Tax Insights
from International Tax
Services

Treasury proposes new CFC pro rata share rules

August 27, 2026

In brief

What happened?

Treasury and the IRS on August 26 published proposed regulations implementing the One Big Beautiful Bill Act (OBBBA) changes to the controlled foreign corporation (CFC) pro rata share rules under Sections 951 and 951A. Most significantly, the proposal would allocate subpart F income, tested income, and tested loss based on the period during which a US shareholder directly or indirectly owns CFC stock, generally using daily proration, rather than limiting Section 951(a)(1)(A) inclusions to shareholders that own stock on the last day of the tax year of the foreign corporation on which it was a CFC (the last relevant day).

The proposal also would require a CFC tax year to close when the corporation becomes or ceases to be a CFC and would permit an elective closing for certain significant ownership shifts exceeding 50 percentage points. It also addresses transition-period dividends, related Form 5471 reporting, midyear stock issuances and redemptions, and the phaseout of the Reg. 1.245A-5 extraordinary reduction rules for later CFC tax years.

Why is it relevant?

The proposed regulations could change the tax consequences of CFC acquisitions and dispositions because a seller may retain a subpart F or tested-income allocation for its ownership period even though it no longer owns the CFC at year-end. Mandatory or elective year closings also could affect the timing of inclusions, Section 956 computations, foreign tax allocations, short-period reporting, and the information that buyers and sellers must exchange after closing.

The rules generally implement the statutory changes made by the OBBBA, while providing specific approaches for applying those changes, particularly daily proration as the general rule and a greater-than-50-percentage-point threshold for elective year closings. The proposal also would phase out the extraordinary reduction rules under Reg. 1.245A-5 once the revised pro rata share rules apply.

Actions to consider

Taxpayers should identify 2025 transition-period dividends and 2026 CFC ownership changes that could be affected, model the consequences of daily proration versus a mandatory or (where available) elective year closing, and review transaction agreements for provisions addressing elections, short-period returns, information sharing, foreign tax allocations, and Form 5471 reporting. Taxpayers considering early reliance also should evaluate whether they and their related parties can apply the proposed regulations in their entirety and consistently, as required by the proposal.

Companies should consider providing comments on the proposed regulations, which are due by October 26, 2026.

In detail

Background

The OBBBA amended Sections 951(a) and 951A to change how a US shareholder determines its pro rata share of a CFC's subpart F income, tested income, and tested loss. For foreign corporation tax years beginning after December 31, 2025, the revised rules generally attribute those amounts based on the stock a US shareholder owns and the period during which the shareholder owns that stock while the corporation is a CFC. This replaces the prior approach under Section 951(a)(1)(A), which generally depended on ownership on the last relevant day and applied the former Section 951(a)(2)(B) dividend-reduction rules.

The OBBBA also established a transition rule for certain dividends during the transition period. On December 4, 2025, Treasury and the IRS issued Notice 2025-75, describing rules expected to be included in the proposed regulations, including rules for determining when a dividend is paid or deemed paid and whether it increases the taxable income of a US person subject to federal income tax. For additional discussion of Notice 2025-75, see this PwC Tax Insight.

Proposed regulations

The proposed regulations implement the revised pro rata share rules under Sections 951 and 951A, address the OBBBA transition rule described in Notice 2025-75, and provide related reporting and coordination rules. The principal provisions are discussed below.

Pro rata share and ownership-change rules

Proposed Reg. 1.951-1 generally would require a US shareholder that owns CFC stock during any portion of a CFC year to include its pro rata share of subpart F income attributable to the period during which it owns the stock while it is a US shareholder and the foreign corporation is a CFC. The inclusion is taken into account in the shareholder tax year containing the last day on which that shareholder owns stock during the CFC year.

For a CFC with one class of stock and a constant number of outstanding shares, the proposed regulations generally use daily proration. A shareholder's pro rata share reflects both its ownership percentage and the portion of the CFC year during which it owned the stock while it was a US shareholder and the foreign corporation was a CFC. Shares within a class that are owned for the same period are treated as a separate 'CFC year block.' If a US shareholder owns different numbers of shares during the CFC year, the daily-proration rule is applied separately to each CFC year block, and the resulting amounts are aggregated to determine the US shareholder's pro rata share of subpart F income for the CFC year.

Where a CFC has multiple classes of stock, the proposed regulations retain a hypothetical-distribution analysis to allocate subpart F income among classes before applying the ownership-period rules, applied at the end of the CFC's tax year. Changes in outstanding shares, including issuances and redemptions, generally are addressed through a weighted-average share count. The proposed regulations also include an anti-abuse rule for transactions or arrangements undertaken with a principal purpose of changing allocations to avoid federal income tax.

Proposed Reg. 1.951A-1 would apply the same general methodology to tested income and tested loss, subject to special rules governing the allocation of tested loss among classes of stock and the allocation of subsequent tested income to classes that were previously allocated tested loss. It also conforms the regulations to the OBBBA's replacement of the former GILTI inclusion amount with net CFC tested income (NCTI) and removes provisions relating to qualified business asset investment, tested interest expense, and tested interest income.

Observation: While Treasury and the IRS assert daily proration provides an administrable default rule, it may not correspond to the CFC's actual economic income earned during a particular shareholder's ownership period and could create administrative challenges for share transfers between unrelated persons. Those issues increase the importance of the tax-year-closing rules described below.

Mandatory and elective CFC year closings

The proposed regulations would require a foreign corporation's tax year to close when a status change event occurs, meaning the corporation becomes or ceases to be a CFC. The closing occurs at the end of the status-change day and applies for all purposes of the Code and to all shareholders. Special rules apply in determining CFC status for this purpose where stock is held through domestic partnerships or attributed through options. These rules generally ensure that CFC status is determined by reference to the US shareholders that are subject to income inclusions under Sections 951 and 951A and treat CFC stock held by a domestic partnership as held directly by the partnership's US shareholder partners. As a result, dispositions or acquisitions of CFC stock between a domestic partnership and a domestic corporation could result in a status change event. Additionally, for purposes of Sections 951 through 964, the proposed regulations generally treat the transferor as owning the stock through the disposition date, while the transferee's ownership begins on the following day.

Observation: Under Section 951B, as enacted as part of the OBBBA, subpart F generally applies to foreign controlled foreign corporations (FCFCs) as well, subject to special rules of application. A status change event includes an event in which a corporation becomes or ceases to be an FCFC, as well as an event in which a CFC becomes an FCFC or vice versa.

A separate elective rule applies to certain substantial changes in CFC ownership. Controlling Section 958(a) US shareholders may elect to close the CFC's tax year if specified transfers undertaken under the same plan result in a decrease of more than 50 percentage points, by vote or value, in ownership by the relevant Section 958(a) US shareholders. Related-party ownership increases generally offset decreases, and certain Section 368(a)(1)(F) reorganizations are disregarded.

The election generally requires a written, binding agreement among relevant shareholders and the filing of an “Elective Section 951 Year-Closing Statement” with the controlling shareholders' timely filed original returns, including extensions. If significant ownership variances occur with respect to multiple CFCs under the same plan or series of related transactions, the election generally must be made consistently for all affected CFCs.

A year closing also could divide a foreign corporation's US tax year without closing its foreign tax year. In that case, the proposed regulations allocate a portion of the foreign income tax that accrues later to the short US tax year ending on the closing date, generally based on foreign taxable income attributable to the pre-closing period.

The proposal would not automatically close the tax year of a partnership in which the foreign corporation is a partner. Treasury and the IRS specifically request comments on whether a CFC year closing should instead be treated as a deemed disposition of the partnership interest for Section 706 purposes.

Observation: The elective closing could be a significant transaction-modeling decision. Purchase agreements may need to address the election, short-period compliance, post-closing information access, foreign tax allocations, and consistency across multiple CFCs. Furthermore, an elective closing cannot be made when a US corporation that owns the CFC departs or joins a consolidated group, even though that corporation’s tax year will close. Finally, the ability to make an elective closing could be difficult in tiered-partnership structures where there is little visibility to ownership changes by ultimate Section 958(a) shareholders.

Reporting and related compliance consequences

The proposed amendments to Reg. 1.6038-2 would revise and clarify the information potentially required on Form 5471. The information includes classes of stock, beginning share counts, issuances and redemptions, other changes in outstanding shares, and changes in direct and indirect ownership during the annual accounting period.

The proposed regulations also would clarify that Form 5471 may require information not specifically enumerated in the regulation, consistent with the broader information-reporting authority in Section 6038(a).

Observation: Taxpayers whose processes have focused primarily on year-end CFC ownership may need more detailed equity and transaction records to support daily allocations, weighted-average share counts, and ownership-change reporting.

Interaction with other international tax rules

The proposed regulations do not amend the Section 960 regulations for allocating CFC taxes. Treasury and the IRS state that those rules should continue to determine deemed-paid foreign taxes appropriately, although changes in the underlying Section 951 and 951A inclusions may affect the resulting foreign tax credit computations.

The proposed regulations would eliminate the extraordinary reduction rules in Reg. 1.245A-5(e) and (f) for foreign corporation tax periods beginning after December 31, 2025, based on Treasury's view that those rules are no longer necessary under the revised pro rata share regime. The proposed regulations similarly limit the application of Reg. 1.1502-80(j), which addresses former Section 951(a)(2)(B), to periods for which the former statutory rule remains relevant.

Treasury and the IRS are separately studying possible changes to the Section 1248 regulations and state that the previously taxed earnings and profits (PTEP) proposed regulations published in December 2024 will be modified in a separate guidance project to reflect the OBBBA and the new pro rata share rules.

Observation: The Reg. 1.245A-5 phaseout removes an overlapping transaction rule, but additional coordination guidance under Section 1248 and the PTEP rules should continue to be monitored.

Transition rule

Proposed Reg. 1.951-4 generally follows Notice 2025-75, including the rules for determining whether a covered dividend increases the taxable income of a US person subject to federal income tax and the related substantiation requirements. For additional discussion, see our prior PwC Tax Insight.

Observation: The transition rule could create significant substantiation requirements, particularly for transactions completed before publication where taxpayers may need to reconstruct the recipient's federal income tax treatment of relevant dividends.

Early reliance

Taxpayers may rely on the proposed regulations before they are finalized, provided the taxpayer and its related parties, within the meaning of Sections 267(b) and 707(b)(1), follow the proposed rules in their entirety and consistently. This condition could require taxpayers to evaluate the effects of early reliance across related entities and affected CFCs rather than on a transaction-by-transaction or provision-by-provision basis.

Applicability dates

The proposed regulations provide different applicability rules for the revised pro rata share provisions and the OBBBA transition period. The principal dates are summarized below.

Provision	**Applicability**
Revised Section 951 inclusion, pro rata share, and tax-year-closing rules	Tax years of foreign corporations beginning after December 31, 2025, and relevant US shareholder tax years
Revised tested income and tested loss rules	Tax years of foreign corporations beginning after December 31, 2025, subject to the special Section 951A overlap rule
Revised Form 5471 information reporting	Tax years of foreign corporations beginning after December 31, 2025
Reg. 1.245A-5 extraordinary reduction rules generally cease to apply	Tax periods of foreign corporations beginning after December 31, 2025
OBBBA dividend transition rule	Foreign corporation tax years that include June 28, 2025, or begin after June 28, 2025, and before the first tax year beginning after December 31, 2025

Section 951A overlap rule	Certain foreign corporation years beginning after December 31, 2025, that end within a US shareholder year beginning on or before December 31, 2025
Early reliance on proposed regulations	Permitted before finalization if the taxpayer and its related parties apply the proposed regulations in their entirety and consistently

See also

- **Tax Insight:** Highlights of Treasury guidance on OBBBA international tax items (December 10, 2025)
- **Tax Insight:** Key updates and insights of the PTEP proposed regulations (December 11, 2024)

Let's talk

For a deeper discussion of how these proposed regulations might affect your business, please contact:

International Tax Services

Wade Sutton
+1 (202) 657-7461
wade.sutton@pwc.com

Aaron Junge
+1 (202) 739-1053
aaron.junge@pwc.com

Marty Collins
+1 (301) 326-6440
marty.collins@pwc.com

Laura Williams
+1 (202) 948-5214
laura.elizabeth.williams@pwc.com

Mergers and Acquisitions – Sub C

Julie Allen
+1 (703) 965-9353
julie.allen@pwc.com

Olivia Orobona
+1 (202) 549-5127
olivia.ley.orobona@pwc.com

Jon Lewbel
+1 (202) 701-4508
jonathan.lewbel@pwc.com

Mergers and Acquisitions – Sub K

Mike Hauswirth
(202) 213-2729
michael.j.hauswirth@pwc.com

Sarah Haradon
(312) 810-5535
sarah.haradon@pwc.com