



May 08, 2020

CC:PA:LPD:PR (REG-105495-19)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Guidance Related to the Allocation and Apportionment of Deductions and Foreign Taxes, the Definition of Financial Services Income, Foreign Tax Redeterminations under Section 905(c), the Disallowance of Certain Foreign Tax Credits Under Section 965(g) and the Application of the Foreign Tax Credit Limitation to Consolidated Groups [[REG-105495-19](#)]

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS or “Service”) to provide guidance related to the allocation and apportionment of deductions and creditable foreign taxes, the definition of financial services income, foreign tax redeterminations, availability of foreign tax credits (FTCs) under the transition tax, and the application of the FTC limitation to consolidated groups.

On December 17, 2019, Treasury and the IRS issued notice of proposed rulemaking REG-105495-19 (the “proposed regulations”) under Internal Revenue Code (IRC or “Code”) sections 861, 954, 704, 904, 905, 960 and 1502.¹ This letter is in response to the proposed regulations.

Overview

The proposed regulations provide guidance for taxpayers in several areas. Specifically, they provide guidance on the allocation and apportionment of certain deductible items. For example, section 861 and regulations thereunder could govern the allocation of apportionment of deductions against gross foreign source income of a taxpayer. The recently proposed regulations provide guidance and request comments with respect to the treatment of research and experimentation costs, interest expense deductions, stewardship expenses, and foreign taxes paid.

Recommendations

The AICPA suggests the following recommendations to the proposed regulations:

¹ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended, and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

1. Modify the proposed regulations such that taxpayers are not required to apportion stewardship expenses that relate solely to domestic subsidiaries on the basis of controlled foreign corporation (CFC) stock;
2. Allow taxpayers to compute their basis in U.S. assets either using the alternative depreciation system (ADS) or by adjusting for section 179 and bonus depreciation under section 168(k) for purposes of section 864(f);
3. Modify Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(B) such that a disregarded item is either assigned to the same groupings to which the other income of a foreign branch is assigned or apply the rule in Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(A); and
4. Provide alternative methods for taxpayers to notify the IRS of foreign tax redeterminations under section 905(c).

Analysis

1. *Modify the proposed regulations such that taxpayers are not required to apportion stewardship expenses that relate solely to domestic subsidiaries on the basis of CFC stock.*

Treasury and the IRS should modify Prop. Treas. Reg. § 1.861-8(e)(4)(ii) and Prop. Treas. Reg. § 1.861-8(g)(18). Specifically, we recommend that Treasury and the IRS provide that taxpayers are not required to apportion stewardship expenses that relate solely to domestic subsidiaries on the basis of CFC stock.

One of the general principles of the section 861 regulations is that an expense is allocated to the item of gross income to which it is factually related. However, the proposed regulations and the corresponding example appear inconsistent.

Taxpayers could interpret the proposed regulations such that stewardship expenses related to activities performed with respect to a domestic corporate affiliate are nonetheless apportioned on the basis of foreign corporate stock. This interpretation, notwithstanding the expenses incurred, has no factual relationship with the foreign corporation. This position follows from Temp. Treas. Reg. § 1.861-11T(c), which disregards stock in corporations within the affiliated group for purposes of apportioning the taxpayer's interest expense.

In order to conform the regulations allocating and apportioning stewardship with the general principles of section 861, Treasury and the IRS should clarify in the final regulations apportionment of stewardship expenses in a manner that results apportionment of the expense item against all categories of gross income reasonably expected to result from the stewardship activity.

2. *Allow taxpayers to compute their basis in U.S. assets either using the ADS or by adjusting for section 179 and bonus depreciation under section 168(k) for purposes of section 864(f).*

Treasury and the IRS should provide that the ADS is used when electing to allocate interest on a worldwide basis under section 864(f). Section 863(e) has been modified for years ending after December 31, 2017 to provide that the interest expense for members of an affiliated group is determined using the adjusted basis of assets rather than on the basis of the fair market value or

gross income. Public L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act, repealed the fair market value analysis approach. In addition, the election under section 864(f), effective for tax years beginning after December 31, 2020, provides that the interest expense of domestic corporations that are members of a worldwide affiliated group is determined as if such worldwide affiliated group were a single corporation. Under these provisions, the allocation and apportionment of interest expense to the U.S. corporation is equal to the excess, if any, of the total interest expense of the worldwide affiliated group multiplied by a ratio that the foreign assets of the worldwide affiliated group bears to all assets of the worldwide affiliated group, over the interest expense of all foreign corporations that are members of the worldwide affiliated group (to the extent such foreign corporations would have allocated and apportioned foreign source income if this subsection were applied to a group consisting of all the foreign corporations in such worldwide affiliated group). In other words, the interest expense allocated to the U.S. is directly impacted by the ratio of foreign assets to total worldwide assets of the affiliated group.

For U.S. purposes, depreciation of the foreign assets of the affiliated group are computed under ADS while the U.S. assets are generally calculated under the Modified Accelerated Recovery System (MACRS), with eligibility for section 179 expense and 168(k) bonus depreciation. This method may result in the potential expensing of 100% of the basis of the U.S. assets in the year of purchase for a significant amount of assets purchased. In addition, the ADS class lives are longer than MACRS such that even if section 179 and bonus depreciation are not used, the basis of the U.S. assets will decline at a faster rate than similar assets located in foreign jurisdictions.

The effect of these two provisions, the accelerated depreciation in the U.S. and extended class lives of foreign assets under ADS, have the effect of distorting the value of foreign assets to worldwide assets based upon whether assets are placed in service within or without the U.S.

A similar issue was identified by Treasury in the preamble to the Prop. Treas. Reg. § 1.863-3, where Treasury stated the need for a new rule to prevent a distortion for allocating and apportioning gross income where there is production activity both within and without the United States. The new rule measures the basis of U.S. production assets based on ADS rather than MACRS.

In order to avoid distortion of asset values identified for purposes of section 863, we recommend that taxpayers should, for purposes of determining the worldwide interest apportionment under section 864(f), apply the same method of computing the basis of assets for assets within and without the U.S. for purposes of the worldwide asset base. Specifically, we recommend the appropriate method to use for section 864(f) is the ADS.

3. *Modify Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(B) such that a disregarded item is either assigned to the same groupings to which the other income of a foreign branch is assigned or apply the rule in Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(A).*

Treasury and the IRS should modify Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(B) such that the foreign taxes paid related to a disregarded item is assigned to the same groupings as other income of a foreign branch (*i.e.*, adopt a rule similar to Prop. Treas. Reg. § 1.904-6(b)(2)(ii), which applies when a U.S. person is the foreign branch owner). Alternatively, Treasury and the IRS could apply

the rule in Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(A) (*i.e.*, look to the assets of the foreign branch owner for purposes of assigning the item).

Proposed Treas. Reg. § 1.861-20(d)(3)(ii)(B) assigns foreign income taxes imposed on a disregarded payment made by a foreign branch owner to a foreign branch to the residual grouping. When the foreign branch owner is a CFC, such taxes are not deemed as paid under section 960, pursuant to Treas. Reg. § 1.960-1(e). Treasury and the IRS need to clarify that Prop. Treas. Reg. § 1.861-20(d)(3)(ii)(B) allows for a deemed paid credit in such an instance.

Cash repatriation and other treasury management functions have become increasingly complex. It is common for a foreign corporation with excess cash to lend such cash to its parent rather than distribute the cash. As a result, the foreign corporation lending the cash will earn interest income. If the foreign corporation has elected to be disregarded from its parent, then the foreign corporation is deemed a foreign branch, and the foreign corporation may receive a disregarded payment from its owner.

In such a case, it seems inappropriate to deny a foreign tax credit for the foreign income tax imposed on the foreign branch for the same reason it is inappropriate to deny such credit when the tax is paid by the foreign branch owner. Instead, the foreign tax paid should be assigned to the category of income out of which the principal was lent (at least as it relates to interest). Alternatively, the disregarded item (and thus, the corresponding tax) should be assigned by looking to the assets of the foreign branch owner. This rule is similarly adopted in the inverse (*i.e.*, when the foreign branch owner makes a payment to the foreign branch) and would then provide a deemed paid credit for taxes imposed on an ordinary business transaction.

4. Provide alternative methods for taxpayers to notify the IRS of foreign tax redeterminations under section 905(c).

Proposed Treas. Reg. § 1.905-3 addresses a redetermination of foreign taxes with respect to a foreign corporation of a U.S. shareholder, including tax law changes in various jurisdictions. Proposed Treas. Reg. § 1.905-4 describes the method for notifying the IRS of such impact to the U.S. shareholder.

The requirement to file amended tax returns without alternatives to simplify this process imposes additional unnecessary administrative burden to taxpayers in order to account for the adjustment in foreign tax credits. As currently proposed, it is necessary for taxpayers to not only amend federal returns but also amend multiple state and local returns. These amended returns often result in little or no adjustments to the impact on taxes paid.

In order to simplify the process to relieve taxpayers of additional administrative burdens, Treasury and the IRS should provide taxpayers options to account for these redeterminations. Viable options could include the option to amend tax returns or alternative methods that would not materially distort the foreign tax credit claimed. For example, taxpayers could adopt a *de minimis* exception to the administrative requirements of claiming FTCs as a result of redeterminations under section 905(c), similar to Temp. Reg. § 1.905-3T(d)(3)(ii), which provides a redetermination is only required if the effect of the redetermination reduces the domestic

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corporation's deemed foreign taxes paid by 10% or more. Furthermore, a taxpayer could elect to maintain these changes through a type of excess limitation account similar to the requirements of section 960(c)(2). Providing alternatives for taxpayers to account for foreign taxpayers to treat foreign tax redeterminations will ensure that the cost and administrative burden of filing amended and state returns is only needed in the event of a significant change in foreign taxes.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact David Sites, Chair, AICPA International Tax Technical Resource Panel, at (202) 861-4104 or David.Sites@us.gt.com; Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Wang@aicpa-cima.com or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,



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Chair, AICPA Tax Executive Committee

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