

**Reg. 1.951A-2(c)(8)(iii)(A),
Example 1**

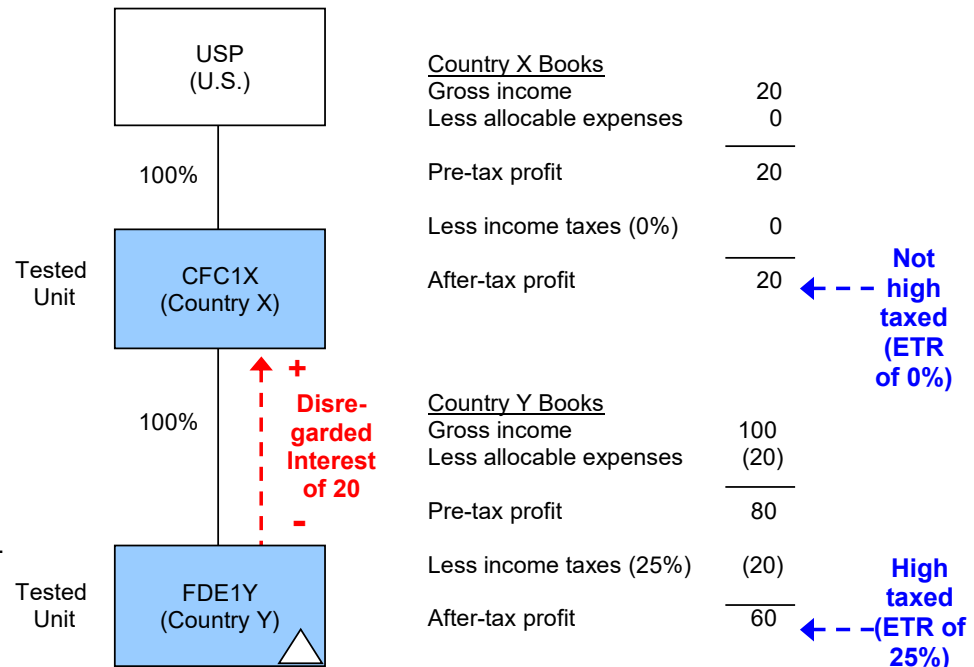
**GILTI High Tax Exception:
Payment of Disregarded Interest**

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(1) Facts—(i) Ownership. USP owns all of the stock of CFC1X, and CFC1X owns all of the interests of FDE1Y.

(ii) Gross income and deductions (other than for foreign income taxes). In Year 1, CFC1X generates €100x of gross income from services to unrelated parties that would be gross tested income without regard to paragraph (c)(7) and that is properly reflected on the books and records of FDE1Y. The €100x of services income is general category income under Reg. 1.904-4(d). In Year 1, FDE1Y accrues and pays €20x of interest to CFC1X that is deductible for Country Y tax purposes but is disregarded for federal income tax purposes. The €20x of disregarded interest income received by CFC1X from FDE1Y is properly reflected on CFC1X's books and records, and the €20x of disregarded interest expense paid from FDE1Y to CFC1X is properly reflected on FDE1Y's books and records.

(iii) Foreign income taxes. Country X imposes no tax on net income, and Country Y imposes a 25% tax on net income. For Country Y tax purposes, FDE1Y (which is not disregarded under Country Y tax law) has €80x of taxable income (€100x of services income from the unrelated parties, less a €20x deduction for the interest paid to CFC1X). Accordingly, FDE1Y incurs a Country Y income tax liability with respect to Year 1 of €20x (€80x x 25%), the U.S. dollar amount of which is \$20x.



(2) Analysis—(i) Tentative gross tested income items. Under paragraph (c)(7)(ii)(A), the tentative gross tested income item with respect to each of the CFC1X tested unit and the FDE1Y tested unit is the aggregate of the gross income of CFC1X that is attributable to the tested unit, that would be gross tested income (without regard to paragraph (c)(7)), and that would be in a single tested income group. Under paragraphs (c)(7)(ii)(B)(1) and (2), items of gross income of CFC1X are attributable to the CFC1X tested unit, or the FDE1Y tested unit, to the extent properly reflected on its separate set of books and records, as determined under federal income tax principles and adjusted to take into account disregarded payments. Without regard to the €20x disregarded interest payment from FDE1Y to CFC1X, gross income attributable to the CFC1X tested unit would be €0 (that is, the €20x of interest income reflected on the books and records of CFC1X would be reduced by €20x, the amount attributable to the payment that is disregarded for federal income tax purposes). Similarly, without regard to the €20x disregarded interest payment from FDE1Y to CFC1X, gross income attributable to the FDE1Y tested unit would be €100x (that is, €100x of services income reflected on the books and records of FDE1Y, unreduced by the €20x disregarded interest payment from FDE1Y to CFC1X). However, under paragraph (c)(7)(ii)(B)(2), the gross income attributable to each of the CFC1X tested unit and the FDE1Y tested unit is adjusted by €20x, the amount of the disregarded interest payment from FDE1Y to CFC1X that is deductible for Country Y tax purposes. Accordingly, the tentative gross tested income item attributable to the CFC1X tested unit (the “CFC1X tentative gross tested income item”) is €20x (€0 + €20x), and the tentative gross tested income item attributable to the FDE1Y tested unit (the “FDE1Y tentative gross tested income item”) is €80x (€100x – €20x).

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(ii) Foreign income tax deduction. Under paragraph (c)(7)(iii)(A), CFC1X's tentative tested income items are computed by treating the CFC1X tentative gross tested income item and the FDE1Y tentative gross tested income item each as income in a separate tested income group (the "CFC1X income group" and the "FDE1Y income group") and by allocating and apportioning CFC1X's deductions for current year taxes under the principles of Reg. 1.960-1(d)(3)(ii) (CFC1X has no other deductions to allocate and apportion). Under paragraph (c)(7)(iii)(A), the €20x deduction for Country Y income taxes is allocated and apportioned solely to the FDE1Y income group (the "FDE1Y group tax"). None of the Country Y taxes are allocated and apportioned to the CFC1X income group under paragraph (c)(7)(iii)(B) and the principles of Reg. 1.904-6(a)(2)(ii)(A), because none of the Country Y tax is imposed solely by reason of the disregarded interest payment.

(iii) Tentative tested income items. Under paragraph (c)(7)(iii), the tentative tested income item with respect to the CFC1X income group (the "CFC1X tentative tested item"), is €20x. The tentative tested income item with respect to the FDE1Y income group (the "CFC1X tentative tested item") is €60x (the FDE1Y tentative gross tested income item of €80x, less the €20x deduction for the FDE1Y group tax).

(iv) Foreign income tax paid or accrued with respect to a tentative tested income item. Under paragraph (c)(7)(vii), the foreign income taxes paid or accrued with respect to a tentative tested income item is the U.S. dollar amount of the current year taxes that are allocated and apportioned to the related tentative gross tested income item under the rules of paragraph (c)(7)(iii). Therefore, the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item is \$20x, the U.S. dollar amount of the FDE1Y group tax. The foreign income tax paid or accrued with respect to the CFC1X tentative tested income item is \$0, the U.S. dollar amount of the foreign tax allocated and apportioned to the CFC1X tentative gross tested income item under paragraph (c)(7)(iii).

(v) Effective foreign tax rate. The effective foreign tax rate is determined under paragraph (c)(7)(vi) by dividing the U.S. dollar amount of foreign income taxes paid or accrued with respect to each respective tentative tested income item by the U.S. dollar amount of the tentative tested income item increased by the U.S. dollar amount of the relevant foreign income taxes. Therefore, the effective foreign tax rate with respect to the FDE1Y tentative tested income item is 25%, computed by dividing \$20x (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item under paragraph (c)(7)(vii)) by \$80x (the sum of \$60x, the U.S. dollar amount of the FDE1Y tentative tested income item, and \$20x, the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the FDE1Y tentative tested income item). The CFC1X tentative tested income item is not subject to any foreign income tax, so is subject to an effective foreign tax rate of 0%, calculated as \$0 (the U.S. dollar amount of the foreign income taxes paid or accrued with respect to the CFC1X tentative tested income item) divided by \$20x (the U.S. dollar amount of the CFC1X tentative tested income item).

(vi) Gross income items excluded under sections 954(b)(4) and 951A(c)(2)(A)(i)(III). The FDE1Y tentative tested income item is subject to an effective foreign tax rate (25%) that is greater than 18.9% (90% of the maximum rate of tax specified in section 11). Therefore, the requirement of paragraph (c)(7)(i)(B) is satisfied, and the FDE1Y tentative gross tested income item qualifies under paragraph (c)(7)(i) for the high-tax exception of section 954(b)(4) and is excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii). The CFC1X tentative tested income item is subject to an effective foreign tax rate of 0%. Therefore, the CFC1X tentative tested income item does not satisfy the requirement of paragraph (c)(7)(i)(B), and the CFC1X tentative gross tested income item does not qualify under paragraph (c)(7)(i) for the high-tax exception of section 954(b)(4) and is not excluded from tested income under sections 951A(c)(2)(A)(i)(III) and 954(b)(4) and paragraph (c)(1)(iii).

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