743(b) adjustment, any remaining adjustment is applied to the basis of the partnership property retained after the liquidation under Reg. §1.734-2(b).[132] Taken together, these rules reflect a general principle: once created, a Code Sec. 743(b) adjustment is integrated into the partnership distribution regime as actual, partner-specific basis (or a lack thereof). This is the same principle articulated for derived basis in the 2024 Proposed Regulations.[133]

Against this backdrop, several points emerge. First, to the extent a distribution of a derivative ownership unit moves PTEP between covered shareholders, yet-to-be-issued rules addressing nonrecognition transactions could provide a mechanism for coordinating that movement.[134] Absent corresponding successor basis, however, a transferee to such PTEP would acquire an inherent layer of Code Sec. 961(b)(2) gain.[135] Because the government has indicated that nonrecognition transactions will be addressed in subsequent guidance, and because some of the exceptions to GSTs in the 2024 Proposed Regulations appear designed with that guidance in mind, this analysis sets that issue aside.[136] Second, given Subchapter K's core principles, coupled with PTEP's anti-double tax policy, derived basis should hew as closely as possible to the treatment of comparable special basis adjustments under Subchapter K. Indeed, the 2024 Proposed Regulations describe derived basis as covered-shareholder-specific adjusted basis maintained at the partnership level, and the mechanics of derived basis are explicitly modelled on Code Sec. 743(b). The Code Sec. 743(b) framework thus provides an intuitive guide that is consistent with the purposes of Subchapter K, including the partnership distribution rules.[137] The difficulty, of course, is that these distributions may sit at the intersection of Subchapter K's nonrecognition norm and the government's concern with perceived basis shifting—a concern that has shaped both the 2024 Proposed Regulations and the withdrawal of the 2006 Proposed Regulations. Derived basis adds an additional layer of complexity to this tension, insofar as it implicates undistributed PTEP.

That tension becomes more concrete when considering how derived basis should operate in different scenarios. First, where a partnership makes a current or liquidating distribution of a derivative ownership unit to the covered shareholder that is the sole person with derived basis in that property unit, applying the principles of Reg. §§1.743-1(g)(1) and 1.732-2(b) to treat derived basis as part of the distributee's basis in the property should be unobjectionable. In that case, no basis shifts to another taxpayer by reason of the derived basis, and the distribution merely preserves the covered shareholder's pre-distribution economic position while advancing both PTEP's anti-double-tax policy and Subchapter K's nonrecognition framework.[138]

More difficult questions arise where the derivative ownership unit is distributed to a different partner. In that setting, concerns about basis shifting come to the fore, as does the potentially distinct treatment of derivative ownership units relative to other partnership property. From a Subchapter K perspective, the default answer would be to follow the Code Sec. 743(b) model reflected in Reg. §1.743-1(g)(2), reallocating the covered shareholder's derived basis to the partnership's remaining property. A similar approach would apply in liquidating distributions to the covered shareholder, where Reg. §§1.743-1(g)(3) and 1.734-2(b) provide analogues for carrying over or reallocating basis if the distributed property does not fully absorb it. Would those results comport with the successor concepts embedded in the PTEP regime? A distribution of a derivative ownership unit necessarily alters the ownership chain through which PTEP is held, and successor principles may therefore call for departures from the straightforward application of Reg. §§1.743-1(g)(2) and (g)(3). Finally, where multiple covered shareholders maintain derived basis in the same derivative ownership unit, the rules would appear to require coordination with the successor rules governing PTEP, raising issues analogous to those encountered in certain corporate transactions.[139]

While these latter scenarios underscore the administrative complexity of extending derived basis through partnership distributions—an admittedly difficult exercise—they also point toward a central theme: as a starting point, treating derived basis as real, partner-specific adjusted basis is both doctrinally coherent and consistent with Subchapter K's nonrecognition framework, without distorting the taxation of PTEP; any departure from that starting point should stem from a feature inherent to the PTEP regime.[140]

C. Code Sec. 1248

The proposed regulations request comments on issues related to Code Sec. 1248 and partnerships.[141] Given the close connection between Code Sec. 1248 and PTEP, it is difficult to consider these issues in a vacuum. Accordingly, the following discussion first addresses broader considerations regarding Code Sec. 1248 in the partnership context, and then turns to a more limited discussion focused on Code Secs. 959 and 961.

Code Sec. 1248 originally served as a bulwark of the subpart F framework by requiring a U.S. person, in the case of a sale or exchange of stock in a CFC or former CFC, to include in income as a dividend certain E&P attributable to the stock sold or exchanged.[142] In recharacterizing stock gain as a dividend, Code Sec. 1248 achieves parity between direct and indirect repatriations of non-subpart F earnings: the value of the stock, to the extent attributable to Code Sec. 959(c)(3) E&P, is taxed at ordinary income rates. As a corollary, Code Sec. 1248 excludes certain amounts from the E&P comprising the deemed dividend, including PTEP and E&P that is not subject to the subpart F framework.[143] Similarly, Code Sec. 1248(g)(2) provides an exception for, in relevant part, amounts treated as a dividend or as ordinary income under another provision of the Code.

As Part I.C highlights, recent legislation significantly modified the role of Code Sec. 1248. First, the TCJA addressed the "lock-out effect" through Code Secs. 245A, 951A, and 965. More recently, the One Big Beautiful Bill Act ("OBBB") amended Code Sec. 951(a) to require each U.S. Shareholder that owns stock in a CFC during the CFC's taxable year to include its *pro-rata* share of the CFC's subpart F income in its gross income for that year.[144] This change eliminated the "hot potato" rule under prior law, as well as certain provisions, like Code Sec. 951(a)(2)(B), that drew Treasury and IRS attention in recent years.[145] Together, these changes alter both the policy role and structural operation of the Code Sec. 1248 rules, which otherwise remain largely unchanged from their original design, and provide the government with an occasion to update the Code Sec. 1248 regulations.

With this background, Code Sec. 1248 has long presented unique challenges for partnership-holding structures.[146] In particular, two related challenges arise: coordination with Code Sec. 751 and structural aggregate-entity tension. First, for a sale or exchange of a partnership interest, any resulting gain or loss is generally capital gain or loss under Code Sec. 741. But the amount received by a transferor of a partnership interest that is attributable to the partnership's unrealized receivables or inventory items—"hot assets"—is considered ordinary income or loss under Code Sec. 751(a).[147] For this purpose, Code Sec. 751(c) defines unrealized receivables to include, among other items, stock in certain foreign corporations described in Code Sec. 1248, to the extent of the gain that would be recharacterized under Code Sec. 1248(a) if the stock were sold by the partnership.[148] Reg. §1.751-1(a)(2) generally determines a partner's share of section 751 items through a hypothetical sale, under which the partnership is treated as if it sold all its property for fair market value in a fully taxable transaction immediately before the transfer of the partnership interest.

For a U.S. partnership, entity treatment has prevailed for Code Sec. 1248: the sale or exchange is, after all, by a U.S. person. As early as Rev. Rul. 69-124, the IRS recognized that this entity-level computation creates partner-level coordination issues—*e.g.*, with Code Sec. 1248(b), which necessarily applies by reference to the partner's characteristics—and resolved those issues at the partner level without rejecting computational entity treatment.[149] Thus, if a U.S. partnership sold stock in a CFC, the Code Sec. 1248(a) amount would be computed at the partnership level and separately stated pursuant to Code Sec. 702 and allocated to the partners under Code Sec. 704. If a partner instead disposes of its interest in a partnership that owns CFC stock, Code Sec. 751(a) applies by reason of Code Sec. 751(c)'s reference to Code Sec. 1248(a), consistent with the coordination rule in Code Sec. 1248(g)(2)(B).[150] For a foreign partnership that owns a CFC, Reg. §1.1248-1(a)(4) takes a different tack, treating the partners as selling their "proportionate share" of the stock of the CFC.[151] Because Code Sec. 1248(a) is gain limited, this rule raises an immediate question: whose basis is taken into account for purposes of determining the gain from the sale or exchange, the partnership's basis in the CFC or the partner's basis in the partnership?[152] Finally, if a partner disposes of its interest in a foreign partnership, the government has informally stated that Code Sec. 751(a) provides ordinary income treatment.[153] Thus, a rough parity obtains under the putative government view: Code Sec. 1248(a) applies to a sale or exchange by a partnership of CFC stock, regardless of the partnership's domicile, and Code

Sec. 751 applies to a sale or exchange of an interest in a CFC-owning partnership, regardless of the partnership's domicile. This distinction between Code Secs. 751 and 1248(a) would be academic if ordinary income treatment and dividend treatment were interchangeable—an issue on which the government has not provided binding guidance.[154]

As discussed in Part I.C.2, partnerships were historically treated similarly under Code Secs. 951 and 1248, but that union was torn asunder by Reg. §1.958-1(d)(1). This raises the question of how Code Sec. 1248 should apply to partnerships. Like the issue described in Part III.A, resolution turns on three questions, the first of which is a normative question, namely, whether the treatment of U.S. partnerships should be different under Code Sec. 1248 and the subpart F inclusion provisions covered by Reg. §1.958-1(d)(1) (Code Secs. 951, 951A, and 956). Given the role of Code Sec. 1248 as a backstop to the subpart F framework, severing the connection between the two for a particular fact pattern does not further any discernible policy goal. Indeed, as with any scenario in which economically similar transactions are treated differently for tax purposes, planning opportunities and traps for the unwary will abound.[155] This result is difficult to justify from a normative perspective.

Next, the more difficult question involves authority: could Treasury and the IRS move U.S. partnerships to an aggregate approach for Code Sec. 1248 purposes? As an initial matter, Code Sec. 1248 shares much in common with relevant subpart F provisions. Code Sec. 1248, for example, refers to Code Sec. 958 ownership, and key parts of the definitions in Code Secs. 1248 and 951 rely on the definition for "U.S. person," which Code Sec. 7701(a)(30) defines as including a "domestic partnership."[156] Code Sec. 7701(a)(4) provides that, in the case of a partnership, "domestic" means "created or organized in the United States or under the law of the United States or of any State unless … the Secretary provides otherwise by regulations." Thus far, the authority underlying Reg. §1.958-1(d)(1) would present no greater difficulty than a comparable aggregate approach under Code Sec. 1248. But circumstances have changed since Reg. §1.958-1(d)(1) was promulgated: the Supreme Court subsequently issued its landmark decision in *Loper Bright Enters. v. Raimondo*.[157] Reg. §1.958-1(d) was not issued under Code Sec. 7701(a)(4); instead, the only authority entry for Reg. §1.958-1 is Code Sec. 7805.[158] In light of *Loper Bright*, it seems likely that this authority entry would have been framed differently had the guidance been issued after 2024. There is, however, an additional point of departure between Code Secs. 1248 and 951: Code Secs. 751(c) and (e), separate statutory provisions, seem to assume that Code Sec. 751(a) will sometimes operate in lieu of Code Sec. 1248(a) with respect to CFC stock held through partnerships.[159] Commentators have suggested interpretations that would adopt an aggregate approach without excising Code Secs. 751(c) and (e) from the Code, instead giving those provisions a residual role.[160] These are difficult issues, the resolution of which likely depends on the as-yet-determined strength of Code Secs. 7701(a)(4) and 7805(a).[161]

There could be interim solutions if adopting an aggregate approach under Code Sec. 1248(a) is a bridge too far. Routine transactions involving partnership structures are clouded in uncertainty, and a few changes and clarifications could reveal valuable guideposts. As a starting point, the 2024 Proposed Regulations do not confirm the application of derived basis in determining Code Sec. 1248(a) gain. Derived basis, as an additional amount of covered shareholder-specific basis, should be taken into account in determining the consequences of a covered shareholder's distributive share of gain or loss from CFC stock, including the application of Code Sec. 1248.[162] For this purpose, a rule similar to Proposed Reg. §1.961-9(c)(2) (coordination with dividend recharacterization provisions for Code Sec. 961(c)) could apply to prevent derived basis from converting to a Code Sec. 1248 amount. Relatedly, to ensure that value is not inappropriately attributed to Code Sec. 959(c)(3) E&P, the rules should ensure that a covered shareholder's PTEP accounts are taken into account under Code Sec. 1248(d). This could occur, for example, through a Rev. Rul. 69-124-type model, under which the covered shareholder would apply its annual PTEP accounts to its allocable share of gain or loss from the sale or exchange (as reduced by its derived basis).[163] This would align the rules for using derived basis and annual PTEP accounts—that is, the partnership makes its Code Sec. 703 computations, with certain items separately stated in the allocations and given partner-level effect—without requiring additional information flows from the partner to the partnership (which could occur if derived basis and PTEP accounts were instead "reflected down" to the partnership).[164]

D. S Corporations and Accumulated Adjustments Accounts

The 2024 Proposed Regulations generally treat S corporations like domestic partnerships.[165] Thus, each owner of an S corporation who is a covered shareholder maintains annual PTEP accounts, dollar basis pools, and PTEP tax pools with respect to a CFC owned by the

S corporation, while the S corporation maintains covered-shareholder-specific basis in any derivative ownership through which a covered shareholder indirectly owns a CFC.[166] As an initial matter, to mitigate potential confusion regarding the operation of these rules in S corporation structures, Treasury and the IRS could consider adding illustrative examples addressing distributions to, and dispositions by, S corporations that own CFCs with respect to which one or more shareholders have taken inclusions.[167] In particular, such examples could address ownership structures including at least one shareholder who is not a covered shareholder with respect to the distributing (or disposed-of) CFC.[168]

Additional guidance may also be necessary to coordinate the PTEP system with the rules under Code Sec. 1368 governing distributions.[169] Code Sec. 1368(b) generally provides that a distribution by an S corporation reduces a shareholder's adjusted basis in S corporation stock before giving rise to gain; however, where an S corporation has accumulated earnings and profits ("AE&P")—that is, E&P earned by a C corporation—Code Sec. 1368(c) interposes the accumulated adjustments account ("AAA"), such that distributions are first sourced to AAA, with any excess treated as a dividend to the extent of AE&P before again applying Code Sec. 1368(b).[170] An S corporation's AAA, which is not allocated among shareholders, preserves single-level taxation by tracking income taxed to shareholders during the corporation's S-corporation years, reduced for non-dividend distributions.[171]

Consider, for example, a case in which several covered shareholders own an S corporation that, in turn, owns a CFC. Assume the S corporation has AE&P from a prior C-corporation period, and the CFC has PTEP with respect to the S corporation's shareholders by reason of shareholder-level inclusions. If the CFC were to make a PTEP distribution, the 2024 Proposed Regulations would treat that distribution as, in substance, made to the S corporation's shareholders: the covered shareholders would adjust their PTEP accounts and reduce basis in their S corporation stock under Code Sec. 961(b), while the S corporation would reduce the covered-shareholder-specific derived basis maintained in the relevant derivative ownership units (*i.e.*, the CFC stock). If the AAA were not adjusted to reflect the inclusions giving rise to the PTEP, the distribution mechanics under Code Sec. 1368(c) could result in dividend treatment notwithstanding that the underlying earnings have already been taxed. To preserve single-level taxation, a coordination rule could permit AAA to be increased by the amount of PTEP distributed to the S corporation (and attributable to its shareholders), with a corresponding reduction to AAA when the S corporation subsequently distributes those amounts to its shareholders.[172] The shareholders' stock basis under Code Sec. 1367 would increase upon the S corporation's receipt of the PTEP—corresponding to the Code Sec. 961(b) basis reduction—and decrease upon a subsequent distribution. In this manner, the mechanics and effect of the rules would parallel those applicable to partnerships under Code Sec. 705.[173]

E. Odds and Ends

Several additional points merit brief discussion. First, the definition of "own" for purposes of the 2024 Proposed Regulations refers to ownership within the meaning of Code Sec. 958(a), which, by operation of Reg. §1.958-1(d)(1), generally excludes ownership by a partnership. This definition may render ownership by a partnership a meaningless description given that both Code Secs. 959 and 961 apply by reference to Code Secs. 951 and 951A.[174] Entity treatment was clearly intended in this context—otherwise the derived basis rules would not operate as described—but Treasury and the IRS should clarify this in the final regulations, for example, by adding Code Sec. 961 to the list in Reg. §1.958-1(d)(2).

Second, the mechanical rules for derived basis could be clarified through an example illustrating the basis consequences of a PTEP distribution through tiered partnerships, which would address uncertainty regarding the interaction of derived basis and Code Sec. 705.[175] Alternatively, or in addition to this clarification, the final regulations could revise the relevant provisions of Proposed Reg. §1.961-4(c)(2) to refer to PTEP "treated as received" by a covered shareholder through a derivative ownership unit.[176]

Third, commentators have raised questions regarding the interaction of the proposed regulations with the rules for maintaining capital accounts under Reg. §1.704-1.[177] A clarification in this regard could address the relationship between (i) the entity-level treatment of a partnership's Code Sec. 703 items (*e.g.*, a dividend or gain or loss from the disposition of stock or other property) and (ii) the general partner-level application of PTEP accounts and derived basis with respect to the partnership allocations of such items.[178] An illustrative example would be helpful, whether through a new example or additional analysis in an existing example.

Finally, Code Sec. 6221 provides centralized examination proceedings for partnership-related items ("PRIs").[179] Unlike prior law, the Bipartisan Budget Act ("BBA") Rules are not simply procedural but instead modify who owes tax and the amount of tax owed. This occurs through Code Sec. 6225 and the imputed-underpayment mechanism, under which a partnership is generally liable for the tax owed on adjustments to PRIs.[180] As a result, whether an item constitutes a PRI can have material consequences. Code Sec. 6241(2)(B) generally defines a PRI as any item or amount with respect to a partnership that is relevant in determining the tax liability of any person (including any partner's distributive share thereof).[181] The regulations illustrate this definition by treating the partnership's basis in its assets and amounts resulting from a Code Sec. 754 election (for example, Code Sec. 743(b) adjustments) as PRIs.[182] But PRIs do not include certain "person-specific items," meaning items or amounts shown on a return, or in the books and records, of a person other than the partnership that result from applying the Code to a PRI based on facts specific to that other person.[183] Given the potential application of Code Sec. 6225, clarity would be welcomed with respect to the interaction of the BBA Rules and the proposed PTEP rules.[184]

IV. Conclusion

PTEP suffers, paradoxically, from its role as part of the foundation of the U.S. international tax system. As new legislation and policy priorities arise, long-standing issues involving PTEP tend to recede into the background; its interaction with partnerships is only one example. It remains to be seen whether, and on what timetable, the 2024 Proposed Regulations will be finalized—the administration's attention is focused on OBBB guidance. While finalization may be unlikely, portions of the partnership-specific guidance discussed in this article appear far less likely, particularly where resolution would require an additional set of proposed regulations.

In the interim—which may be indefinite—these issues remain. This article attempted to sketch the contours of possible solutions to some of the most pressing issues raised by partnership-held CFCs and PTEP. But absent further guidance, taxpayers and advisors will continue to operate in an uncertain space, navigating between statutory principle and incomplete regulatory machinery.

ENDNOTES

* I would like to thank Layla J. Asali and Jeffrey M. Tebbs for their thoughtful review and comments.

1 Code Sec. 959's sister, Code Sec. 961, has not yet raised similar issues.

2 Aspects of the subpart F regime have withstood multiple constitutional attacks over the years. *See, e.g.*, *Garlock Inc.*, 58 TC 423, Dec. 31,413 (1972), *aff'd*, CA-2, 74-1 USTC ¶9141, 489 F2d 197; *Whitlock Est.*, 59 TC 490, Dec. 31,797 (1972), *aff'd in part and rev'd in part*, CA-10, 74-1 USTC ¶9388, 494 F2d 1297; *Dougherty*, 60 TC 917, Dec. 32,138 (1973), *supp'd*, 61 TC 719 (1974); *Moore*, SCt, 2024-1 USTC ¶50,163, 602 US 572, *aff'g*, CA-9, 2022-1 USTC ¶50,165, 36 F4th 930.

3 This concept is not novel. For example, Subchapter S (Code Sec. 1361 *et seq.*) adopts a hybrid Subchapter C and Subchapter K approach. Similarly, aspects of the Code Sec. 1502 consolidated return regulations—*e.g.*, the stock-basis and earnings-and-profits adjustment rules under Reg. §§1.1502-32 and -33—broadly echo similar concepts.

4 Code Secs. 956 and 951(a)(1)(B) address investments in U.S. property by the CFC, which achieve the same economic effect as a dividend distribution.

5 Code Secs. 959(a) and (b); *see also* H.R. Rep. No. 87-1447, at A101-A102 (1962) ("1962 House Report").

6 In contrast, E&P under Code Sec. 312 is generally shared across all a corporation's stock.

7 Code Sec. 959(c)(1) PTEP includes PTEP arising from Code Sec. 951(a)(1)(B) inclusions or Code Sec. 959(a)(2) recharacterizations.

8 Code Sec. 959(c)(2) PTEP includes PTEP arising from Code Sec. 951(a)(1)(A) inclusions, Code Sec. 951A(a) inclusions, and amounts treated as included under Code Sec. 951(a)(1)(A) under another provision (*i.e.*, Code Secs. 245A(e)(2), 964(e)(4), 965(a) and (b), and 1248(a) and (f)).

9 Code Sec. 959(c).

10 Code Sec. 959(d) provides that any distribution excluded under Code Sec. 959(a) is, for purposes of Chapter 1 of Subtitle A, treated as a distribution that is not a dividend, except that it immediately reduces E&P.

11 Code Sec. 959(f). Code Sec. 959(a)(2) does not reference 959(c)(1) PTEP because that PTEP is already included in the determination of the Code Sec. 956 amount under Code Secs. 956(a) and (b)(1).

12 Code Sec. 959 thus follows the rules for dividends in Code Sec. 316(a), under which the characterization of a corporate distribution is determined at year end, after determining E&P for the year.

13 This phrase begins Code Secs. 961(a), (b), and (c).

14 When the PTEP distribution exceeds the basis of the stock or other property with respect to which it is received, Code Sec. 961(b)(2) treats the excess amount as gain from the sale or exchange of property.

15 *See* 1962 House Report, at A106; H.R. Rep. No. 105-148, at 529-30 (1997).

16 The consolidated return regulations also present a modified analog, generally replacing immediate gain recognition with basis adjustments and deferred recognition principles under Reg. §§1.1502-13(f) and 1.1502-32.

17 Code Sec. 961(c), enacted as part of the Taxpayer Relief Act of 1997 (P.L. 105-34), was a later addition.

18 *See, e.g.*, 89 FR, at 95379.

19 There are 10 PTEP groups under Reg. §1.960-3(c)(2), each of which corresponds to a particular provision giving rise to PTEP.

20 *See, e.g.*, Reg. §1.986(c)-1.

21 Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 358 (Comm. Print 2017) ("TCJA Explanation").

22 TCJA Explanation, at 113.

23 TCJA Explanation, at 358 and 361.

24 *See, e.g.*, Code Sec. 250(a); TCJA Explanation, at 375. P.L. 119-21, dubbed the One Big Beautiful Bill Act ("OBBB"), modified these rules by striking the "intangible" element and rebranding the deductions as provided for "foreign-derived deduction eligible income" and "net CFC tested income."

25 As noted, Code Sec. 965 recently survived constitutional challenge. *See supra*, n. 2.

26 Code Sec. 245A E&P, after the OBBB, will generally consist of earnings attributable to: (i) high-taxed income for which an election is

made under Code Sec. 954(b)(4) (and Reg. §1.954-1) or Reg. §1.951A-2; (ii) CFC tested income that is offset by tested loss of another CFC owned by the same U.S. Shareholder in determining NCTI under Code Sec. 951A(b) and Reg. §1.951A-2; (iii) foreign oil and gas extraction income (as defined in Code Sec. 907(c)(1)); (iv) certain pre-1987 E&P; and (v) income earned by a specified 10-percent-owned foreign corporation that is not a CFC (as defined in Code Sec. 245A(b)). The OBBB eliminated the net deemed tangible income return under prior law by removing related rules in both Code Secs. 250 and 951A.

27 Code Secs. 961(d) and 1059 may require basis reductions in certain cases.

28 *See* 89 FR, at 95365-95366 ("PTEP may not be preferable to section 959(c)(3) E&P and taxpayers might take inappropriate positions to maximize the existence of section 959(c)(3) E&P"); *cf*. 71 FR, at 51156 (Code Secs. 959 and 961 are infused "with the legislative intent of avoiding double taxation and allowing United States persons to receive the full benefit of their PT[EP] at the earliest possible time").

29 Code Sec. 958(a).

30 T.D. 9866 (84 FR 29288) and T.D. 9960 (87 FR 3648), respectively.

31 Reg. §1.958-1(d)(1).

32 Code Secs. 959 and 961 apply by reference to Code Secs. 951A by reason of 951A(d)(1).

33 Reg. §1.958-1(d)(2).

34 For commentary on these issues, both historically and in connection with Reg. §1.958-1(d) , *see* Chris Bowers & Natán J. Leyva, *The Application of §§ 959 and 961 to Indirectly Owned CFCs*, 34 Tax Mgmt. Int'l J. 307 (Jun. 2005); F. Scott Farmer, Gary R. Huffman, Monte A. Jackel & Brooke E. Hintmann, *Partnership Dispositions of Stock in Controlled Foreign Corporations*, Tax Notes (Apr. 21, 2006); Monte A. Jackel & Robert J. Crnkovich, *CFC Stock Held by Foreign Partnerships: Confusion Galore*, Tax Notes (Aug. 17, 2009); Jonathan S. Brenner & Josiah P. Child, *I'm Looking Through You, You're Not the Same: Partnership-Held CFCs*, 164 Tax Notes Fed. 21 (Oct. 7, 2019); Monte A. Jackel, *Subchapter K Under the TCJA International Regs*, 164 Tax Notes Fed. 457 (Oct. 21, 2019) ("Jackel Subchapter K and TCJA"); Joshua Ruland, Mark Opper & Carlos Vaca Valverde, *Amidst the Mists: §1248, PTEP, and Domestic Partnerships After the Final GILTI Regulations*, 49 Tax Mgmt. Int'l J. 21 (Jan. 10, 2020).

35 Given its role as the transition tax, guidance under Code Sec. 965 was at the vanguard of TCJA implementation. This guidance (84 FR 1838), therefore, was issued before Reg. §1.958-1(d).

36 The guidance did not describe the mechanism for how this basis would operate. *See* 84 FR, at 1849.

37 *See generally* T.D. 6795 (30 FR 943) and T.D. 6850 (30 FR 11854).

38 71 FR 51155 (the "2006 Proposed Regulations").

39 *See* Proposed Reg. (2006) §§1.959-3(e)(2), (f) through (h); Proposed Reg. (2006) §1.961-1(b)(1); Proposed Reg. (2006) §1.961-2(b)(1); Proposed Reg. (2006) §1.961-3(a)(1) and (b)(1); and Proposed Reg. (2006) §1.961-4.

40 IRB 2019-02, 275.

41 In withdrawing the 2006 Proposed Regulations (87 FR 63981), the government cited "possible abuse or misuse" of the rules governing basis adjustments in Code Sec. 304(a)(1) transactions. In general, the 2006 Proposed Regulations provided rules that moved PTEP in cross-chain Code Sec. 304(a)(1) transactions, regardless of whether the PTEP was sourced from the acquiring or issuing corporation and regardless of whether the controlling shareholder already maintained PTEP accounts with respect to the transferor or acquiring CFC. Code Sec. 961 basis adjustments followed the PTEP account adjustments.

42 89 FR, at 95366. The proposed regulations include an extensive authority entry, the persuasiveness of which is beyond the scope of this article. 89 FR, at 95400.

43 *See generally* Proposed Reg. §§1.959-12(b), (d); Proposed Reg. §1.961-14(b). Certain provisions related to Code Sec. 959 that were described in Notice 2019-01 (IRB 2019-02, 275) would apply earlier. Proposed Reg. §1.959-12(c).

44 89 FR, at 95377.

45 89 FR, at 95384.

46 *Id.*

47 Proposed Reg. §§1.959-2(b) and (d).

48 Proposed Reg. §1.959-1(b).

49 87 FR 3890.

50 IRB 2020-39, 604.

51 Proposed Reg. §1.959-1(c).

52 Proposed Reg. §1.959-2(b).

53 This approach ensures that PTEP-related items are not shared among covered shareholders or among types of PTEP. Given that different types of PTEP may bring different tax consequences, the accounts break down further into a matrix of subaccounts based on PTEP groupings and PTEP subgroups, with certain simplifying conventions available for dollar basis pools and PTEP tax pools.

54 This follows from PTEP (as E&P) and associated foreign income taxes being corporate-level attributes, albeit with a shareholder-specific effect, and facilitates the computations under Code Sec. 956 and the allocation and apportionment of current year taxes paid or accrued. A foreign corporation does not maintain dollar basis pools because the 2024 Proposed Regulations do not require FX gain or loss recognition upon tiered distributions between CFCs. The dollar basis in distributed PTEP carries over to the recipient CFC, as reduced by the imposition of current year taxes (which morphs the dollar basis into PTEP taxes), which will ultimately give rise to FX gain or loss at the covered shareholder-level upon repatriation. Proposed Reg. §§1.959-3(d) and (e) and 1.986(c)-1(c).

55 Proposed Reg. §§1.952-1(c)(5), 1.959-11(e), and 1.961-13(d). The "push out" will occur when the 2024 Proposed Regulations are finalized because Reg. §1.958-1(d)(1) is already applicable. Reg. §1.958-1(d)(4).

56 Proposed Reg. §§1.959-3(c) (PTEP accounts), (d) (dollar basis pools), and (e) (PTEP tax pools).

57 For Code Sec. 951(a)(1)(A), at the beginning of the year; for Code Sec. 951(a)(1)(B), at the end of the year.

58 Proposed Reg. §1.959-3(f). Adjustments to dollar basis and PTEP tax pools occur at the same time as the corresponding adjustment to annual PTEP accounts. *Id.*

59 Proposed Reg. §§1.959-4(b) and (d). The rules are more complex for inter-CFC dividends. *See* Proposed Reg. §1.951-1(c) and Proposed Reg. §1.951-2. While issues involving Code Sec. 959(b) and inter-CFC dividends are beyond the scope of this article, the solution proposed would address issues arising in split-ownership structures that were exacerbated by Code Sec. 951A and the potential for non-*pro-rata* PTEP among U.S. Shareholders. *See* 89 FR, at 95370-71.

60 Proposed Reg. §1.959-3(c)(1); *see also* 89 FR, at 95371-72.

61 *Id.*

62 Proposed Reg. §§1.959-4(e)–(g).

63 Proposed Reg. §1.959-10(c)(1)(iv) illustrates this rule.

64 Once the 2024 Proposed Regulations are finalized, such that the proposed rules and Reg. §1.958-1(d)(1) apply, any remaining partnership-level PTEP will be pushed out to the partners.

65 Proposed Reg. §1.959-7(b).

66 The 2024 Proposed Regulations also do not address redemptions of stock.

67 *Id.* The preamble describes that, in addition to implementing the statutory language in Code Sec. 959 regarding successors, "these rules ensure that E&P retains its PTEP status and thus remains subject to the rules under section 959 and 961, rather than reverting to section 959(c)(3) E&P." 89 FR, at 95374. Thus, these rules depart from the proof-of-identity requirements in current Reg. §1.959-1(d).

68 Proposed Reg. §1.959-7(c)–(f). Separate rules apply to Code Sec. 959(e) PTEP (*i.e.*, PTEP attributable to a Code Sec. 1248 amount arising on the GST).

69 Proposed Reg. §1.959-7(g)(1).

70 *Id.* Proposed Reg. §1.959-7(g)(2) instructs the successor covered shareholder to use a reasonable method in determining the amount of PTEP and associated foreign income taxes it succeeds to, taking into account adjustments that would have been made under Proposed Reg. §1.959-3 during the offshore period. *See also* Proposed Reg. §1.959-11(d)(4).

71 89 FR, at 95376.

72 Proposed Reg. §1.961-2(b). By maintaining basis in U.S. dollars, intervening exchange rate fluctuations will be captured under Code Sec.

986(c) upon direct or indirect repatriation, rather than under Code Sec. 961.

[73] Proposed Reg. §1.961-2(c).

[74] Proposed Reg. §1.961-2(d). For an issue with respect to the definition of "own", *see infra*, Part III.E.

[75] *Id.*

[76] *Id.*

[77] Proposed Reg. §1.961-2(e).

[78] *Id.*

[79] Proposed Reg. §1.961-3(b), (c).

[80] The existing regulations under Reg. §§1.961-1 and 1.961-2 could be read to suggest that basis increases occur at year end while basis decreases for distributions of PTEP occur at the time of the distribution, which raises the potential for Code Sec. 961(b)(2) gain for current-year PTEP distributions strictly due to the timing of adjustments under Code Secs. 961(a) and (b). The IRS alleviated these concerns in AM 2023-002 (POSTS-117518-22), which is non-precedential advice issued to IRS:LBI before the 2024 Proposed Regulations. *See also* LTR 202304008 (Nov. 03, 2022) (reaching a result consistent with AM 2023-002 (Mar. 15, 2023)).

[81] Proposed Reg. §1.961-3(e); *see also* Proposed Reg. §1.961-3(d) (allocation rule for actual distributions during the taxable year of inclusion).

[82] Proposed Reg. §§1.961-4(b)–(d).

[83] Proposed Reg. §1.961-4(e).

[84] For example, separation could occur through an issuance, either of stock or a partnership interest. As additional examples, PTEP and basis separation could occur by reason of (i) a Code Sec. 302(d) redemption or a distribution by a partnership, (ii) a corporate distribution to a direct covered shareholder described in Code Sec. 301(c)(2) (if the foreign corporation generates an E&P deficit after earning PTEP such that it cannot distribute a dividend for Code Sec. 316 purposes), (iii) an imperfect allocation of basis upon PTEP generation (*e.g.*, in the case of preferred stock), (iv) or, as discussed below, a GST.

[85] In disclaiming the approach adopted by the 2006 Proposed Regulations, the preamble describes that the government is "of the view that a shifting approach could give rise to inappropriate results, is not required under section 961 … and would depart from analogous provisions like section 358." 89 FR, at 95386. The proposed regulations permit a form of limited Code Sec. 961(c) basis sharing with respect to Code Sec. 961(c) ownership units that are shares of stock in the same CFC. Proposed Reg. §1.961-4(c).

[86] CA-4, 71-1 USTC ¶9148, 435 F2d 1257.

[87] 89 FR, at 95386; *cf.* Reg. §1.1367-1(c)(3). Multiple commentators requested that the final regulations allow some form of limited basis sharing for Code Sec. 961(a) ownership units. *See, e.g.*, New York State Bar Ass'n Tax Section, *Report on Proposed Regulations Regarding Previously Taxed Earnings and Profits*, Report No. 1512, at 26-40 (Apr. 16, 2025) ("NYSBA PTEP Report 1"); Nat'l Foreign Trade Council, *Comments on Previously Taxed Earnings and Profits (REG-105479-18)*, at 2-3 (Feb. 28, 2025).

[88] Rev. Rul. 84-53, 1984-1 CB 159.

[89] Proposed Reg. §§1.961-4(c) and (f)(2).

[90] *Id.*

[91] Proposed Reg. §§1.961-4(d), (f)(3); *see also* Proposed Reg. §1.961-11.

[92] These rules do not technically allow basis to go negative. *See* Reg. §1.1502-19 for a conceptual sibling to negative derived/Code Sec. 961(c) basis.

[93] This approach allows limited shifting between types of basis in the same property unit, rather than shifting of basis among property units.

[94] Proposed Reg. §1.961-4(c)(3). *See infra*, Part III.E for a comment on this interaction.

[95] For this purpose, common basis is reduced by any negative Code Sec. 743(b) adjustment as to the covered shareholder. This treats the negative Code Sec. 743(b) adjustment as a current limitation on adjusted basis, without requiring an actual modification of the underlying Code Sec. 743(b) adjustment.

[96] *Id.* The preamble describes that "[t]hese rules do not affect the treatment or availability of a partnership's common basis … under any other provision of the Code (and thus, for example, do not impact the application of section 704(c))." 89 FR, at 95381.

[97] Proposed Reg. §1.961-4(d)(3). Of course, the Code Sec. 743(b) adjustments applicable to derivative ownership units have no relevance for Code Sec. 961(c) ownership units.

[98] Proposed Reg. §1.961-10. Subsequent guidance may modify these triggering events, especially if the guidance addresses nonrecognition transactions. 89 FR, at 95388.

[99] Proposed Reg. §1.961-5(c). The preamble describes that, "in the case of an acquired partnership, [the automatic transfer] ensure[s] that the successor covered shareholder succeeds to derived basis (as compared to an approach that attempted to replace all of a portion of derived basis with a section 743(b) basis adjustment, which would require an election under section 754 to be in effect or a substantial built-in loss.)" 89 FR, at 95382.

[100] Notice 2024-16, IRB 2024-5, 622, however, describes rules that would convert Code Sec. 961(c) basis to adjusted basis (*i.e.*, Code Sec. 961(a) basis) in certain limited circumstances.

[101] 89 FR, at 95383. This theme reappears as part of the open issues described in Part III.B.

[102] Proposed Reg. §1.961-8(b)(1).

[103] Proposed Reg. §1.961-8(b)(2).

[104] *Id*; *see also* 89 FR, at 95384. The proposed regulations include an additional limitation when the boot-within-gain rules of Code Secs. 351(b) and 356(a)(1) apply, ensuring that positive derived basis is taken into account only to the extent it would reduce gain recognized. Proposed Reg. §1.961-8(b)(2).

[105] Proposed Reg. §1.961-8(c).

[106] Proposed Reg. §1.961-8(b)(1).

[107] Proposed Reg. §1.961-8(d).

[108] *Id.*

[109] Proposed Reg. §§1.961-2(e)(2) and 1.961-9(d); *see also* Proposed Reg. §1.951-2.

[110] *Id.*

[111] The preamble, in describing the authority for this approach, explains that the rules "operate[] in a similar manner to the section 959(b) exclusion[,]" thus creating parity under Code Secs. 959 and 961 for tiered distributions and dispositions. 89 FR, at 95384.

[112] For commentary suggesting a shareholder-level approach to Code Sec. 961(c) (and Code Sec. 959(b)), *see* NYSBA PTEP Report 1, at 45-56; *see also* Douglas Poms, *The Elusive Nature of Code Sec. 961(c) Basis in a Post-TCJA Multiverse*, 48 INT'L TAX J. 47, September-October 2022. Consideration of that approach is beyond the scope of this article.

[113] Proposed Reg. §1.961-9(h). This rule is a consequence of the limited Code Sec. 961(c) basis sharing allowed under Proposed Reg. §1.961-9(c). 89 FR, at 95386.

[114] *See* New York State Bar Ass'n Tax Section, *Report on Partnership Aspects of the Proposed PTEP Regulations*, Report No. 1514 (July 14, 2025) ("NYSBA PTEP/Partnership Report"); Monte A. Jackel, *A Not-So-Peaceful Coexistence: Partnerships and Proposed PTEP Regs*, 186 TAX NOTES FED. 265 (Jan. 13, 2025) ("Jackel PTEP and Partnerships"); Bruce Lemons, *Proposed PTEP Regs Require a Rethink for S Corporations*, 187 TAX NOTES FED. 679 (Apr. 28, 2025) ("Lemons PTEP and S Corporations"). The preamble requested comments on foreign trusts and estates, which raise issues like those facing partnerships. 89 FR, at 95394. For brevity, this article will not focus on those issues; instead, I will refer the reader to American Institute of Certified Public Accountants, *Comments on REG-105479-18—Proposed Regulations Regarding Previously Taxed Earnings and Profits and Related Basis Adjustments Under Sections 959 and 961* (May 14, 2025).

[115] *See supra*, Part III.C.

[116] As Part I.C.1 illustrates, PTEP may not be preferable for taxpayers that could otherwise utilize Code Sec. 959(c)(3) E&P, which would not bring an automatic basis reduction or FX gain (if applicable). Thus, the lack of coordination with Code Sec. 1248 could give rise to results that the preamble to the 2024 Proposed Regulations characterizes as undesirable regarding PTEP and Code Sec. 959(c)(3) E&P.

[117] NYSBA PTEP/Partnership Report, at 22-23; Jackel PTEP and Partnerships, at 269.

[118] *See supra*, Part I.C.2. Code Sec. 958(a)(2) provides an aggregate rule for stock owned through foreign entities (including foreign partnerships) that treats the entity's owner(s) as owning a proportionate share of the CFC stock, the principles of which have been extended for certain purposes to U.S. partnerships under Reg. §1.958-1(d)(1). The determination of proportionate ownership has

long been a subject of consternation when the intermediary is a partnership. *See*, *e.g.*, Giovanna T. Sparagna, *Allocating Foreign Stock Attributes Through Partnerships Under Subpart F—Planners Beware*, 2 J. TAX'N GLOBAL TRANS. 63 (2002).

[119] *Cf.* Code Sec. 961(a) ("... and the basis of property ...") and Code Sec. 961(b) ("... or other property ...").

[120] Although not ultimately enacted, Build Back Better Act proposals would have amended section 961(c) to extend basis adjustments to "other property." *See*, *e.g.*, H.R. 5376, 117th Cong. If PTEP-derived basis in non-stock property were not permitted under Code Sec. 961(c), but a CFC-owned partnership could maintain some form of Code Sec. 961(c) basis in a lower-tier CFC, Code Secs. 954(c)(4) and 964(e) might provide a form of "rough justice" upon a disposition by the upper-tier CFC of its partnership interest. In such a case, Code Sec. 954(c)(4) would effectively treat the CFC as selling its proportionate share of the partnership's underlying assets for purposes of Code Sec. 954(c), while Code Sec. 964(e) could apply Code Sec. 1248-style recharacterization to gain recognized by a CFC on the sale of stock in a lower-tier CFC, including gain determined under any provision of subtitle A. If these provisions were applied to treat the CFC as effectively selling lower-tier CFC stock owned through a partnership, a coordination rule analogous to Proposed Reg. §1.961-9(c), discussed in Part II.B.2.iv, could provide a mechanism to prevent double inclusion of value attributable to PTEP. As an initial matter, however, current guidance does not address the interaction of Code Secs. 954(c)(4) and 964(e). More fundamentally, such an approach would depart from the statutory framework applicable to directly held partnership interests, under which Code Sec. 961(a) provides outside basis from which the proposed regulations "derive" covered-shareholder-specific basis at the partnership level; instead, it would collapse the structure by treating the CFC partner as selling its share of the partnership's lower-tier CFC stock, akin to the mechanism described in Reg. §1.1248-1(a)(4), discussed below. Finally, this approach would require information to flow from the CFC partner to the partnership, obligating the partnership to obtain the information necessary for the CFC partner to analyze its deemed sale. This follows from the language of Code Sec. 954(c)(4), but the resulting computations would nevertheless raise practical issues and further strain the consistency of entity-level partnership reporting with partner-level international tax determinations. For roughly comparable partner-to-partnership information flows in other contexts involving deemed sales by a partnership, *see* Reg. §1.864(c)(8)-2 and Reg. §1.6050K-1 (as recently amended by T.D. 10048, May 19, 2026).

[121] 89 FR, at 95378.

[122] Stated differently, derived basis "derives" from actual adjusted basis under Code Sec. 961(a). A CFC partner, in contrast, maintains Code Sec. 961(c) basis, so any basis "derived" from that structure would be Code Sec. 961(c) basis. This article does not take a position on the general mechanics for Code Sec. 961(c) basis in the 2024 Proposed Regulations. *See supra*, n. 111 and n. 112.

[123] As commentary has noted (Jackel PTEP and Partnerships, at 269), partner-level tracing and aggregate treatment can push against the principle that the partnership is the computational vehicle for purposes of determining taxable income. *See*, *e.g.*, *J.A. Basye*, SCt, 73-1 USTC ¶9250, 410 US 441, 93 SCt 1080 and *Textron Inc. & Subsidiary Cos.*, 117 TC 67, Dec. 54,465 (2001). Those concerns are ultimately directed at Reg. §1.958-1(d)(1)—the treatment of PTEP and PTEP-related basis are downstream of the approach for inclusions—and the authority for, and wisdom of, Reg. §1.958-1(d) are beyond the scope of this article.

[124] Reg. §1.958-1(d)(2) retains an entity approach for determining controlling U.S. Shareholder status from aggregate treatment. Treasury and the IRS issued proposed regulations, which have not been finalized, that would adopt an aggregate approach to this determination. *See* 87 FR, at 3900.

[125] 87 FR, at 95384. This has been an active area in the domestic context. *See*, *e.g.*, *Otay Project LP*, Dec. 62,821(M), TC Memo. 2026-21. Although guidance on these provisions was recently withdrawn—*see*, *e.g.*, 91 FR 11003—related guidance (Rev. Rul. 2024-14, IRB 2024-28) remains, suggesting that the government may rely on Code Sec. 7701(o) to police transactions that, in the government's view, use the partnership distribution rules to inappropriately accelerate cost recovery or distort gain or loss recognition.

[126] H.R. Rep. No. 1337, at 65 (1954) ("***1954 House Report***"); S. Rep. No. 1622, at 89 (1954) ("1954 Senate Report"). *See also D.A. Foxman*, 41 TC 535, 551, Dec. 26,613 (1964) ("one of the underlying philosophic objectives of [Subchapter K] was to permit the partners themselves to determine their tax burdens *inter sese* to a certain extent, and this is what the committee reports meant when they referred to 'flexibility'"); Reg. §1.701-2(a).

[127] *See also* 1954 House Report, at 69; 1954 Senate Report, at 96.

[128] *See infra*, Part II.D; *see also* 89 FR, 95379 and 95393.

[129] Code Sec. 731(a)(2) allows loss recognition in a liquidating distribution of money or Code Sec. 751 property. Another exception to nonrecognition applies where a distribution would otherwise allow character conversion (Code Sec. 751(b)).

[130] Code Sec. 732(d) permits a partner who recently acquired a partnership interest to elect treatment that approximates the effect of a Code Sec. 754 election, even if no election was in effect at the time of the transfer. Code Sec. 732(d) mandates special basis adjustments in certain post-acquisition distributions where a partnership interest was acquired, and the partnership's built-in gain and asset composition would otherwise permit shifting basis from non-depreciable property to depreciable or amortizable property. Reg. §1.732-1(d)(4).

[131] Code Secs. 734(c) and 743(c). Code Sec. 755(a) and its regulations generally allocate basis adjustments among partnership properties in a manner that reduces disparities between fair market value and adjusted basis, while Code Sec. 755(b) requires allocations by reference to character. *See also* Reg. §§1.755-1(b) and (c).

[132] Reg. §1.743-1(g)(4) provides, in relevant part, that the rules of Code Sec. 751 apply before the Code Sec. 743(b) rules. *See also* Code Secs. 731(d) and 732(e); Reg. §§1.732-1(e) and 1.751-1(b).

[133] 89 FR, 95383.

[134] 89 FR, at 95366.

[135] Successor basis may not prevent inherent Code Sec. 961(b)(2) gain if Code Secs. 732(a)(2) or (b) apply.

[136] *See*, *e.g.*, Proposed Reg. §1.959-7(b)(2). Identical coordination issues also arise for corporate nonrecognition transactions.

[137] NYSBA PTEP/Partnership Report, at 31–33.

[138] This assumes Reg. §1.743-1(g)(3) would not apply, which is discussed in the next paragraph.

[139] If the government were concerned that the results described above could facilitate inappropriate basis shifting, there are tools available that would not require withholding otherwise necessary guidance. For example, the rules could include a clearly articulated anti-abuse rule—perhaps modeled on analogous concerns addressed in the corporate context (*e.g.*, Code Sec. 355). As noted above, the government has indicated a willingness to invoke Code Sec. 7701(o) where transactions using partnership distributions are perceived to lack economic substance, and Subchapter K contains many rules aimed at transactions using partnership distributions to achieve results inconsistent with Congressional intent.

[140] As discussed in Part III.C, a derivative ownership unit could constitute a hot asset under Code Sec. 751(c) to the extent Code Sec. 1248(a) would otherwise apply. A sensible coordination rule could provide that, for purposes of Code Sec. 1248, CFC stock does not give rise to Code Sec. 1248 gain to the extent of derived basis, which would also address the interaction between the Subchapter K distribution rules and Code Sec. 751. *See* Reg. §§1.751-1(c)(4)(iv), (c)(5), and (c)(6).

[141] 87 FR, at 95384.

[142] *See* 1962 House Report, at A123-A127; S. Rep. No. 87-1881, at 107-109 (1962) ("1962 Senate Report"). Code Sec. 1248(f) addresses corporate nonrecognition transactions (*e.g.*, Code Secs. 337, 355(c)(1), and 361(c)(1)).

[143] Code Sec. 1248(d)(1); Reg. §§1.1248-2(e)(3) and -3(e)(2).

[144] For discussion of the amendments to Code Sec. 951, *see* Joshua Ruland & Shane McCarrick, *Some Liked It Hot: Big, Beautiful Changes to the Pro Rata Share Rules*, 119 Tax Notes Int'l 1689 (Sep. 15, 2025).

[145] *See*, *e.g.*, Reg. §1.245A-5 and Reg. §1.1502-80(j).

[146] *See supra*, n. 34.

[147] Code Sec. 751(b) extends this treatment to certain disproportionate distributions that alter the allocation of Code Sec. 751 items among partners in a distributing partnership. Proposed regulations issued in 2014 (79 FR 65151) would have elaborated on this framework, including its application to Code Sec. 1248, but were never finalized. *See*, *e.g.*, Proposed Reg. §1.751-1(g), Ex. 8; *see also* New York State Bar Ass'n Tax Section, *Report on June 2019 GILTI and Subpart F Regulations*, Report No. 1423, at 33–43 (September 18, 2019).

[148] Reg. §1.751-1(c)(4)(iv); *see also* Reg. §§1.751-1(c)(5) and (c)(6); H.R. Rep. No. 94-658, at 248 (1976); S. Rep. No. 94-938, pt.1, at 271 (1976).

[149] The IRS held that when a domestic partnership sells CFC stock and gain is recharacterized under Code Sec. 1248(a), the Code Sec. 1248(a) amount is separately stated and allocated to the partners, and the tax attributable to those amounts is subject to the limitation in Code Sec. 1248(b). *See also* Code Sec. 751(e) and LTR 199908044 (Nov. 17, 1998) and LTR 199908045 (Nov. 17, 1998) (extending the reasoning of Rev. Rul. 69-124, 1969-1 CB 203 to S corporations).

[150] *See also* Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, JCS-33–76, at 266 (Dec. 29, 1976).

[151] *See supra*, at n. 114. Similar language also appears in Reg. §1.367(a)-1T. *See also* 71 FR 31985, at 31989 for the government's reasoning in adopting Reg. §1.1248-1(a)(4).

[152] One possible approach grounded in Subchapter K methodology would be to determine gain by reference to a hypothetical sale construct. *See*, *e.g.*, Reg. §§1.751-1(a)(2), 1.743-1(d), 1.755-1(b)(1), and 1.864(c)(8)-1(c).

[153] *See*, *e.g.*, T.D. 9345 (72 FR, at 41443). This interpretation is dubious. Code Sec. 751(c) does not seem to apply in the case of a sale of CFC stock by a foreign partnership because there is no sale or exchange by a U.S. person. It is possible that the government view intended to insert Reg. §1.1248-1(a)(4) as part of the hypothetical sale under Reg. §1.751-1(a)(2), but that would result in a self-referential loop of deemed sales in the same transaction. *See also* Jackel Subchapter K and TCJA, at 461.

[154] In this context, the uncertainty involves whether an amount determined under Code Sec. 751 would be eligible for the Code Sec. 245A DRD; former Code Sec. 902 gave rise to similar issues.

[155] *See supra*, Part III.A.

[156] Notably, in contrast to Code Sec. 951(b), which refers to ownership both by vote and by value in defining U.S. Shareholder, Code Sec. 1248 refers only to ownership by vote. While the ultimate reason for this disconnect is unknown, it seems likely that it represents a legislative oversight as part of the TCJA, which amended Code Sec. 951(b). *See, e.g.,* Tax Technical and Clerical Corrections Act (Jan. 2, 2019) Discussion Draft §4(kk) (an unenacted bill introduced by former House Ways and Means Committee Chairman Brady that would have aligned Code Secs. 951(b) and 1248).

[157] SCt, 603 US 369, 144 SCt 2244 (2024).

[158] 87 FR, 3650; *cf*. T.D. 9866 (84 FR 29288) (regarding former Reg. §1.951-1(h)).

[159] *See* NYSBA PTEP/Partnership Report, at 21.

[160] *Id.*

[161] The Court of Federal Claims recently issued an opinion rejecting the government's contention that Code Sec. 7805(a) serves "as some kind of *Loper Bright* exception." *See Keysight Technologies Inc.*, FedCl, No. 1:25-cv-00137, 2026-2 ustc ¶50,206.

[162] *See supra,* Part II.B.2; 89 FR, at 95377 and 95383.

[163] The government appeared to suggest this approach in T.D. 9960. 87 FR, at 3650; *see also* NYSBA PTEP/Partnership Report, at 21-22.

[164] From a normative perspective, a partner under this approach should be allocated a share of the partnership's common basis in the CFC stock. The proposed regulations, as described above, provide similar concepts (*e.g.*, Proposed Reg. §1.961-4(c)(3)). *See also* Proposed Reg. §§1.959-11(e)(2) and 1.952-1(c)(5)(ii); *supra*, at n. 152.

[165] Proposed Reg. §§1.959-1(c)(1) and 1.961-1(c). *See supra,* Part II.B.

[166] In adopting this approach, Treasury and the IRS cite Code Sec. 1373(a). 89 FR, at 95393. Whether Code Sec. 1373(a) independently supports this approach raises questions beyond the scope of this article. *See* Lemons PTEP and S Corporations, at 679–682.

[167] The statutory and regulatory model for derived basis—Code Sec. 743(b)—does not apply to S corporations. So, an example showing the application of derived basis principles to a covered shareholder's *pro-rata* share of an S corporation's income could illustrate the intended mechanics.

[168] This example would also address concerns that the 2024 Proposed Regulations might require "special allocations" of S corporation income—potentially in tension with Code Sec. 1377(a)—to account for non-covered shareholder owners. In my view, the proposed regulations do not require special allocations for either S corporations or domestic partnerships: the aggregate approach effectively treats relevant amounts as taken into account at the shareholder level, and derived basis operates to reduce a covered shareholder's *pro-rata* share under Code Sec. 1377(a) at the shareholder level, rather than through entity-level reallocation. An illustrative example would help eliminate any uncertainty.

[169] *See* Lemons PTEP and S Corporations, at 691–92.

[170] As noted above, Treasury and the IRS issued guidance allowing an S corporation to elect entity treatment in limited circumstances. Proposed Reg. §1.958-1(e) (87 FR 3890) and section 3.02 of Notice 2020-69, IRB 2020-39, 604.

[171] Code Sec. 1368(e)(1); Reg. §1.1368-2; *see also* S. Rep. No. 354, at 3258 (1982).

[172] Reg. §1.1368-2 arguably reaches this result currently, but explicit confirmation or coordination would be welcomed.

[173] As discussed in part III.E, the mechanical rules for derived basis could be clarified to illustrate the basis consequences of a PTEP distribution received by a partnership. When an election under Notice 2020-69 is applicable, both the S corporation and its owners could be covered shareholders, in which case the rules regarding distributions of PTEP apply to the S corporation as a covered shareholder before applying to its owners as covered shareholders. Proposed Reg. §1.959-11(d); Proposed Reg. §1.961-13(c). In such a case, an increase to the S corporation's AAA for a PTEP distribution would be duplicative to the extent of the S corporation's PTEP, so the illustration in this paragraph would be limited to PTEP as to the covered shareholders that are owners of the S corporation, rather than the S corporation itself.

[174] Reg. §1.959-1(b) and Reg. §1.961-1(b). This would impact, for example, the definition of derivative ownership unit.

[175] *See*, *e.g.*, NYSBA PTEP/Partnership Report, at 24–31; Jackel PTEP and Partnerships, at 269. An additional example could be modeled on Proposed Reg. §1.961-12(c)(4)(iv).

[176] Proposed Reg. §§1.961-4(c)(1) and (c)(2)(i). *See also* 89 FR, 95380 (describing Proposed Reg. §1.961-4(c)(1) as applying to "covered shareholder partners treated as receiving PTEP …").

[177] *See* NYSBA PTEP/Partnership Report, at 18; Jackel PTEP and Partnerships, at 268.

[178] This clarification would not relate to derived basis as such—which provides partner-specific, rather than common, basis—but would relate to the tax effect of partnership-level items involving a derivative ownership unit. *See*, *e.g.*, Reg. §§1.704-1(m)(2) and (3) and 1.743-1(j)(2).

[179] Code Secs. 6221–6241 form the regime enacted by the Bipartisan Budget Act of 2015, P.L. 114-74 (collectively, the "BBA Rules").

[180] Code Sec. 6226(a) permits a partnership to elect to "push out" the imputed underpayment.

[181] Reg. §301.6241-1(a)(6)(iii).

[182] Reg. §301.6241-1(a)(6)(v). The derived basis rules, while modeled off of Code Sec. 743(b) adjustments, do not provide reporting rules akin to Reg. §1.743-1(k).

[183] Reg. §301.6241-1(a)(6)(iii).

[184] NYSBA PTEP/Partnership Report, 16–17.