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RE: Comments on Section 909 regarding Foreign Tax Credit Splitting Events by P.L. 111-226

Dear Messrs. Shulman, Wilkins, and Musher:

The American Institute of Certified Public Accountants (AICPA) offers the following comments as the government prepares to issue additional guidance regarding new Section 909,[1] Suspension of Taxes and Credits until Related Income Taken into Account, which was enacted as part of P.L. 111-226. These comments were developed by the Section 909 Task Force of the AICPA's International Taxation Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the national professional organization of certified public accountants comprised of approximately 370,000 members. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

[1] Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended (the "Code"), and to the treasury regulations (the "Regulations" or "Reg.") promulgated pursuant to the Code.

Executive Summary

We commend the Treasury and IRS for providing helpful guidance in the Notice with respect to pre-2011 splitter arrangements (as defined in the background section below). We also note that, in the Notice, the Treasury and IRS have requested comments in a number of key areas regarding the application of section 909, and particularly regarding post-2010 splitter arrangements. In this regard, we provide the following initial comments with respect to some of these key areas:

1. We recommend that the 2006 proposed technical taxpayer rules addressing foreign consolidation regimes (Prop. Reg. § 1.901-2(f)(2)) be finalized. Additionally, we recommend finalizing the 2006 proposed regulations addressing foreign taxes that are imposed under foreign law on the income of hybrid partnerships and disregarded entities (Prop. Reg. § 1.901-2(f)(3)).[2]

2. We recommend the issuance of guidance regarding the impact of dispositions that do not constitute section 381 transactions on related income and split taxes under section 909.

3. We recommend the issuance of an exclusive list of arrangements that would be subject to section 909 for post-2010 tax years.

We anticipate providing additional comments in the future relating to the application of section 909.

Background

Section 909 was added to the Code on August 10, 2010, as part of a series of statutory amendments included in Section 211 of the legislation commonly referred to as the Education Jobs and Medicaid Assistance Act (EJMAA).[3] These amendments were intended to limit a U.S. corporation's ability to claim foreign tax credits (FTCs).[4] As discussed in more detail below, section 909 generally suspends foreign income taxes when such foreign taxes are separated from the related income (or earnings and profits (E&P)) upon which the taxes were imposed (the "related income").[5] Section 909 is effective for foreign income taxes paid or accrued during taxable years beginning after December 31, 2010 (post-2010 years). Additionally, section 909 is effective for foreign income taxes paid or accrued during taxable years beginning before January 1, 2011 (pre-2011 years), for purposes of applying the indirect FTC rules of sections 902 and 960 to post-2010 years.

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[2] This letter does not comment on the treatment of reverse hybrid entities under Prop. Reg. § 1.901-2(f)(2)(iii).
[3] P.L. 111-226, 124 Stat. 2389 (2010) (the "Act").
[4] The Act also added Code sections 901(m), 904(d)(6) and 960(c), each of which places restrictions on a taxpayer's ability to claim FTCs.
[5] Section 909(d)(3) (defining "related income" as "with respect to any portion of any foreign income tax, the income (or, as appropriate, E&P) to which such portion of foreign income tax relates").

Section 909 provides that if there is a "foreign tax credit splitting event" with respect to foreign income taxes paid or accrued by the taxpayer, the foreign income taxes will not be taken into account for U.S. tax purposes before the taxable year in which the taxpayer takes into account the related income.[6] A foreign tax credit splitting event occurs with respect to foreign income taxes if the related income is (or will be) taken into account by a "covered person."[7] The term "covered person" means, with respect to any person who pays or accrues a foreign income tax (the "payor"): (1) any entity in which the payor holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value); (2) any person that holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value) in the payor; (3) any person that bears a relationship to the payor described in section 267(b) or section 707(b); and (4) any other person specified by the Secretary.[8]

Section 909 explicitly provides the Secretary of the Treasury with the ability to issue regulations or other guidance, as necessary or appropriate to carry out the purposes of section 909, including, but not limited to, exceptions to section 909, and the application of section 909 to hybrid instruments.[9]

On December 6, 2010, the Department of the Treasury (Treasury) and Internal Revenue Service (IRS) issued the first piece of guidance regarding the application of section 909, IRS Notice 2010-92 (the "Notice"). The Notice primarily addressed the application of section 909 to foreign income taxes paid or accrued by "section 902 corporations"[10] during pre-2011 years. For this purpose, the Notice identified an exclusive list of arrangements that would be treated as giving rise to foreign tax credit splitting events in pre-2011 tax years. These arrangements included reverse hybrid structures (section 4.02 of the Notice), certain foreign consolidated group regimes (section 4.03 of the Notice), certain group relief and loss sharing regimes (section 4.04 of the Notice), and certain hybrid instruments (section 4.05 of the Notice). Section 4.06(b) of the Notice provides rules regarding related income for purposes of pre-2011 splitter arrangements. Section 4.06(c) of the Notice provides rules with respect to split taxes for purposes of pre-2011 splitter arrangements.

Specific Comments

1. Finalize Certain Portions of the 2006 Proposed Section 901 Regulations

We recommend that the Treasury and IRS finalize the portion of the section 901 proposed regulations (REG-124152-06) addressing the allocation of foreign taxes among members of a foreign consolidated group.

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[6] Section 909(a).
[7] Section 909(d)(1).
[8] Sections 909(d)(4) and (e).
[9] Section 909(e).
[10] A "902 corporation" is a foreign corporation with respect to which a U.S. corporation can claim a section 902 deemed foreign tax credit. *See* sections 909(d)(5), 902(a), (b).

Treas. Reg. § 1.901-2(f)(1) provides that:

> The person by whom tax is considered paid for purposes of sections 901 and 903 is the person on whom *foreign law* imposes *legal liability* for such tax, even if another person (*e.g.,* a withholding agent) remits such tax. For purposes of this section, Treas. Reg. section 1.901-2A, and Treas. Reg. section 1.903-1, the person on whom *foreign law* imposes such liability is referred to as the "taxpayer."… (Emphasis added.)

Thus, Treas. Reg. § 1.901-2(f)(1) focuses on the foreign legal liability for the taxes to determine who is treated as paying the foreign income taxes.

Treas. Reg. § 1.901-2(f)(3) also must be considered in the context of a foreign consolidated group.[11] That portion of the regulation provides that:

> If foreign income tax is imposed on the combined income of two or more related persons (for example, a husband and wife or a corporation and one or more of its subsidiaries) *and they are jointly and severally liable* for the income tax *under foreign law*, foreign law is considered to impose legal liability on each such person for the amount of the foreign income tax that is attributable to its portion of the base of the tax, regardless of which person actually pays the tax. (Emphasis added.)

Based on an interpretation of this regulation, some taxpayers have taken (and currently do take) the position that, in certain foreign jurisdictions, the foreign parent of a foreign consolidated group is the person that has legal liability for the foreign taxes for the entire group, regardless of who generates the income giving rise to the foreign taxes. This may result in a separation of the foreign taxes from the related income on which the foreign taxes are based. As more fully discussed below, the IRS and Treasury believe that Treas. Reg. § 1.901-2(f)(1) of the current final regulations requires as a general rule a pro rata allocation of foreign tax among the members of a foreign consolidated group earning the income, and that Treas. Reg. § 1.901-2(f)(3) illustrates the application of the general rule in cases where the group members are jointly and severally liable for that consolidated tax. Thus, the IRS's view is that the current regulation generally does not permit separation of the foreign taxes from the related income on which the foreign taxes are based.

[11] Under the Notice, a foreign consolidated group exists when a foreign country imposes tax on the combined income of two or more entities. Tax is considered imposed on the combined income of two or more entities even if the combined income is computed under foreign law by attributing to one such entity the income of one or more other entities. A foreign tax is not considered to be imposed on combined income solely because foreign law: (1) permits one entity to surrender a net loss to another entity pursuant to a group relief or similar regime; (2) requires a shareholder of a corporation to include in income amounts attributable to taxes imposed on the corporation with respect to distributed earnings pursuant to an integrated tax system that allows the shareholder a credit for such taxes; or (3) requires a shareholder to include, pursuant to an anti-deferral regime, income attributable to the shareholder's interest in a corporation. See also Prop. Reg. § 1.901-2(f)(2)(ii).

This issue of who has legal liability for the foreign taxes under the current regulations was litigated in the context of a Luxembourg consolidated group. In *Guardian Industries Corp. and Subsidiaries v. United States*, 65 Fed. Cl. 50 (2005)[12] *aff'd,* 477 F.3d 1368 (Fed. Cir. 2007), the court concluded that a Luxembourg disregarded entity (owned by a U.S. corporation) that was the parent of a Luxembourg consolidated group was solely liable for the taxes of the Luxembourg group under the regulation above and the subsidiaries of the group did not have legal liability for such taxes. The court reached that conclusion even though the income on which the foreign tax liability was imposed was generated by the subsidiaries of the group and was not included in the U.S. parent's taxable income.

Following the *Guardian* case, the IRS and Treasury have issued proposed regulations under section 901 that provided specific rules dealing with the allocation of foreign taxes among members of a foreign consolidated group (REG-124152-06).[13] Generally speaking, as they relate to the allocation of foreign taxes among members of a foreign consolidated group, these proposed regulations would prevent the separation of foreign taxes from the related income giving rise to the foreign taxes. In the preamble to the proposed regulations, the IRS and Treasury included the following language relating to the application of the current regulations to foreign consolidated groups:

> Thus, the IRS and Treasury Department believe that [Treas. Reg.] § 1.901-2(f)(1) of the current final regulations requires as a general rule pro rata allocation of foreign tax among the members of a foreign consolidated group, and that [Treas. Reg.] § 1.901-2(f)(3) illustrates the application of the general rule in cases where the group members are jointly and severally liable for that consolidated tax. Failure to allocate appropriately the consolidated tax among the members of the group may result in a separation of foreign tax from the income on which the tax is imposed.

The IRS and Treasury also stated in the same preamble the following:

> The proposed regulations would provide detailed guidance regarding how to treat taxes paid on the combined income of two or more persons. First, the proposed regulations would *clarify* the application of [Treas. Reg.] § 1.901-2(f) to foreign consolidated-type regimes where the members are not jointly and severally liable in the U.S. sense for the group's tax. (Emphasis added.)

Therefore, there are different positions that may be taken by taxpayers in certain foreign jurisdictions as it relates to the allocation of foreign taxes among members of a foreign consolidated group. Some taxpayers apply the current regulations as interpreted by the IRS, while other taxpayers take positions similar to the position taken in the *Guardian* case in certain foreign jurisdictions based on a particular interpretation of how legal liability works in that foreign jurisdiction. Depending on the particular position taken, a taxpayer may (or may not)

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[12] The taxpayer in the case was granted its motion for summary judgment on the issue.

[13] For a prior discussion of these rules, see Calianno and Cornett, *Guardian Revisited: Proposed Regs Attack Guardian and Reverse Hybrids*, 44 Tax Notes International 305 (Oct. 23, 2006).

have a foreign tax credit splitter arrangement subject to section 909. This may result in similarly situated taxpayers being treated differently depending on their interpretation of Treas. Reg. § 1.901-2(f). This situation may create administrative burdens for IRS agents.

By finalizing the section 901 proposed regulations addressing the allocation of foreign taxes among members of a foreign consolidated group, the Treasury and IRS would create consistency among taxpayers as it relates to whether there is a foreign tax credit splitting event under section 909, and reduce the number of arrangements to which section 909 applies. We further believe that, if finalized, the regulation should be prospective only but should permit taxpayers to elect to apply it retroactively.[14]

Additionally, Prop. Reg. § 1.901-2(f)(3) provides specific rules addressing foreign taxes that are imposed under foreign law on the income of hybrid partnerships and disregarded entities. In certain instances, the finalization of these proposed regulations could reduce the number of arrangements potentially subject to section 909 along with the compliance burdens associated with the application of section 909. For instance, Prop. Reg. § 1.901-2(f)(3)(ii) provides rules relating to the allocation of foreign taxes of a disregarded entity when there is a change in ownership of a disregarded entity, and such entity's foreign tax year does not close as a result of the change in ownership. It provides that:

> If foreign tax is imposed at the entity level on the income of an entity described in [Treas. Reg.] § 301.7701-2(c)(2)(i) of this chapter (a disregarded entity), foreign law is considered to impose legal liability for the tax on the person who is treated as owning the assets of the disregarded entity for U.S. income tax purposes. Such person shall be considered to pay the tax for U.S. income tax purposes. If there is a change in the ownership of such disregarded entity during the entity's foreign taxable year and such change does not result in a closing of the disregarded entity's foreign taxable year, foreign tax paid or accrued with respect to such foreign taxable year shall be allocated between the old owner and the new owner. The allocation shall be made under the principles of [Treas. Reg.] § 1.1502-76(b) based on the respective portions of the taxable income of the disregarded entity (as determined under foreign law) for the foreign taxable year that are attributable to the period ending on the date of the ownership change and the period ending after such date. If, as a result of a change in ownership, the disregarded entity becomes a hybrid partnership and the entity's foreign taxable year does not close, foreign tax paid or accrued by the hybrid partnership with respect to the foreign taxable year shall be allocated between the old owner and the hybrid partnership under the principles of this paragraph (f)(3)(ii). If the person who owns a disregarded entity is a partnership for U.S. income tax purposes, see [Treas. Reg.] § 1.704-1(b)(4)(viii) for rules relating to the allocation of such tax among the partners of the partnership.

[14] The proposed regulations currently have a prospective effective date. See Notice 2007-95 (providing that Prop. Reg. § 1.901-2(f), when finalized, will be effective for tax years beginning after publication in the Federal Register, rather than tax years beginning on or after 1/1/2007), modifying the effective date contained in Prop. Reg. § 1.901-2(h).

For the reasons stated above, we recommend finalizing this section of the proposed regulations.

2. Impact of Non-Section 381 Dispositions on Related Income and Split Taxes under Section 909

We request guidance relating to the impact of dispositions that do not constitute section 381 transactions on related income and split taxes under section 909.

The Notice addresses pre-2011 related income and split taxes and provides guidance as to the treatment of related income and split taxes in transactions that qualify under section 381 (e.g., asset reorganizations and section 332 liquidations). Section 4.06 (b)(6) of the Notice provides:

> Related income carries over to other corporations in the same manner as earnings and profits carry over under section 381, Treas. Reg. Sec. 1.367(b)-7, or similar rules, and retains its character as related income with respect to the associated pre-2011 split taxes.

In addition, Section 4.06(c)(3) of the Notice provides:

> Pre-2011 split taxes that carry over to another foreign corporation, including under section 381, §1.367(b)-7 or similar rules, retain their character as pre-2011 split taxes. The transferee foreign corporation will be treated as the payor section 902 corporation with respect to those pre-2011 split taxes.

Furthermore, Section 4.06(b)(5) of the Notice provides:

> Distributions, deemed distributions, and inclusions of related income (including indirectly through a partnership) to persons other than the payor section 902 corporation retain their character as related income with respect to the associated pre-2011 split taxes.

The Notice does not address what happens to related income and split taxes in the case of dispositions of section 902 corporations through transactions other than those that qualify under section 381. Specifically, it is not clear what happens to split taxes and related income when a disposition to an unrelated person occurs. For example, would any gain recognized by a U.S. owner upon disposition of a section 902 corporation qualify as related income?[15] This may be the only way that the U.S. owner can ever receive any benefit from the split taxes before such taxes become a tax attribute of an unrelated person. Alternatively, split taxes could potentially carry over to the acquirer of the section 902 corporation in a manner similar to previously taxed income under section 959.[16] However, such a framework would work only if the potential to recognize related income also was transferred to the acquirer of the section 902 corporation.

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[15] It would appear that, at a minimum, gain that is recharacterized as ordinary dividend income pursuant to section 1248 could qualify as related income for these purposes. Confirmation of such treatment would be welcomed.

[16] See section 959(a); Treas. Reg. § 1.959-1(d).

3. An Exclusive "Splitter List"

Because section 909(d)(1) defines a "foreign tax credit splitting event" broadly, taxpayers will need guidance on the scope of section 909. Whether an arrangement is within the scope of section 909 could affect how an arrangement is treated for tax return, financial accounting[17] and Schedule UTP reporting purposes. The potential application (or non-application) of section 909 also could impact how transactions are structured.

Given the need for certainty as it relates to the type of arrangements covered by section 909, we recommend the issuance of an exclusive list of arrangements that would be subject to section 909 for post-2010 tax years. This approach would be consistent with the approach taken by the Treasury and IRS in the Notice dealing with foreign income taxes paid or accrued by section 902 corporations for pre-2011 tax years. If the Treasury and IRS were to issue such an exclusive list and later identify additional arrangements that should be covered by section 909, they could update the list to make such arrangements subject to section 909 on a prospective basis.

We believe that the approach outlined above would provide taxpayers much needed certainty as it relates to the application of section 909 while retaining flexibility for the Treasury and IRS to add to the list additional arrangements in the future that they identify as being foreign tax credit splitting events.

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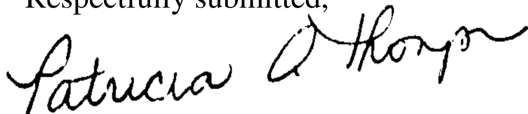
We appreciate the opportunity to comment as the government is formulating the guidance in this area, and welcome a further discussion of the comments. If you have any questions, please contact Douglas Poms, Chair, AICPA Section 909 Task Force at (202) 533-5510, or dpoms@kpmg.com; Joseph M. Calianno, Chair, AICPA International Taxation Technical Resource Panel at (202) 521-1505, or joe.calianno@us.gt.com; or Michelle R. Koroghlanian, AICPA Technical Manager, at (202) 434-9268, or mkoroghlanian@aicpa.org.

Respectfully submitted,



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[17] For U.S. generally accepted accounting principles (U.S. GAAP) purposes, per FASB ASC 740-10.

Barbara Felker, Branch Chief, International – Branch 3, IRS
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