Foreign Tax Credit Issues

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Poll: 1. Are taxes imposed by a country that are consistent with the Pillar One and Pillar Two model rules automatically creditable?
Introduction:
Role of the foreign tax credit, direct and deemed paid credits
Purpose of the foreign tax credit rules

- Potential double tax on same income = 40%

Purpose of foreign tax credit (FTC) is to mitigate double taxation of the same income where such income is properly sourced to a foreign country.
Credit vs. deduction

—Annual election to:
  - Deduct foreign taxes—section 164(a)
  - Credit foreign taxes—section 901
—Election made by filing
  - Form 1118 (corporations)
  - Form 1116 (individuals)
—Generally cannot claim deduction and credit in same year
—When would you choose a deduction over a credit?
Substantiation of foreign tax credit

— Section 905(b) requires taxpayer to prove payment of tax to claim credit
— Generally require tax receipt but may accept secondary evidence
— Proof of payment must be provided on audit, not submitted with tax return
Taxes eligible for “direct” credit: Section 901 and Section 903 “in lieu of taxes”

— Taxes paid directly by U.S. taxpayer
  - E.g., taxes on profits of foreign branch
— Distributive share of taxes paid by partnership

![Diagram showing the flow of taxes between U.S. Corp, Foreign branch, For Corp, Foreign PE, and PRS.]

Similar to the example of taxes on profits of a foreign branch, the distributive share of taxes paid by a partnership can also be considered for credit. In this scenario, the partnership's foreign PE (Foreign Partnership Entity) pays taxes to the foreign jurisdiction, and the U.S. Corp receives a distributive share of these taxes. This flow is represented in the diagram with arrows indicating the direction of the financial transactions and tax credits.
Section 960

— Section 960 provides an indirect credit upon inclusions of taxable income by a U.S. corporation of income earned by its foreign corporations resulting from a subpart F or GILTI inclusion, rather than an actual dividend.

— TCJA eliminated “pooling,” and now section 960(a) and (d) credits may only be sourced from current year taxes attributable to an income group resulting in a deemed income inclusion (subpart F inclusions and GILTI inclusions).
  • In particular, taxes on tested income that are not deemed paid in the current year are not carried forward.

— Section 960(a): deemed paid FTC for taxes paid with respect to section 951(a) inclusions.

— Section 960(b) and (c): special rules for distributions from previously-taxed earnings and profits (PTEP).

— Section 960(d): deemed paid FTC for 80% of taxes paid with respect to section 951A inclusions.
Section 78 Gross-up

— Section 78 is relevant to all taxes deemed paid under Section 960, both pre- and post-TCJA

— It is aimed at putting the U.S. taxpayer in the same position with respect to deemed paid credits that it would have been in if it had instead paid the taxes directly

— Foreign taxes deemed paid included in gross income as additional dividend

— Applies only at domestic corporation level
Identifying creditable foreign taxes
What is a creditable tax under Sections 901 and/or 903?

— Creditability analyzed in respect of each separate levy

— A foreign levy is creditable under section 901 if:
  - It is a “tax,” defined as a *compulsory payment* pursuant to a foreign country’s authority to levy taxes
  - Its *predominant character* is that of an income tax in the U.S. sense:
    - Includes a realization, gross receipts and cost recovery requirement, as well as a new attribution requirement, that were substantially revised in 2021 Final Regulations under Reg. § 1.901-2 (discussed in subsequent slides).
  - It is not a soak up tax:
    - A tax is a soak-up tax if liability for the tax is dependent on the availability of a credit for the tax against the payer's income tax liability to another country
Section 901 generally provides that only income, war profits, and excess profits taxes (collectively “income taxes”) may qualify for the foreign tax credit. The tax must be a levy that is not a payment for a specific economic benefit and the predominant character of the tax must be an income tax in the U.S. sense.

Section 903 generally provides that a tax in lieu of a generally imposed income tax may be creditable. Regulations issued in 2021 revised existing regulations interpreting sections 901 and 903 defining the type of foreign taxes that may be creditable.

— Concern over an increasing trend of countries to enact “novel” taxes that may be viewed as extraterritorial in light of existing U.S. and international taxing norms.

— A view that U.S. should not be subsidizing foreign jurisdictions exercising taxing rights in an unreasonable manner that expands the foreign tax base or does not provide for significant recovery of costs on gross receipts.

— Foreign jurisdiction imposing the tax should have “sufficient nexus to the taxpayer’s activities or investment of capital or other assets that give rise to the income base on which the foreign tax is imposed.” See preamble to final regulations.

— U.S. tax principles (as opposed to foreign law and principles) should control the determination of whether a tax is an income tax.

Further changes to FTC regulations may be necessary as a result of implementation of Pillars 1 and 2.
Changes to creditable “Net income taxes”

The creditability of a given foreign levy is determined separately from the creditability of any other foreign levy

— Levies constitute separate levies if:
  - Imposed by different foreign tax authorities
  - Separate bases
  - Imposed on nonresidents versus imposed on residents
  - Withholding tax as applied to each separate class of income described in section 61, as well as certain subsets of income
  - Foreign levy as modified by a treaty or contract with the foreign country is separate from the general levy

In order for a levy to be a creditable foreign income tax, it must be a foreign tax and qualify as either a net income tax or an “in lieu of” tax in its entirety for all persons subject to the tax

Applicability date – taxes paid or accrued in tax years beginning on or after December 28, 2021 (with a delayed effective date for certain taxes paid to Puerto Rico)

Corrections to final Regulation (87 Fed. Reg. 45018) published on July 27, 2022 (the “Technical Corrections”), and proposed regulations in November 2022 (the “Proposed Regulations”)

For purposes of the corporate AMT, foreign taxes will need to satisfy these rules too
Changes to creditable net income taxes (continued)

Must satisfy the “net gain requirement” which includes the realization; gross receipts; cost recovery; and attribution requirements

Realization
— Foreign tax must generally be imposed upon a realization event under the Code, with allowance for certain prerealization events (e.g., mark-to-market or CFC regimes)

Gross receipts
— Foreign tax is imposed on the basis of actual gross receipts or, in the case of a tax imposed in connection with certain prerealization events that satisfy the realization requirement, deemed gross receipts

Cost recovery
— Foreign tax must permit recovery of “significant costs and expenses” reasonably attributable to gross receipts
  - Interest, rents, royalties, wages, services payments, R&E, CapEx are per se “significant”
  - Other costs must be evaluated based on whether they constitute a significant portion of the costs and expenses of all taxpayers subject to the tax
  - Certain other disallowances, such as those consistent with any principle underlying the disallowances required under the Code, including the principles limiting BEPS and public policy concerns, are permissible
  - Timing of recovery is generally irrelevant
— Alternative cost allowances must by its terms never be less than actual costs
Proposed regulations would modify cost recovery requirement:

- To only require recovery of “substantially all” of each item of significant cost or expense
- Add safe harbors that permit certain partial disallowances of significant costs
- Add examples regarding the application of cost recovery rules to better illustrate the cost recovery requirement added by the Final Regulations and revised by the Technical Corrections.

- Add a safe harbor to the source-based attribution rule for royalties that allows all or a portion of foreign withholding taxes on royalties to satisfy the attribution requirement if certain documentation requirements are met.

Applicability date for the Proposed Regulations:

Cost recovery and single-country license changes: Proposed to apply to foreign taxes paid in taxable years ending on or after November 22, 2022. Once finalized, taxpayers may choose to apply the Regulations to foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 22, 2022, provided that they consistently apply those rules to such taxable years.

General reliance rule: Taxpayers may rely on one or more of the three changes made by the Proposed Regulations before the effective date of such Regulations if the taxpayer and its related parties, within the meaning of sections 267(b) (determined without regard to sections 267(c)(3)) and 707(b)(1)), consistently follow all proposed regulations with respect to the change or changes in the Proposed Regulations relied upon for all relevant years until the effective date of the final regulations adopting the rules.
Per Se Significant Costs and Expenses – Proposed Regulations

**First safe harbor:** A disallowance is permitted if it is of a stated portion of an item (or multiple items), and the total portion of the item (or items) that is disallowed does not exceed 25 percent of the item.

**Second safe harbor:** A limitation caps the recovery of an item, or multiple items that relate to a single category of significant costs and expenses, is permitted if the cap is:

- A stated portion of gross receipts, gross income, or a similar measure, that is not less than 15 percent of such measure, or
- A stated portion of taxable income (determined without regard to the item at issue) or a similar measure that is not less than 30 percent of such measure.
Attribution requirement

Separate attribution requirements apply to nonresident taxes and resident taxes.

Nonresident taxes

Activities based nexus
- Tax based on ECI-type or PE-type principles
- No destination-based criterion
- Cannot attribute activities or income of an affiliate or other nonagent third person

Sourced based nexus
- Sourcing rules must be similar to U.S. sourcing rules (specific rule for services and royalties)
  - Services income must be sourced based on place where the services are performed, NOT location of the payor
  - Royalty income must be sourced based on place of use or right to use
- Foreign law characterization of income generally controls (exception for sales of copyrighted articles as determined under rules similar to Reg. section 1.861-18)
- Does not apply to sales or dispositions of property
Attribution requirement (continued)

Situs-based nexus (nonresident taxes continued)
— Applies with respect to taxes imposed based on situs of real property or business property of a taxable presence
— Sale or disposition of stock satisfies situs-based nexus only under a FIRPTA-type regime
— Gross receipts from the sale or disposition of property, other than stock, that are attributable to business property of a taxable presence under rules reasonably similar to section 864(c) (including section 864(c)(8))

Resident taxes
— Foreign tax imposed on a resident may be on worldwide income
— Must incorporate arm’s length transfer pricing principles and cannot take into account destination-based criterion as a significant factor
  - Uncertainty as to how the IRS would determine if a foreign country's tax laws allocate income using the arm’s length standard, with the consequence of an adverse conclusion being that ALL taxes imposed on residents of that country would be noncreditable
Changes to Brazil’s Transfer Pricing System and impact on creditability

Historical rules:

• Specific methods used (no ALP—violates attribution requirement)
  — Designed for tangible transactions
  — Fixed margins required by law
  — Taxpayer can select any method
  — Lack of TNMM and Profit Split

• Disallowance of deductions (violates cost recovery requirement)
  — Applies to specific related party transactions
  — Automatic/non-discretionary disallowance

Provisional Measure:

• Transition to ALP
  • Consistency with OECD Guidelines in terms of scope and pricing
  • Adoption of Cost Contribution Arrangement concepts
  • Examination of foreign tested parties allowed
  • Methodologies

• Removal of automatic deduction disallowance rules
  • To be replaced by anti-abuse provisions

Mandatory for taxable years beginning January 1, 2024.

Taxpayers would have the option to apply for the taxable year beginning January 1, 2023.
U.S. FTC Considerations: Section 903 taxes

Section 903 (“in lieu of taxes”) creditability requirements:

- A good **generally imposed net income** (“GINI”) **tax** creditable under Section 901
- **Non-duplication**: No net income tax in the country applies to the same base
- **Close connection**: GINI tax would have applied to that base if “in lieu of” tax didn’t apply
- **Attribution**: If the GINI, or a hypothetical new separate levy with respect to the GINI were applied to the tax base of this levy, such GINI or separate levy would meet the attribution requirements
- Immaterial whether the base bears any relation to net gain

“Covered WHTs” imposed on non-residents need to satisfy only non-duplication and source-based attribution requirements

- Existence of a good GINI
- Must be imposed on non-residents
- Non-duplication requirements
- Source-based attribution requirements
- Note: WHT with respect to each class of income (or certain subsets thereof) tested as separate levies
Single Country License (SCL) exception for royalty WHTs—Proposed Regulations

Special relief for royalty WHTs

• “Place of use or right to use” in the U.S. vs. Residence of payor or location of registration in many other jurisdictions

• Proposed FTC regulations introduced the “single-country license” exception:
  - License should limit the use of the IP to the territory of the country imposing the tax.
  - Portion of the royalty WHT may satisfy if underlying agreement delineates the portion related to in-country use (whether via a specified amount or a formula).
  - License agreements to be provided within 30 days of request and must generally be executed no later than the date of royalty payment.

• Grace period provided until 180 days after the Proposed FTC regs are finalized and filed with the federal register to execute amended agreements to satisfy single country license exception (Notice 2023-31).
Interaction with tax treaties

Taxes paid directly by U.S. residents:
— If the United States has an income tax treaty in force with a foreign jurisdiction that treats the foreign tax as an income tax for purposes of applying the relief from double taxation article, then such tax may not be impacted by the section 901 and 903 changes to the definition and would still be eligible to be credited
— U.S. residents must elect to claim benefits under the treaty

Taxes paid by a controlled foreign corporation (CFC) of a U.S. shareholder:
— If the CFC is paying the foreign tax, it is the position of the IRS and Treasury that the foreign tax would not be covered by the relief from double taxation article of the U.S. income tax treaty (if any).
— The foreign tax would need to be separately analyzed to determine whether it would meet the definition of a foreign income tax or in lieu of tax under the regulations
— In making this determination, third country treaties may be taken into account to determine whether the foreign tax as applied to the CFC and as modified by the applicable third country treaty would make the tax creditable under the regulations
Interaction of the attribution requirement with income tax treaties

Assume, in each of the scenarios below, that the Country A capital gains tax does not satisfy the attribution requirement, and therefore would not be creditable absent application of a tax treaty.

**Scenario 1**
- **Treaty:** US-Country A treaty treats such capital gains tax as an income tax, and USP elects treaty benefits
- **Conclusion:** Country A capital gains tax may be creditable

**Scenario 2**
- **Treaty:** US-Country A treaty treats such capital gains tax as an income tax
- **Conclusion:** Country A capital gains the IRS and Treasury maintain such tax is not creditable because CFC-X is not a US tax resident under US tax treaties

**Scenario 3**
- **Treaty:** Country X-Country A treaty limits Country A tax to apply in a manner similar to US FIRPTA
- **Conclusion:** Country A capital gains, as modified by relevant treaty, may satisfy attribution requirement and be creditable
FTC Limitation
Overview –
Section 904(a)
Foreign Tax Credit Limitation

The FTC limitation is calculated on a basket-by-basket basis such that the numerator represents only foreign source income (FSI) in a particular basket.

* Determined without regard to Section 245A Dividends and Section 904(b)(4) Deductions
  (Section 904(b)(4) addresses the treatment of expenses allocated and apportioned to dividends qualifying for the section 245A DRD, such as interest and stewardship apportioned to the stock of a foreign corporation producing dividends qualifying for the section 245A DRD)

** WW Taxable Income also determined without regard to Section 904(b)(4) Deductions

<table>
<thead>
<tr>
<th>Limitation formula</th>
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<tbody>
<tr>
<td>FTC Limitation per Basket</td>
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</table>

Limitation formula:

\[
\text{FTC Limitation per Basket} = \frac{\text{Pre-credit US tax at §11 rate on worldwide taxable income}}{\text{Foreign source taxable income in basket}^*} \times \text{Adjusted worldwide taxable income}^{**}
\]
Purpose of FTC Limit: Example

100 US source income
US corp tax rate = 21%
US tax = 42

US Corp

100 foreign source income
Foreign corp tax rate = 30%
Foreign tax = 30

Foreign branch
Let’s change the facts

100 US source income

US corp tax rate = 21%
US tax = 42

Foreign branch

100 foreign source income

Foreign corp tax rate = 15%
Foreign tax = 15
FTC Carryback & Carryover

- Generally, unused FTCs may be
  - carried back first to the previous year to the extent of excess limitation in such preceding year, then
  - carried forward to the succeeding 10 years to the extent of the excess limitation therein
  - “Excess limitation” is the amount by which the FTC limitation in that basket for a given taxable year exceeds the amount of FTCs otherwise taken in such year
- However → no carryback or carryover allowed with respect to GILTI basket taxes, as provided in § 904(c)
Basket Gross Income and Foreign Taxes
Separate limitation category “baskets”

<table>
<thead>
<tr>
<th>General</th>
<th>GILTI</th>
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<tbody>
<tr>
<td>Passive</td>
<td>Foreign branch</td>
</tr>
</tbody>
</table>

— Other Code sections may create additional separate categories or baskets:

- Sections 904(d)(6) and (h)(10), 865(h) – separate application to items resourced under treaties (by country / by basket)
- Section 901(j) – Income from blacklist countries
Passive category income

Passive category income means any income received or accrued by any person which is of a kind which would be FPHCI (as defined in section 954(c)) if such person were a CFC

Generally takes primacy over the branch and GILTI baskets

Also, includes a partner’s distributive share of partnership income that is earned or accrued by the partnership in the passive category

— Full distributive share of limited partners that own less than 10% (by value) is treated as passive. Reg. § 1.904-4(n)

Exceptions include “active” rents and royalties, “financial services income,” and “high-taxed” income
Section 951A category income includes only income that arises from a section 951A inclusion, including the section 78 gross up

Applies only at USSH level – CFCs do not have section 951A basket income (but may have section 951A previously taxed earnings and profits (PTEP))

Section 951A category income does not include any amounts included under section 951A(a) that are allocable to passive category income under look-through rules

Taxes assigned to the section 951A category are subject to a 20% “hair-cut”
Foreign branch category income

Generally includes non-passive business profits of a U.S. person attributable to a section 989(a) qualified business unit (QBU) in a foreign country.

Starts with gross income reflected on the books and records of a QBU, adjusted to conform with US tax principles; such amounts may be adjusted on account of “disregarded reallocation transactions” (DRTs) between a branch and its owner. For example, a disregarded service payment from a branch to its owner may reallocate gross income from the branch to its owner.

Only U.S. persons can have branch basket income; foreign persons, including CFCs, cannot have branch basket income.

Distributive share of income from a partnership may be characterized as branch basket income in the hands of the partners that are themselves not pass-through entities (to the extent not passive)
Example: DRT from Branch Owner to Branch providing contract R&D services

**Facts:**

- FDRE provides contract R&D services to U.S. Parent.
- U.S. Parent owns all IP created via the services provided by FDRE.
- FDRE incurs $100 of expense for providing contract R&D services in 2022.
- U.S. Parent pays $150 to FDRE for contract R&D services.

**Discussion & Analysis:**

- The $100 costs incurred through the FDRE are subject to mandatory capitalization under section 174.
- Income of U.S. Parent is reattributed under the disregarded reattrition transaction (“DRT”) rules.
Example: DRT from Branch Owner to Branch providing contract R&D services (cont’d.)

Discussion & Analysis (cont’d):

- DRT rules require U.S. Parent to treat only the $10 deduction on the $150 disregarded payment as if it were regarded; and determine how much of such payment would be allocated and apportioned to the foreign branch category if the payment were so regarded.

- The amount reattributed to the FDRE is assigned to the branch basket without changing amount, character or source of the underlying gross income. This results in $10 of U.S. source branch basket income.

- If available, treaty benefits may be claimed to resource the reattributed income of $10 to foreign source.
General category income is generally described as the residual basket (i.e., income not basketed in the passive, branch, or GILTI categories)

May include:

- Subpart F income that is FBCSal or FBCSsvc
- Royalties received from CFCs engaged in an active trade or business
- Foreign active business income earned by U.S. person directly from foreign customers
- Passive income subject to the high-tax kickout
Allocation and apportionment of foreign income taxes

General rule of Reg. § 1.861-20(c): a foreign income tax is allocated and apportioned to the statutory and residual groupings that include the items of foreign gross income (FGI) included in the base on which the tax is imposed.

— **Step 1**: FGI determined under foreign law but characterized under U.S. law
  - FGI characterized based on “corresponding U.S. item” if one exists
  - Otherwise, special rules are applied to characterize FGI, including detailed rules for disregarded payments, corporate and partnership distributions, and various timing differences

— **Step 2**: allocate and apportion foreign law deductions to FGI, generally based on foreign law

— **Step 3**: allocate and apportion foreign income tax by reference to foreign taxable income

The rules characterizing FGI are prescriptive and turn on the nature of the transaction or event giving rise to the FGI and its U.S. tax characterization. The same transaction, as viewed from a foreign law perspective, can be characterized differently based on, e.g., whether it is regarded or disregarded for U.S. tax purposes. The use of foreign law elections or grouping rules (such as group relief and consolidation) can also affect the application of Reg. § 1.861-20.
Overall Foreign Losses, Overall Domestic Losses, and Separate Limitation Losses
Rationale for Loss Recapture Rules

The expense allocation and apportionment rules can result in some foreign tax credit categories having net income and other foreign tax credit categories having net loss.

— A loss in a foreign tax credit category, other than the residual U.S.-source category, is referred to as a Separate Limitation Loss,” or “SLL.”
  
  - Initially, an SLL offsets, on a pro rata basis, income in the other foreign tax credit baskets.
  
  - If there is no remaining foreign-source income to offset, the SLL offsets U.S.-source income. This results in an Overall Foreign Loss, or “OFL.”

— If the U.S.-source category has a net loss and offsets income in the other foreign tax credit categories, this results in an Overall Domestic Loss or “ODL.”
# Creation of SLL and OFL

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<tr>
<th></th>
<th>General</th>
<th>Passive</th>
<th>US</th>
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</thead>
<tbody>
<tr>
<td><strong>Initial Income (Loss)</strong></td>
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<td>$100</td>
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<tr>
<td><strong>SLL Allocation</strong></td>
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<td>($500)</td>
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<td><strong>Net Income (loss) after SLL</strong></td>
<td>($100)</td>
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<td>$100</td>
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<td><strong>Ending SLL Account</strong></td>
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<tr>
<td><strong>OFL Allocation</strong></td>
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<td>($100)</td>
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<td><strong>Ending OFL Account</strong></td>
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<tr>
<td><strong>Net Income (Loss) after SLL and OFL</strong></td>
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# Recapture of SLL and OFL

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<th>Taxable Year 2</th>
<th>General</th>
<th>Passive</th>
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<tr>
<td>Initial Income</td>
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<tr>
<td>Beginning OFL Account</td>
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<tr>
<td>OFL Recapture</td>
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<tr>
<td>Net Income (loss) after OFL Recapture</td>
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<td>Beginning SLL Account</td>
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<tr>
<td>SLL Recapture</td>
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<td>$200</td>
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<tr>
<td>Net Income after SLL Recapture</td>
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<tr>
<td>Ending SLL Account</td>
<td>$300 Passive</td>
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</tbody>
</table>
Loss Recapture

If an SLL, ODL, or OFL reduces income in a foreign tax credit category, it creates an SLL, ODL, or OFL account in that category.

— When there is net income in that category in a later year, the net income is recharacterized as income in the other separate category.

— A very complicated set of limitations and ordering rules apply
Timing Considerations and Foreign Tax Redeterminations
Section 905(c)

Foreign Tax Redeterminations:
- Taxpayer receives refund from foreign tax authority
- Taxpayer pays taxes more than 24 months after the close of the taxable year in which accrued (two redeterminations)
- Amount of accrued taxes when paid differs from amount originally claimed as a credit
- Taxpayer corrects or makes other adjustments to accrued amounts to reflect the final foreign tax liability
- Change from credit to deduction or from deduction to credit

US Tax Redetermination:
- If the foreign tax redetermination affects US tax liability (i.e., a US tax redetermination), the taxpayer must notify the IRS, who shall redetermine the correct amount of the US tax liability. Regulations specify the form of notification required, which is generally through the amendment of the taxpayer’s return
- Refunds are translated at rate in year of payment and additional payments translated at rate at time of payment
Overview: Timing Rules – Reg. § 1.905-1

Accrual method taxpayers must compute the amount of foreign income taxes available to be claimed as a foreign tax credit on an accrual basis.

— Foreign income taxes accrue in the taxable year in which all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy
  - Withholding taxes accrue when payment of amount subject to withholding is made
  - No immediate economic performance requirement (but actual payment “perfects” accrual method taxpayer’s foreign tax credit claim)

Cash method taxpayers generally claim a foreign tax credit using the cash method

— The amount of foreign income taxes that may be claimed as a credit in a taxable year is determined by the amount of foreign income taxes that are actually paid by the taxpayer in that year

— Cash method taxpayers may make a one time irrevocable election to claim foreign tax credits using the accrual method
Credit vs. deduction

— Special 10-year statute of limitations under section 6511(d)(3) allows taxpayer to change from deduction to credit, and to change the amount of FTC, including correcting math errors

— The 10-year period runs from due date, without extensions, of return for year in which taxes actually paid or accrued. See Albemarle v. United States, 118 Fed. Cl. 549 (2014), aff'd 797 F.3d 1011 (Fed. Cir. 2015), reh'g denied, 805 F.3d 1060 (Fed. Cir. 2015)

  - Trusted Media Brands v. U.S., 899 F.3d 175 (2d Cir. 2018), held that, although taxpayers had 10 years to elect to deduct or credit foreign income taxes, the 10-year SOL did not apply to refund claims relating to foreign taxes that the taxpayer deducts rather than credits

— For tax years beginning on or after December 28, 2021, a 3-year statute of limitations under section 6511(a) allows a taxpayer to change from credit to deduction

— Change election by filing amended return
Overview: “Relation-Back” Doctrine

— Reg. § 1.905-1 codifies what is commonly referred to as the “relation-back” doctrine. A change in a taxpayer’s foreign tax liability, including additional tax paid when a contest with a foreign tax authority is resolved, relates back and is considered to accrue at the end of the foreign taxable year with respect to which the tax is imposed (the “relation-back year”) in the case of an accrual method taxpayer

— When a “foreign tax redetermination” (as defined in Reg. § 1.905-3) occurs, the taxpayer must make a redetermination of its U.S. tax liability for the relation-back year and any other affected year

— Additional foreign income taxes that would relate back for FTC purposes to a taxable year in which the taxpayer elected to deduct foreign income taxes may be claimed as a deduction in the taxable year in which such taxes are finally determined and paid (even if the taxpayer elects to credit foreign income taxes in that taxable year)

  - Specific exception to the general rule that a taxpayer may not deduct any foreign income taxes paid or accrued in a taxable year with respect to which the taxpayer elects to claim a foreign tax credit
Foreign Tax Redeterminations (FTRs)

Broad definition of FTR that includes:

— An accrual method taxpayer that claims a foreign tax credit in a taxable year and later ultimately pays more or less foreign income tax with respect to such taxable year;

— An accrual method taxpayer that corrects or makes other adjustments to accrued amounts to reflect the final foreign tax liability;

— An accrual method taxpayer claims a foreign tax credit in a taxable year but does not pay such tax until more than 24 months after the close of such taxable year (two redeterminations);

— An accrual or cash method taxpayer that receives a refund of foreign income tax; and

— A change from credit to deduction or from deduction to credit
FTRs (continued)

FTRs not limited to the effects on a U.S. taxpayer’s foreign tax credit and includes changes in the foreign income tax liability of a foreign corporation that change:

— Distributions or inclusions under sections 951, 951A, or 1293 from the foreign corporation,

— The application of the high-tax exception (subpart F or GILTI), and

— Certain PFIC taxes

Effectively, if a change in foreign income tax liability may effect the taxpayer’s U.S. tax liability, then such change in foreign income tax liability is an FTR
What Happens?

U.S. Tax Redetermination

— Change with respect to foreign income tax “relates back” to the relevant tax year

— Technical Corrections to the 2021 the Final Regulations revised the applicability date to clarify that prior Reg. 1.901-2 applies to determine whether a foreign tax that relates back to a pre-effective taxable year is a foreign income tax.

— U.S. persons

  - Adjustments are made to the taxpayer’s foreign tax credit in the relation back year (and any other affected years)

— Foreign corporations

  - Adjustments are made to the foreign corporation’s subpart F income, tested income, and earnings and profits in the relation back year (and any other affected years)

  - Adjustments are made to account for the effect of the FTR on USSHs of the foreign corporation

    — Characterization and amount of distributions or amounts included under sections 951, 951A, or 1293,

    — The application of the HTE (subpart F or GILTI), and

    — Deemed paid taxes / section 78 gross-up.

— U.S. taxpayer’s election to deduct or credit foreign income taxes irrelevant to whether the adjustments above must be made
What Is Required?

Notifications

— New Schedule L to Form 1118

— Corporations: amended returns, amended Forms 1118, and statements
  - Increase in U.S. tax liability – due with original return (including extensions) of year in which FTR occurs
  - Decrease in U.S. tax liability – due within 10-year SOL for claiming FTC refunds
  - Special rules for multiple redeterminations
  - Exceptions for filing amended returns and Forms 1118 (but not statements) if no change in U.S. tax liability, meet requirements of “audit exception,” or IRS prescribes alternative notification requirements through forms, instructions, publications, or other guidance

— “Just” statements for many pass-through entities

— Administrative adjustment requests (AARs) for “BBA” partnerships

Note: A special irrevocable pooling election may be available for certain FTRs of foreign corporations related to tax years beginning before January 1, 2018
Thank you