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Proposed regulations: Guidance under section 951(a) on pro rata share of subpart F income, tested income, or tested loss of CFCs

The U.S. Treasury Department and IRS today released **proposed regulations** (REG-115646-25) under section 951(a) and section 951A, as amended by Pub. L. No. 119-21 (known as the “One Big Beautiful Bill Act” (OBBBA)), for determining a U.S. shareholder’s pro rata share of subpart F income, tested income, or tested loss of a controlled foreign corporation (CFC). The proposed regulations also provide guidance on the transition rule that was announced in Notice 2025-75.

Background

Section 951(a)(1) (as amended by the OBBBA) requires a U.S. shareholder that owns (under section 958(a)) stock in a CFC on any day during the tax year to include in income its pro rata share of that CFC’s subpart F income even if the shareholder does not own such stock on the last day of the year on which the foreign corporation is a CFC (i.e., the prior “last day” rule of section 951(a)(1) was eliminated). However, a U.S. shareholder will continue to have a section 956 inclusion with respect to a foreign corporation only if it owned stock in such corporation on the last day in the corporation’s tax year on which such corporation is a CFC.

Under section 951(a)(2) (as amended by the OBBBA), a U.S. shareholder’s pro rata share of a CFC’s subpart F income for a “CFC year” (i.e., a tax year in which a foreign corporation is a CFC at any time during the year) is the portion of such income that is attributable to (A) the stock of such corporation owned (under section 958(a)) by such shareholder, and (B) any period of the CFC year during which (i) such shareholder owned such stock, (ii) such shareholder was a U.S. shareholder, and (iii) such corporation was a CFC.

Under section 951(a)(3) (as amended by the OBBBA), a CFC inclusion for a CFC year is included in a U.S. shareholder’s gross income for the shareholder’s tax year that includes the last day during such CFC year on which the shareholder owns the stock in the CFC.

Section 951(a)(4) provides that the Treasury Secretary shall prescribe necessary or appropriate guidance to carry out the purposes of the amended rules, including by regulations or other guidance allowing or requiring a foreign corporation to close its tax year upon a direct or indirect disposition of stock of such corporation.

The OBBBA also made conforming changes to section 951A such that the new rules are also generally used for calculating a U.S. shareholder’s pro rata share of CFC tested items for net CFC tested income (NCTI) inclusion purposes.

The amended rules under sections 951(a) and 951A generally apply to tax years of foreign corporations beginning after December 31, 2025. A special transition rule, however, provides that, except as provided by the Treasury Secretary, a dividend paid by a CFC is not treated as a dividend for purposes of applying section 951(a)(2)(B) if the dividend does not increase the taxable income of a U.S. person that is subject to U.S. federal income tax for the tax year and either (1) the dividend was paid on or before June 28, 2025, during the tax year of the CFC which includes such date and the U.S. shareholder did not own the stock of such CFC during the portion of such tax year on or before June 28, 2025, or (2) the dividend was paid after June 28, 2025, and before such CFC's first tax year beginning after December 31, 2025.

Treasury and the IRS released **Notice 2025-75** in December 2025, describing rules expected to be included in forthcoming proposed regulations regarding the application of the transition rule, including rules addressing the meaning of dividends paid or deemed paid by a CFC and the determination of whether a dividend does not increase the taxable income of a U.S. person subject to federal income tax.

The OBBBA added section 951B, which generally applies the CFC inclusion rules to "foreign controlled United States shareholders" (F-USSHs) of "foreign controlled foreign corporations" (F-CFCs). An F-USSH is any U.S. person that would be a U.S. shareholder with respect to any foreign corporation if the ownership threshold were more than 50% instead of 10% and the constructive ownership rules in section 958(b) were applied without regard to section 958(b)(4). An F-CFC is any foreign corporation, other than a CFC, that is held more than 50% by F-USSHs, applying the rules of section 958(a) or (b), without regard to section 958(b)(4).

Proposed regulations

The proposed regulations would provide rules under sections 951 and 951A for determining a U.S. shareholder's pro rata share of a CFC's subpart F income, tested income, or tested loss, and would also provide rules for the application of the transition rule that are consistent with the rules described in Notice 2025-75. The proposed regulations would also modify information reporting regulations under section 6038 and the applicability date of certain regulations under sections 245A and 1502.

The proposed regulations provide that generally, in cases in which there is no change of ownership of stock of a CFC during its taxable year, a U.S. shareholder's pro rata share would be the same as determined under the existing rules in Treas. Reg. § 1.951-1(e). However, to address changes in ownership of stock of a CFC, the proposed regulations would generally apply a daily proration approach to allocating subpart F income, tested income, or tested loss to U.S. shareholders, based on the number of days in the year a U.S. shareholder owned stock in a CFC, and, in certain cases, would require or permit a closing of the tax year.

The proposed regulations would require a closing of a foreign corporation's tax year only in circumstances in which the change in ownership of stock of a foreign corporation results in the foreign corporation becoming or ceasing to be a CFC (i.e., a "status change event") (subject to certain modifications for determining CFC status that generally are intended to prevent avoidance of the rule). The tax year of the foreign corporation closes as of the end of the day on which the status change event occurs, which is the last day that the foreign corporation is or is not a CFC (unless the taxable year otherwise closes as of such date under another provision of the Code, for example, as a result of a section 338(g) election).

For changes in the ownership of stock of a CFC involving unrelated persons that result in shifts of ownership of more than 50% in ownership of CFC stock by section 958(a) U.S. shareholders (a "significant ownership variance"), the proposed regulations would provide an election to close the CFC's tax year. A significant ownership variance generally occurs if specified transfers result in a decrease by more than 50% in section 958(a) shareholder ownership. For this purpose, a specified transfer generally includes a change in the ownership of the stock of a CFC resulting from a sale, exchange, or other disposition of stock of a foreign corporation or a partnership interest, as well as an issuance of stock or a partnership interest. However, the proposed regulations would generally provide that, in determining whether there is a significant ownership variance, the percentage of ownership of stock of the CFC owned by section 958(a) U.S. shareholders is not treated as decreasing to the extent there is an increase in the percentage of ownership of stock of the CFC by a related U.S. person. If the election is made, the tax year of the CFC closes for all shareholders of the foreign corporation and for all purposes of the Code as of the end of the day on which such significant ownership variance occurs.

The preamble to the proposed regulations states that pursuant to the application of section 951B, the proposed regulations under sections 951 and 951A would apply to F-USSHs and F-CFCs in the same manner. The election to close the tax year of a foreign corporation under Prop. Treas. Reg. § 1.951-1(d)(2) would not be available to F-USSHs with respect to a F-CFC because such shareholders cannot own the requisite percentage of stock of an F-CFC (more than 50% of the vote or value) for a significant ownership variance to occur. The mandatory closing of a foreign corporation's tax year under Prop. Treas. Reg. § 1.951-1(d)(2), however, is required if a foreign corporation becomes or ceases to be a F-CFC.

In addition, the proposed regulations would provide rules addressing partnerships and the allocation of foreign income taxes in connection with a mandatory or elective closing of the foreign corporation's tax year.

The proposed regulations would also amend the applicability date of Treas. Reg. § 1.1502-80(j) to clarify that it applies only to the extent former section 951(a)(2)(B) is applicable and the applicability date of the extraordinary reduction rules in Treas. Reg. § 1.245A-5(e) and (f) to provide that such rules would not apply for tax years of foreign corporations beginning after December 31, 2025.

The preamble to the proposed regulations also states that (1) Treasury and the IRS are studying the regulations under section 1248, and revisions to those regulations may be proposed in a separate guidance project and comments are requested on the extent to which revisions to the regulations under section 1248 are necessary to coordinate with the proposed regulations under sections 951 and 951A, and (2) Treasury and the IRS intend to modify the proposed regulations under sections 959 and 961 regarding previously taxed earnings and profits (PTEP) issued in December 2024 to reflect the amendments to sections 951 and 951A made by the OBBBA and the rules in the proposed regulations in a separate guidance project.

The proposed regulations are generally proposed to apply to tax years of foreign corporations beginning after December 31, 2025, and to tax years of U.S. shareholders for which such tax years of those foreign corporations are relevant. The preamble to the proposed regulations states that taxpayers may rely on all aspects of the proposed regulations before the date the regulations are finalized, provided the taxpayer and its related parties follow the proposed regulations in their entirety and in a consistent manner. The preamble also specifically states that the Treasury Department and IRS expect to finalize the proposed regulations by January 4, 2027.

Comments on the proposed regulations are due by October 26, 2026.

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