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February 18, 2020

Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Via: Online Submission

RE: Proposed Foreign Tax Credit Regulations [REG-105495-19]

Dear Sir or Madam:

The Internal Revenue Service (the Service) and the United States Department of the Treasury (together, the Government) published proposed regulations regarding issues related to the U.S. foreign tax credit on December 17, 2019 (the Proposed Regulations).[1] The Government requested comments from interested stakeholders no later than February 18, 2020. I am pleased to respond to the Government's request for comments on behalf of Tax Executives Institute, Inc. (TEI).

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in North and South America, Europe and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting sound tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world.[2] We believe the diversity and professional experience of our members – who work across all industries – enables TEI to bring a balanced and practical perspective to the issues raised by the Proposed Regulations.

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[1] *See* 84 Fed. Reg. 69,124 [REG-105495-19].

[2] TEI is a corporation organized under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. federal income taxation under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended) (the Code). Hereinafter, all "section" references are to the Code and all "§" references are to the Treasury Regulations promulgated thereunder.

<u>TEI Comments</u>

TEI commends the Government for its work in issuing the Proposed Regulations, as well as finalizing related foreign tax credit regulations published in the Federal Register on the same date.[3] These regulations continue the Government's exemplary effort to provide guidance under Pub. L. 115-97, colloquially known as the "Tax Cuts and Jobs Act" (TCJA). The TCJA, however, has made it more difficult for taxpayers to claim a foreign tax credit for adjusted foreign taxes, both substantively and administratively. This is particularly the case for foreign tax redeterminations under section 905(c). The Proposed Regulations should be modified to ease the compliance burden on taxpayers who have such redeterminations, as set forth below. We also recommend changes to the Proposed Regulations treatment of payments to foreign disregarded entities and "stewardship expenses."

<u>Administrative Issues Under Section 905(c)</u>

The process for obtaining a foreign tax credit for foreign taxes subject to adjustment by non-U.S. tax authorities has never been easy or straightforward. The Proposed Regulations, regrettably, include additional unnecessary administrative hurdles taxpayers must overcome to obtain a foreign tax credit for adjusted foreign taxes, which were not required by the prior regulations under section 905(c). The change from the pre-TCJA system of foreign tax credit pools to the post-TCJA system, along with the TCJA's global intangible low-taxed income (GILTI) and foreign derived intangible income (FDII) regimes, present additional complexities. Historically, for example, a foreign tax redetermination typically only impacted a single foreign entity. Under the new GILTI and FDII regimes, however, a foreign tax redetermination may affect the amounts calculated under such regimes, potentially requiring taxpayers to file amended returns for all their foreign entities. Such a redetermination, for example, will affect a taxpayer's current year taxes, which are apportioned across all U.S. shareholders, and thus impact all the Form 5471s filed by the taxpayer.

Obtaining tax credits for foreign tax redeterminations is particularly difficult due to their retrospective nature, apart from the new issues presented by the TCJA. The tax filings of a multinational enterprise's non-U.S. operations are, of course, subject to audit in non-U.S. jurisdictions. These audits, just as in the United States, often drag on for years before a final adjustment is issued or a settlement is reached. Taxpayers may also decide to litigate a foreign adjustment or elevate it to the mutual agreement procedure under the relevant bilateral income tax treaty after a completed audit, which further delays the final tax determination.[4] Further, non-U.S. advanced pricing agreements obtained by taxpayers often include rollback periods, which may require adjustments to the amount of foreign tax in a particular year and thus the amount of a taxpayer's foreign tax credit for such year. In addition, a taxpayer may deposit amounts with foreign tax authorities during a contested tax assessment to prevent the accrual of interest

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[3] *See* T.D. 9882, 94 Fed. Reg. 69,022 (Dec. 17, 2019).

[4] Indeed, the non-compulsory payment regulations may compel a taxpayer to litigate an adjustment in court, further delaying the final determination of foreign taxes for which a taxpayer may claim a credit. *See* Treas. Reg. § 1.901-2(e)(5).

and penalties while continuing to contest the underlying issues on the merits. Finally, in many instances non-U.S. tax returns are not filed until after the due date of a taxpayer's U.S. federal income tax return.

For all these reasons, the tax reported on a final, non-U.S. return may differ from the tax reported and claimed as a credit on the U.S. return (i.e., because the U.S. return is due before the non-U.S. return and therefore the U.S. return includes an estimate of the non-U.S. tax due). Thus, as acknowledged in the Code and regulations, the determination of the amount of foreign taxes which may be claimed as a credit is often not final until many years after a U.S. taxpayer has filed its return for the year at issue, the U.S. audit is completed, and the U.S. year is closed.[5] Even the ten year statute of limitations period for claiming a credit for foreign tax redeterminations may have passed in certain cases.

The process for taxpayers to claim a foreign tax credit after such an assessment should be as simple as possible, in light of the length of time it may take to obtain a final tax assessment from a non-U.S. jurisdiction. The Proposed Regulations, regrettably, would impose an unrealistic and, in our view, unnecessary burden on a taxpayer claiming a foreign tax credit after a redetermination. These burdens include:

1. Requiring taxpayers to file an amended return reflecting an adjustment to foreign taxes by the extended due date of the return for the year in which the adjustment occurred.[6] This can lead to multiple amended filings for foreign tax adjustments related to the same prior year. For example, assume a taxpayer receives notification of a change for 2016 in calendar year 2019. An amended return for 2016 must be filed by the 2020 return due date under the Proposed Regulations. Assume another change for 2016 occurs in 2020; 2016 (if the year is open) must be amended again by 10/15/2021 (if the second 2016 change was finalized after 10/15/2020).

2. Requiring the inclusion of an additional extensive disclosure with the current year tax return notifying the Service of any historical changes in foreign taxes resulting in additional tax due.[7]

3. Limiting amended returns to changes taking place only within two consecutive tax years.[8]

4. Requiring a notification to the Service's audit team within a 120-day window of any changes in foreign taxes resulting in additional U.S. tax liability for the years under audit.[9]

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[5] Financial reporting issues add to a taxpayer's overall U.S. government regulatory burden as foreign taxes and the associated (potential) foreign tax credit must be incorporated into a taxpayer's financial statements in the correct quarter and year, at least for publicly traded U.S. companies. Taxpayers may thus be faced with restating their financial statements if a foreign tax adjustment is material and no corresponding credit is available in the United States.

[6] Prop. Treas. Reg. § 1.905-4(b)(1)(i).

[7] *Id*. While the Government has not drafted a form for this purpose, the information requirements detailed in the regulations are onerous. *See* Prop. Treas. Reg. § 1.905-4(c)

[8] Prop. Treas. Reg. § 1.905-4(b)(1)(iv).

[9] Prop. Treas. Reg. § 1.905-4(b)(4)(ii)(A)-(C).

All these proposed filings and notification requirements are unduly burdensome and unnecessary, in TEI's view. The TCJA further complicates matters due to the transition tax under section 965,[10] the move away from foreign tax credit pooling for post-TCJA years, and as noted the FDII and GILTI regimes. Many multinational taxpayers anticipate their last taxable year prior to the TCJA's enactment remaining open indefinitely due to these administrative requirements and the changes wrought by the TCJA.[11]

Adding to the compliance burden of filing multiple amended federal returns is the requirement to file amended state and local returns. Filing an amended federal return will require filing of hundreds of amended state and local returns for many large multinational taxpayers. The number of amended state and local tax return filings may be in the thousands if multiple amended federal returns are filed. Filing so many amended state and local tax returns obviously requires state and local tax authorities to process and analyze such returns. But these amended state and local returns often result in little or no adjustment to a taxpayer's state and local tax liability, thus wasting the resources of state and local tax authorities.

The Service, moreover, lacks a simple administrative process for taxpayers claiming a refund or paying additional tax related to a foreign tax adjustment for past years. Paying additional U.S. tax or claiming a refund must typically be done manually as the Service's e-file schema (and thus private sector tax management software) limits the ability to file amended returns electronically to the current year and the prior two years. Taxpayers who have foreign tax adjustments in earlier years thus must file amended returns (or at least the amended schedules) on paper. Such returns may run into the hundreds or even thousands of pages depending on the structure of a taxpayer's foreign operations and, as noted in the example in 1. above, under the Proposed Regulations a taxpayer may be required to file multiple amended returns for the same year resulting in duplicative burdensome paper filings, not to mention the associated state and local tax return filing burden.

TEI recommends the Government allow taxpayers to take into account prior year foreign tax adjustments on their current year returns to solve these issues instead of requiring taxpayers to file amended returns. Taxpayers would continue to recompute their tax liability for the adjustment year (and all subsequent years, if necessary), along with all affected tax attributes, but any resulting tax due (including interest) or refund owed – taking into account any differences in the tax rate between the current and prior year – would be reported on the taxpayer's current return. A taxpayer would thus maintain in its books and records the necessary changes accompanying an amended return (or returns), only without being required to prepare and file such a return. The taxpayer would include a disclosure on its current year return under our recommended approach to notify the Service of the foreign tax redetermination. The disclosure could take the form of a "Section 905(c) Statement" notifying the Service of a taxpayer's prior year foreign tax redetermination, the affected year(s), and the amount of additional

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[10] For years prior to the effective date of the TCJA, for example, a refund of foreign taxes would increase the earnings and profits of the relevant foreign entity, which would increase the U.S. tax due under section 965 and thus the installment payment amount going forward (if the taxpayer elected to pay its transition tax in installments).

[11] Financial reporting issues may also arise if the change is not reported in the proper quarter.

U.S. tax owed or refund due as a result. Alternatively, the Service could amend Schedule E of Form 5471 to include information regarding prior year(s) foreign tax redeterminations for the entity to which Form 5471 relates and the associated change in the amount of a taxpayer's U.S. federal income tax in such prior year. To the extent a foreign tax redetermination relates to a year prior to the effective date for the taxpayer of the TCJA and a taxpayer has an ongoing liability under section 965 because it has elected to pay the section 965 transition tax in installments, the amount of the redetermination could be taken into account in an adjusted installment payment amount via a revised section 965 calculation. Permitting taxpayer to report foreign tax redeterminations on their current year return would simplify the compliance and administrative burden of taxpayers having to file multiple amended returns for the same year, possibly in the form of hundreds of pages of text.

TEI also recommends – either in addition to or in lieu of our recommendation above – the government adopt a *de minimis* exception to the administrative requirements of claiming foreign tax credits as a result of redeterminations under section 905(c). Such an exception should be computed as a percentage of a consolidated U.S. taxpayer's foreign tax paid in the year at issue.[12] We believe a *de minimis* threshold of ten percent of the amount of foreign tax paid would be appropriate. A ten percent threshold would be analogous to the ten percent threshold set by the prior section 905 proposed and temporary regulations, which did not require a full U.S. tax liability redetermination if the foreign tax paid by a foreign corporation reduced a domestic corporate shareholder's foreign taxes deemed paid under section 902 or 960 by less than ten percent.[13] While the prior ten percent threshold applied on a foreign entity-by-entity basis, such a system was appropriate under the pre-TCJA foreign tax credit pooling approach. In the post-TCJA environment, in contrast, applying a ten percent de minimis rule on a consolidated bases is more consistent with a consolidated approach. Taxpayers would simply report and pay any foreign tax redetermination on their current year return, without having to amend prior years, in a *de minimis* case.

Final regulations should also clarify whether multiple payments to foreign tax authorities pursuant to a single assessment (for example, payments to stop the running of interest and penalties) each result in a section 905(c) foreign tax redetermination. Revenue ruling 74-373 states: "deposits against [a] future [tax] liability" are only eligible for a foreign tax credit in the year in which the deposit is "actually applied as a deduction against an otherwise creditable" tax.[14] Thus such payments would not be subject to the section 905(c) redetermination rules until applied against a corresponding tax liability. Separately, revenue ruling 84-125[15] holds payments pursuant to an assessment of additional tax (even if the payment is only a partial payment such tax) is a creditable tax in the year in which the payment is made. The latter ruling potentially implies, in TEI's view, that multiple payments with respect to the same assessment across one or more taxable years require the same number of foreign tax

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[12] A percentage based *de minimis* rule for foreign tax redeterminations would be analogous to the subpart F *de minimis* rule in section 954(b)(3)(A)(i).

[13] *See* Treas. Reg. § 1.905-3T(d)(3)((ii) (2007).

[14] 1974-2 C.B. 203.

[15] 1984-2 C.B. 125.

redeterminations because such payments would be a creditable tax under the ruling. Taxpayers would be required to comply with the Proposed Regulations' attendant excessive compliance costs, as delineated above (e.g., amendment of prior year tax returns and/or a full re-computation of tax liability), if our view is correct. TEI requests the Government provide guidance on whether multiple tax payments regarding the same foreign tax assessment each constitute a foreign tax redetermination under section 905(c) and, if so, whether taxpayers must satisfy the compliance requirements of the Proposed Regulations for each such payment.

Apart from the above administrative issues related to the foreign tax credit under section 905(c), an important unanswered question is whether the same (or similar) rules under section 905(c) apply to taxpayers who elected to take a deduction for their foreign taxes paid in prior years in lieu of a credit (e.g., taxpayers who could not claim a foreign tax credit in such years). For example, does the ten-year statute of limitations apply to adjustments to such a deduction (rather than a credit)? Do the administrative rules in the Proposed Regulations also apply to taxpayers who claimed a deduction? TEI recommends the government clarify whether the Proposed Regulations, and the general rules under section 905(c), apply to taxpayers deducting foreign taxes rather than claiming a credit.

Other Issues under the Proposed Regulations

Assignment of foreign gross income to statutory and residual groupings

Proposed Treas. Reg. § 1.861-20(d), related to the assignment of items of foreign gross income to the statutory and residual groupings, would (effectively) disallow foreign tax credits related to foreign income derived by a branch in connection with a payment by the branch's U.S. owner to the branch (e.g., a payment by a U.S. entity to a foreign branch disregarded for U.S. tax purposes but regarded for foreign tax purposes). Such taxes would potentially be creditable if the foreign operations were conducted via an entity recognized for U.S. tax purposes or if the payor were not the branch's U.S. tax owner but nevertheless a related party. The Code should not discriminate against businesses conducted in branch form. While the exception for payments in exchange for property under Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(B) is helpful, it does not alleviate issues related to payments for services, royalties, or rents. TEI recommends the exception for payments in exchange for property be expanded to include payments for services, royalties, and rents to alleviate these issues.

Issues related to "stewardship" expenses

The Proposed Regulations provide a specific rule for the allocation and apportionment of "stewardship" expenses under the Treas. Reg. § 1.861-8 regulations regarding the computation of taxable income from sources within the United States and from other sources and activities.[16] The current regulations permit taxpayers to select one of a variety of methods to apportion their stewardship expenses.[17] The Proposed Regulations, in contrast, prescribe a single method of apportioning

16 *See* Prop. Treas. Reg. § 1.861-8(e)(4).

17 *See* Treas. Reg. § 1.861-8(e)(4)(ii).

stewardship expenses to gross income.[18] The Preamble posits a prescribed method is preferable to "provide certainty for taxpayers and the IRS . . . while ensuring that stewardship expenses are apportioned to gross income in a manner that reflects the purpose of the expenses to protect capital investments or to facilitate compliance with reporting, legal, or regulatory requirements."[19] TEI recommends the Government retain the current regulations' methodological flexibility for apportioning stewardship expenses because the current regulations better reflect different operating approaches across industries and business models.

TEI also recommends the Government permit the parent of a consolidated group to apportion some of its overall stewardship expenses to the management of its domestic subsidiaries. We agree that stewardship-type expenses are incurred in connection with "overseeing" functions, as defined under Treas. Reg. § 1.482-9(l)(3)(iii) and (iv) resulting from "duplicative activities" and "shareholder activities." We do not agree, however, that stewardship expenses can only relate to dividends and inclusions from foreign corporations.

Stewardship costs are economically linked to the oversight and protection of an investor's worldwide business endeavors, regardless of the geographical location or the taxpayer's choice of entity in making such investments. For example, duplicative stewardship expenses incurred by a U.S. taxpayer performing an internal audit of a directly held, wholly owned foreign subsidiary electing disregarded entity treatment under Treas. Reg. § 301.7701 are just as related to the business activities conducted through the foreign disregarded entity (giving rise to foreign branch income) as if those expenses were incurred with respect to a wholly owned controlled foreign corporation (an entity recognized for U.S. federal income tax purposes). Stewardship functions overseeing a foreign disregarded entity are indistinguishable from those overseeing a controlled foreign corporation and stewardship expenses should not be allocated and apportioned solely to income of one entity form and not the other. A taxpayer's choice to structure its foreign operations via a flow-through entity for U.S. federal income tax purposes should not change the fact that the taxpayer incurs "duplicative" and "shareholder-type" oversight activities in either structure. Such stewardship expenses definitely relate to income in the branch basket and arguably should be allocated and apportioned to such basket.[20]

Stewardship expenses also relate to the oversight, duplicative, and shareholder activities of domestic subsidiaries. The Government, however, has offered no rationale for changing its view that stewardship costs cannot relate to a taxpayer's investment in a domestic corporation, as is now suggested by the proposed change to Example 18 under Prop. Treas. Reg. § 1.861-8(g). Longstanding Example 18, prior to its proposed amendment by the Proposed Regulations, has held stewardship expenses are allocable and apportionable to investments in domestic subsidiaries.[21] We request the Government clarify whether this change to Example 18 is intended and, if so, the rationale for such change.

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[18] *See* Prop. Treas. Reg. § 1.861-8(e)(4)(ii).

[19] 84 Fed. Reg. 69,125.

[20] *See* Treas. Reg. § 1.861-8(a)(2).

[21] Treas. Reg. § 1.861-8(g).

TEI recommends Example 18 of the Proposed Regulations be modified in one of the following ways to return to the original understanding of stewardship expenses being allocable to domestic subsidiaries as well as foreign subsidiaries:

1. Some of the Tentative Stewardship amount of $540 should first be allocated (using a reasonable method) to domestic and foreign branch activity, and the remainder of the Tentative Stewardship falls within the definition of stewardship, or

2. The entire $540 falls within the amended definition of stewardship (i.e., because the definition of stewardship would be amended to specify stewardship expenses relate to a worldwide investments) and the entire $540 should be allocated across the worldwide tax basis of assets in the same manner as interest expense.

We encourage Treasury, in this regard, to amend Prop. Treas. Reg. § 1.861-8(e)(4)(ii)(A) to show stewardship expenses are allocable to other classes of gross income in addition to controlled foreign corporation (CFC) dividends, subpart F income, GILTI, and passive foreign investment company inclusions, or that a portion of the Tentative Stewardship amount is definitely allocable to domestic and foreign branch activities.

Alternatively, the definition of stewardship could be amended to align with the proposed allocation of stewardship expenses to items of income solely related to investments in CFCs. Such a change would amend the definition of stewardship to mean expenses incurred by any member of a consolidated group which solely relates to duplicative activities, oversight, or shareholder activities performed with respect to a CFC (or specified foreign corporation).

It would be helpful if the Government issued additional guidance on coordinating the allocation and apportionment rules of Prop. Treas. Reg. §§ 1.861-14(e)(4) and -14T(e)(4), regardless of the how the final rules allocate and apportion stewardship expenses. A comprehensive example would be useful to illustrate for taxpayers the intended outcome of the interaction of these sections, both of which relate to stewardship expenses. Treasury Reg. § 1.861-14T(e), however, also refers to "supportive" functions under the heading "stewardship expenses." We recommend Prop. Treas. Reg. § 1.861-14(e)(4) be amended to treat consolidated group members as a single corporation solely for purposes of determining the gross income of each member as the gross income base, upon which stewardship expenses are allocated and apportioned.

Finally, TEI agrees distinguishing stewardship expenses from supportive functions is problematic. We could not, in our discussions, develop a bright-line test to aid in a distinguishing between, for example, stewardship and general and administrative costs, as any such analysis would depend on a taxpayer's facts and circumstances. Should Treasury agree stewardship expenses are more appropriately allocable across worldwide gross income, however, then in TEI's view distinguishing between stewardship and supportive functions would be less important. Therefore, the Government should treat stewardship and supportive functions as "residual expenses" (i.e., costs incurred by the U.S. shareholder or consolidated group not providing a direct or indirect benefit) as controlled services

required to be charged out under the appropriate section 482 approach for ease of administrability.[22] Such residual expenses would then be allocated and apportioned to worldwide income based on a reasonable method.

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TEI appreciates the opportunity to comment on the Proposed Regulations. Should you have any questions regarding TEI's comments, please contact Benjamin R. Shreck of the Institute's legal staff at bshreck@tei.org or 202.464.8353.

Respectfully submitted,
TAX EXECUTIVES INSTITUTE

Katrina H. Welch
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22 In particular, Treas. Reg. § 1.482-9.