CAPITOL TAX
PARTNERS

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Summary of Final and Proposed Regulations Relating to Foreign Tax Credits
Released by Treasury on December 2, 2019

On December 2, 2019, Treasury and IRS (collectively, "Treasury") released final foreign tax credit regulations ("Final FTC Regulations") and proposed foreign tax credit regulations ("2019 Proposed FTC Regulations).

I. Final FTC Regulations

The Final FTC Regulations generally adopt the provisions of proposed regulations published in the Federal Register on December 7, 2018 ("2018 Proposed FTC Regulations"), with several revisions. Consistent with the proposed effective dates of the 2018 Proposed FTC Regulations, the Final FTC Regulations related to TCJA are generally applicable to tax years beginning after December 31, 2017. Other provisions are generally effective for tax years ending on or after December 4, 2018.

In addition, the Final FTC Regulations finalize proposed regulations issued in 2012 related to overall foreign losses (OFLs) and portions of proposed and temporary regulations issued in 2007 related to foreign tax redeterminations and currency translation rules for foreign taxes. These regulations are effective for taxable years ending on or after the date of filing in the Federal Register (and foreign tax redeterminations occurring in such taxable years).

The following summarizes the notable revisions and rejected comments identified in the Preamble.*

A. Revisions identified as important provisions revised from the 2018 Proposed FTC Regulations.

1. **Transition rules for foreign tax credit carryovers**. The Final FTC Regulations generally retain the transition rules for pre-2018 foreign tax credit carryovers and post-2017 carrybacks to a pre-2018 year, but adopt, as a safe harbor, a simplified rule for taxpayers who elect the branch carryover exception. Under the safe harbor, taxpayers may assign foreign tax credits to the foreign branch category proportionately based on the ratio of foreign taxes paid or accrued by the taxpayer's branches to total general category foreign taxes paid or accrued (or deemed paid) by the taxpayer in the year thee unused foreign taxes arose. §1.904-2(j).
2. **Transfers of IP for purposes of the foreign branch category**. The Final FTC Regulations generally retain the rules applicable to disregarded transfers of intangible property, with the following modifications: (i) the rules are limited to disregarded transfers occurring on or after December 7, 2018; and (ii) the rules do not apply to transfers by a foreign branch or foreign branch owner that (a) owns the intangible property transitorily (e.g., a CFC election to be treated as a disregarded entity); and (b) does not develop, exploit, or otherwise employ the property in a trade or business, other than in the ordinary course of its business during the period of transitory ownership. §§1.904-4(f)(2)(vi)(D)(*2*), (*3*).

* References to Preamble are to the document released by Treasury and IRS on December 2, 2019, which may vary slightly from the official document published in the Federal Register.

3. **Treatment of GILTI for purposes of the interest allocation rules**. The Final FTC Regulations retain the exempt income and asset treatment for the amount of gross income that is offset by the GILTI and FDII deduction, and a corresponding percentage of assets producing such income, including CFC stock basis that generates GILTI. In addition, the final regulations require lower-tier CFC tested income to tier-up to upper-tier CFCs for purposes of allocating interest expense under the modified gross income ("MGI") method in order to minimize differences between the asset method and the MGI method. §1.861-9(j)(2)(ii).

B. <u>Allocation and apportionment of deductions (section 861 regulations).</u>

1. **Definition of exempt asset by reason of FDII deduction**. The Final FTC Regulations modify the definition of exempt assets related to the FDII deduction to refer to assets that produce gross FDDEI (rather than FDII). Accordingly, the portion of assets treated as exempt is determined by dividing the FDII deduction by gross FDDEI (rather than FDII). §1.861-8(d)(2)(ii)(C)(*2*). This change results in a significant reduction in the amount of assets treated as exempt by reason of FDII, thus attracting more expenses to general and residual FTC limitation categories (and less to GILTI category).

2. **Specified partnership loans**. The Final FTC Regulations adopt the 2018 Proposed Regulations, with some clarifications, with respect to source and separate category of interest income and expense related to a "downstream" loan to a partnership by a US person (or member of same affiliated group) that owns an interest in the partnership (directly or indirectly). §1.861-9(e)(8).

    a. <u>Anti-avoidance rule</u>. Where the anti-avoidance rule applies, the loan receivable is held by a CFC rather than the US shareholder; appropriate adjustments are made to the value and characterization of CFC stock to reflect the amount of the loan that is disregarded.

    b. <u>Upstream partnership loans</u>. The 2019 Proposed FTC Regulations would expand the rules to apply to interest income and expense related to an "upstream" loan from a partnership to a partner. Preamble at 18; Prop. Reg. §1.861-9(e)(9)(ii) (see part II.A.6. below).

    c. <u>Guaranteed payments</u>. The 2019 Proposed FTC Regulations also address partnership equity structures to treat guaranteed payments for the use of capital similarly to interest deductions. Prop. Reg. §§1.861-9(b) and 1.954-2(h)(2)(i) (see part II.A.7. below).

3. **Applying the asset method at the CFC level**. The Final FTC Regulations clarify that, when applying the asset method of expense allocation at the level of a CFC, the rules in §1.861-12 apply to characterize and value the stock of lower-tier CFCs for purposes of all operative sections. Thus, for example, basis adjustments are made to reflect the earnings and profits of lower-tier CFCs. §1.861-9(g)(4).

4. **Assets funded by disallowed interest**. The 2019 Proposed FTC Regulations clarify the scope of the rule in §1.861-12T(f)(1), which requires a reduction to the adjusted basis of an asset connected to interest expense that is capitalized, deferred, or disallowed. Prop. Reg. §1.861-12(f) (see part II.A.8. below).

5. **Election to change to the sales method for research expense allocation**. The Final FTC Regulations provide additional time for the one-time exception with respect to the five-year binding election period to use either the sales method or gross income method under §1.861-17. A taxpayer may change its method for each taxable year beginning after December 31,

2017 and before January 1, 2020 (rather than only in the first taxable year beginning after December 31, 2017). §1.861-17(e)(3). This revision corresponds with the 2019 Proposed Regulations (which may be relied upon retroactively if applied consistently) that eliminate the gross income method and apply the sales method in a manner that does not allocate research expenses to the GILTI basket. Prop. Reg. §1.861-17 (see II.A.4. below).

C. Foreign tax credit limitation (section 904 regulations).

1. **Transition rule for SLL or OFL account incurred in pre-2018 general category**. The Final FTC Regulations retain as the default rule that pre-2018 general category SLLs and OFLs are allocated to the post-2017 general category. However, rather than tying the allocation to the FTC branch carryover exception, the final regulations allow taxpayers to choose to allocate any pre-2018 general basket balance to the post-2017 branch category to the extent it would have been allocated to the branch category had it existed in the year(s) the loss(es) giving rise to the account were incurred. A safe harbor is provided in lieu of branch loss account reconstruction to allow recapture the pre-2018 account balance from the first available income in the post-2017 general or foreign branch category. §1.904(f)-12(j)(2).
2. **Transition rule for recapture of pre-2018 SLL or ODL**. The Final FTC Regulations retain as the default rule that pre-2018 SLLs and ODLs are recaptured in the same post-2017 separate category of income that was offset by the loss. However, rather than tying recapture to the FTC branch carryover exception, the final regulations allow taxpayers to choose to recapture losses that offset pre-2018 general category income against foreign branch category income to the extent the loss would have offset branch category income, had it existed in the year(s) the loss(es) were incurred. A safe harbor is provided in lieu of reconstruction to allow recapture based on the FTC branch carryover exception. §1.904(f)-12(j)(3).
3. **Transition rule for foreign losses part of pre-2018 NOL carryforwards**. The Final FTC Regulations adopt as a default rule for purposes of applying §1.904(g)-3(b)(2), that a foreign loss from a pre-2018 separate category is treated as a loss attributable to the same post-2017 separate category. However, taxpayers may choose to attribute a pre-2018 general category NOL to the foreign branch category to the extent the NOL would have been attributable to the foreign branch category had it existed in the year(s) the NOL arose. A safe harbor is provided in lieu of reconstruction to allow recapture based on the amounts of general category income and foreign branch category income available in the carryforward year to be offset by the NOL carryforward. §1.904(f)-12(j)(4).
4. **Special rules for certain disregarded payments for purposes of foreign branch category**. The Final FTC Regulations (1) clarify that disregarded payments that would be capitalized into amortizable or depreciable basis produce adjustments under §1.904-4(f)(2) in the year(s) that the amortization or depreciation deductions would be allowed; and (ii) provide additional guidance on disregarded payments that would not be deductible, including disregarded sales of property where basis would be recovered other than through cost recovery deductions. §§1.904-4(f)(2)(vi)(B)(*1*), (*2*).
5. **Definition of foreign branch**. The Final FTC Regulations provide that activities conducted outside the United States that constitute a PE under treaty per se constitute a trade or business for purposes of the foreign branch definition (rather than presumptively). §1.904-4(f)(3)(vii)(B). In addition, the final regulations provide a standard to construct hypothetical books and records for purposes of the special rule treating a partnership as maintaining a separate set of books and records with respect to the activities of a foreign trade or business, even if not actually maintained. §1.904-4(f)(3)(vii)(C)(*2*).

6. **Intent to issue future guidance coordinating the allocation and apportionment of expenses with the determination of foreign branch category income**. Treasury is considering proposing rules applicable to regulated financial institutions regarding the allocation of interest expense to foreign branch category income and identifies two approaches under consideration. Treasury is also studying whether additional rules for allocating and apportioning expenses to foreign branch category income or limiting the amount of the adjustments to the attribution of gross income as a result of certain disregarded payments are appropriate. ***Comments requested*** as part of notice and comment on the 2019 Proposed FTC Regulations. Preamble at 56-57.

7. **Characterization of distributive shares of partnership income**. The Final FTC Regulations provide that, in the case of a corporate partner that is a general partner, the partner's distributive share of partnership income is characterized based on the income of the partnership regardless of the corporate partner's ownership threshold (rather than as passive income if the partner is a less than 10 percent owner). §§1.904-4(n)(1)(ii) and 1.861-9(e)(4).

8. **Treatment of disallowed interest deductions for purposes of section 904(d)(3) look-through rules**. The Final FTC Regulations provide that the allocation and apportionment rules that apply for purposes of the look-through rules are applied in the year the US shareholder takes the interest income into account, regardless of whether the related interest expense of the CFC is disallowed or deferred in that year. §1.904-5(c)(2)(i).

9. **Allocation and apportionment of foreign taxes – base and timing differences**. Treasury declined to override Code §904(d)(2)(H)(i), which allocates taxes associated with base differences to the foreign branch category. Preamble at 65. The Final FTC Regulations make no changes to the 2018 Proposed FTC Regulations in §1.904-6(a)(iv), but the Treasury references 2019 Proposed FTC Regulations, which provide additional guidance and an opportunity for taxpayers to comment. Prop. Reg. §§1.861-20 and 1.904-6 (see part II.B.2. below).

D. Translation of foreign taxes and foreign tax redeterminations (sections 986 and 905 regulations)

1. **Translation of foreign income taxes**. The Final FTC Regulations adopt portions of the 2007 temporary regulations related to currency translation rules, with several clarifications in response to comments. §§1.986(a)-1(a)(2)(i), 1.986(a)-1(c), 1.905-3(a), 1.986(a)-1(a)(1), 1.986(a)-1(a)(2) (relevant taxable year and meaning of "two years"); 1.986(a)-1(a)(2)(iii) (definition of inflationary currency); 1.986(a)-1(a)(2)(iii), (a)(2)(iv) (year-end translation rate); 1.986(a)-1(a)(2)(iv)(A), (B) (election to translate accrued taxes using the rate on the date of payment); 1.986(a)-1(e)(2), (3) (section 988 gain or loss when there is a change in functional currency).

2. **Definition of a foreign tax redetermination**. The Final FTC Regulations adopt portions of the 2007 temporary regulations, with several clarifying changes to what constitutes a foreign tax redetermination (FTR), including: (1) an FTR includes certain situations covered by section 905(c) that do not involve a change in foreign tax liability; (2) an FTR includes adjustments, such as a return to accrual adjustment; (3) an FTR occurs if any tax claimed as a credit or added to a PTEP group is subsequently refunded in whole or in part. §1.905-3(a).

3. **Adjustments to foreign taxes claimed as a direct credit**. The Final FTC Regulations adopt potions of the 2007 temporary regulations, with clarifications that (1) if an FTR occurs with respect to a foreign tax claimed as a direct credit, a redetermination of US tax liability is required for the year the credit was claimed and any year to which excess credits were carried;

and (2) in the case of FTRs occurring with respect to multiple foreign countries, the exception to a redetermination of US tax liability applies only if the $10,000 or 2% threshold is satisfied for each and every foreign country. §1.905-3(b)(1)(i).

E. **Deemed paid foreign taxes (section 960 regulations)**

1. **Current year taxes and timing differences for purposes of determining deemed paid taxes under section 960**. Treasury rejected several comments seeking changes to the definition of current year taxes to address timing differences, such as those arising as a result of a CFC having different US and foreign taxable years. Preamble at 86-93.
2. **Assignment of current year taxes imposed on pre-TCJA income**. Treasury confirms that a tax imposed in a post-TCJA year with respect to pre-TCJA income is assigned to a tested income group if the pre-TCJA income would be tested income if it was recognized in the year imposed. Final regulations revised to eliminate any inference that the timing difference rule assigns tax based on the separate categories that existed in the inclusion year. §1.960-1(d)(3)(ii)(B)(*2*).
3. **No deemed paid taxes for section 956 inclusions**. Treasury rejected comments seeking a modification to allow for a deemed paid credit with respect to a section 956 inclusion. Preamble at 99.
4. **PTEP groups in annual PTEP accounts**. The Final FTC Regulations consolidate certain PTEP groups listed in Notice 2019-1, reducing the number of PTEP groups from 16 to 10. §1.960-3(c)(2).
5. **Transition rule for foreign taxes deemed paid with respect to PTEP groups**. The Final FTC Regulations eliminate the condition that taxes were paid or accrued in a taxable year of the CFC that began before January 1, 2018 in order to be treated as PTEP group taxes. This change allows taxes imposed after 2017 on a distribution from a PTEP group form an inclusion year before 2018 to be treated as PTEP group taxes. §1.960-3(d)(3).
6. **No credit allowed for taxes attributable to section 965(a) earnings offset by deficit**. The Final FTC Regulations confirm that no credit is allowed under section 960(b) or any other provision of the Code for taxes attributable to section 965(a) earnings offset by an aggregate foreign E&P deficit what would have been deemed paid had the amounts actually been included in income under section 951(a). Preamble at 108.
7. **Taxes deemed paid under section 960(b) treated as section 78 dividend**. Treasury declined to override the statutory language of section 78, which states that taxes deemed paid under section 960(b) give rise to a section 78 dividend. Preamble at 110. As a result, distributions of PTEP remain subject to tax until a technical correction is enacted.

[Summary of 2019 Proposed FTC Regulations begins on the next page]

II. 2019 Proposed FTC Regulations

The 2019 Proposed FTC Regulations include guidance related to (i) the allocation and apportionment of deductions (e.g., stewardship, R&E); (ii) the definition of financial services income for purposes of section 904(d)(2)(C); (iii) allocation and apportionment of foreign taxes (also applicable to determine creditable deemed paid foreign taxes); (iv) foreign tax redeterminations under section 905(c); and (v) disallowance of foreign tax credits under section 965(g); and (vi) FTC limitation of consolidated groups.

Comments and requests for public hearing on the proposed regulations must be received by the date that is 60 days after publication in the Federal Register.

The following summarizes the 2019 Proposed FTC Regulations and their effective dates, as well as specific comments requested by Treasury in the Preamble.[**]

A. <u>Allocation and apportionment of expenses and calculation of section 904(a) taxable income.</u>

1. **Allocation and apportionment of stewardship expenses**. Stewardship expenses are allocable to dividends, subpart F inclusions, GILTI inclusions, and PFIC inclusions (along with related section 78 dividends) from related corporations. Stewardship expenses must be apportioned among foreign tax credit limitation categories based on relative values of the stock, as determined using the same method used for allocating and apportioning interest expense. Prop. Reg. §1.861-8(e)(4)(ii).
    a. <u>Definition of stewardship expenses</u>. Expenses that result from "overseeing" functions undertaken for a corporation's own benefit as an investor in a related corporation. Such expenses are those resulting from "duplicative activities" or "shareholder activities" (as defined in §1.482-9(l)(3)(iii) and (iv)).
        i. For example, an activity the sole effect of which is either to protect the corporation's capital investment in the related corporation or to facilitate compliance by the corporation with reporting, legal, or regulatory requirements applicable specifically to the corporation, or both.
        ii. Does not include fees for services or royalties that generate other US or foreign source income.
    b. <u>Partnerships</u>. The same principles apply with respect to stewardship expenses incurred with respect to a partnership interest. Such expenses are allocated and apportioned to a partner's distributive share of partnership income.
    c. <u>Application</u>. An example in the proposed regulations illustrates the application of these rules, showing that stewardship expenses are ultimately apportioned only to CFC stock basis, because domestic stock basis is eliminated. As a result, stewardship expenses will reduce the FTC limitation in the GILTI basket, general basket, and/or passive basket, depending on CFC stock categorization.
    d. <u>Applicability date</u>. Taxable years that end on or after date of filing in the Federal Register.
    e. <u>***Comments requested***</u>. Treasury requests comments regarding (1) exceptions to the general rule where it is more appropriate to treat stewardship expenses as definitely

[**] References to Preamble are to the document released by Treasury and IRS on December 2, 2019, which may vary slightly from the official document published in the Federal Register.

related to a more limited class of gross income; (2) whether it is more appropriate in certain cases to allocate and apportion stewardship expenses on a separate entity, rather than an affiliated group basis; (3) the definition of stewardship expenses and how to readily distinguish such expenses from supportive expenses that are allocated and apportioned under §1.861-8(b)(3) along with the deductions to which they relate; and (4) whether additional changes to the rules are appropriate in light of TCJA and in order to better reflect modern business practices that are increasingly global and mobile in nature.

2. **Litigation damages awards, prejudgment interest, and settlement payments**. Such expenses are allocated and apportioned based on the groupings to which related income would be assigned if the income were recognized in the taxable year in which the deduction is allowed. Prop. Reg. §1.861-8(e)(5). Expenses arising from –

    a. Product liability and similar claims are allocated to the gross income produced by the specific sales of products or services that gave rise to the claims for damage or injury.

    b. Events incident to the production of goods or provision of services (rather than damage or injury caused by the product or service) are allocated to gross income produced by the assets involved in the event and apportioned based on relative asset values using the same method used for allocating and apportioning interest expense.

    c. Claims by investors for negligence, fraud or other malfeasance of the corporation are allocated to all income of the corporation and apportioned based on relative asset values using the same method used for allocating and apportioning interest expense.

    d. Applicability date. Taxable years that end on or after date of filing in the Federal Register.

3. **Net operating loss deduction**. A net operating loss is assigned to the statutory and residual groupings by reference to the losses in each statutory or residual grouping (determined without regard to adjustments made under section 904(b)) that are not allocated to reduce US source income or income in other separate categories under sections 904(f) and 904(g) in the taxable year of the loss. An NOL deduction allowed under section 172 is allocated and apportioned by reference to the statutory and residual grouping components of the NOL that is deducted in the taxable year. Except as provided in regulations, a partial NOL deduction is treated as ratably comprising the components of the NOL. §1.861-8(e)(8).

    a. Applicability date. Taxable years that end on or after date of filing in the Federal Register.

    b. Section 250 as operative section. Comments requesting clarification on the application of §1.861-8(e)(8) with respect to pre-TCJA NOLs deducted in a post-TCJA year will be addressed as part of finalizing the section 250 proposed regulations.

4. **Research and experimentation expenses**. The 2019 Proposed FTC Regulations revise the rules for allocating and apportioning research and experimentation (R&E) expenses in several ways and result in no expense allocation to GILTI inclusions, subpart F inclusions, or PFIC inclusions. Prop. Reg. §1.861-17.

    a. Scope of R&E expenditures. Expenditures that a taxpayer deducts, or amortizes and deducts, in a taxable year under section 174 or 59(e). Does not include expenditures reduced by cost sharing transaction payments pursuant to §1.482-7(j)(3)(i).

b. Allocation, in general. The rules recognize that gross income derived from successful R&E must bear the cost of unsuccessful R&E, and that successful R&E expenses ultimately result in the creation of intangible property (as defined in section 367(d)(4)) that will be used to generate income. Therefore, R&E expenditures ordinarily are deductions that are definitely related to gross intangible income reasonably connected with the relevant Standard Industrial Classification Manual code ("SIC code") category of the taxpayer and therefore allocable to gross intangible income as a class related to the SIC code category.

c. Definition of gross intangible income. All gross income that is attributable (in whole or in part) to intangible property. Includes gross income from sales or leases of products or services derived from intangible property, income from sales of intangible property, income from platform contribution transactions, royalty income from licensing intangible property, and section 367(d) deemed royalties from a transfer of intangible property. Also includes a distributive share of such amounts. Does not include dividends, subpart F, GILTI, or PFIC inclusions.

d. Exclusive apportionment. Solely for purposes of applying section 904, 50 percent of R&E expenditures in a SIC code category is apportioned exclusively to US source (foreign source) gross intangible income if at least 50 percent of the R&E activity is performed in (outside) the United States. The rule allowing taxpayers to demonstrate an exclusive apportionment percentage higher than 50 percent is eliminated, based on Treasury's observation that taxpayers have rarely used the rule.

e. Legally mandated rule eliminated. The rule providing that R&E expenditures undertaken solely to meet legal requirements imposed by a political entity are allocated directly to gross income within the geographic source imposing the requirement has been eliminated, based on Treasury's observation that taxpayers rarely rely on the rule.

f. Sales method apportionment. The gross income method is eliminated. R&E expenditures remaining after application of the exclusive apportionment rule are apportioned to the taxpayer's statutory groupings of gross intangible income based on relative amounts of gross receipts from sales and leases of products (before COGS) and services within the relevant SIC code category. Gross receipts of certain controlled and uncontrolled parties that are exploiting the taxpayer's intangible property are taken into account.

    i. *Gross receipts of controlled corporations*. Gross receipts of a controlled corporation (based on section 267(b), but an affiliated group is treated as a single taxpayer) are taken into account if the taxpayer can reasonably be expected to license, sell, or transfer (directly or indirectly) intangible property to the corporation that would arise from the taxpayer's current R&E expenditures. This condition is presumed to be satisfied if the taxpayer has previously licensed, sold, or transferred intangible property related to the same SIC code category to the controlled corporation.

        - Effect of cost sharing arrangements. If the controlled corporation has entered into a cost sharing arrangement with the taxpayer under §1.482-7 for the purpose of developing intangible property, the taxpayer is not reasonably expected to license, sell, or transfer to the controlled corporation intangible property that would arise from the taxpayer's share of R&E expenditures with respect to the cost shared intangibles.

ii. *Gross receipts of uncontrolled parties*. Gross receipts of each uncontrolled party (any person not related based on section 267(b)) from particular products or services incorporating intangible property that was licensed, sold, or transferred by the taxpayer to the uncontrolled party (directly or indirectly) are taken into account if the taxpayer can reasonably be expected to license, sell, or transfer to the uncontrolled party intangible property that would arise from current R&E expenditures. This condition is presumed to be satisfied if the taxpayer has previously licensed, sold, or transferred intangible property related to the same SIC code category to the uncontrolled party.

iii. *Special rules for partnerships*. A taxpayer's R&E expenditures include its distributive share of a partnership's R&E expenditures, which are treated as incurred by the partner for the same purpose and in the same location as incurred by the partnership. The full amount of a controlled partnership's gross receipts are taken into account as if the partnership were a corporation.

g. Applicability date. Taxable years beginning after December 31, 2019. However, taxpayers on the sales method for taxable years beginning after December 31, 2017 and before January 1, 2020, may rely on Prop. Reg. §1.861-17 if they apply it consistently. Therefore, a taxpayer on the sales method for its taxable year beginning in 2018 may rely on Prop. Reg. §1.861-17 but must also apply the sales method for its taxable year beginning in 2019.

h. ***Comments requested***. Treasury requests comments on whether (1) a different classification method (from the 3-digit SIC code) that takes into account more recent changes in the economy and business practices should be used (e.g., NAICS codes); and (2) whether contract research arrangements involving expenditures reimbursed by a foreign affiliate are generally paid or incurred by the taxpayer in connection with its trade or business such that a deduction under section 174 is allowable, and whether a special rule for such expenditures should be considered.

i. Section 250 as operative section. Further changes to the rules for allocating and apportioning R&E expenditures will be considered as part of addressing comments in finalizing the section 250 proposed regulations.

5. ***Other requests for comments on expense allocation***. Treasury requests comments on a number of expense allocation issues:

   a. Interest expense. Treasury continues study interest allocation rules and whether further guidance is required, taking into account the changes made by TCJA and the further implementation of section 864(f) (worldwide interest allocation, effective for tax years beginning after 2020).

   b. Tax book value method. Treasury is considering whether rules providing for the capitalization and amortization of certain expenses solely for purposes of §1.861-9 may better reflect asset values under the tax book value method (e.g., treat R&E expenditures and advertising expenses as if capitalized and amortized).

   c. Foreign branch income. As noted in the preamble to the Final FTC Regulations, Treasury is studying whether additional rules for allocating and apportioning expenses to foreign branch category income, or limiting the amount of the gross income reallocated as a result of disregarded payments, are appropriate to more accurately reflect the business profits of a foreign branch, while maintaining administrability for taxpayers and the IRS.

6. **Certain loans made by partnerships to partners**. To the extent the borrower (a partner) in an "upstream partnership loan" (loan from partnership to partner) takes into account both interest expense and interest income with respect to the same loan, the interest income is assigned to the same statutory and residual groupings as those from which the matching amount of interest expense is deducted. Prop. Reg. §1.861-9(e)(9).
    a. This rule correlates to the specified partnership loan rule in the final regulations (§§1.861-9(e)(8)), which addresses a loan made by a partner to a partnership (downstream partnership loan).
    b. Under this rule, for example, a US partner's distributive share of interest income on a loan from a foreign partnership to such partner would be assigned based on how the partner's interest expense is allocated and apportioned (rather than as US source income).
    c. Applicability date. Taxable years that end on or after date of filing in the Federal Register.
7. **Guaranteed payments for the use of capital**. Guaranteed payments for the use of capital described in section 707(c) are treated similarly to interest deductions for purposes of allocating and apportioning deductions under §§1.861-8 through -14 and are treated as income equivalent to interest under section 954(c)(1)(E). Prop. Reg. §§1.861-9(b) and 1.954-2(h)(2)(i).
    a. Treasury is aware of taxpayers converting existing partnership debt structures to equity structures to increase FTC limitation before the issuance of §1.861-9(e)(8) (downstream partnership loans), and taking the position that the guaranteed payments are neither allocated and apportioned nor included in subpart F income by reason of §1.954-2(h). No inference intended on the treatment of guaranteed payments for taxable years before the proposed regulations are applicable.
    b. Applicability date. Taxable years that end on or after date of filing in the Federal Register.
8. **Treatment of assets connected with capitalized, deferred, or disallowed interest**. The scope of the rule that reduces the value of an asset by the principal amount of connected indebtedness the interest on which is capitalized, deferred or disallowed is limited. Assets are connected with debt only if using the debt proceeds to acquire or produce the asset causes the interest to be capitalized, deferred, or disallowed. Examples illustrate the application of this rule and conclude that capitalized interest under section 263A results in asset basis being reduced, but disallowed interest under section 163(l) does not. Prop. Reg. §1.861-12(f).
    a. Applicability date. Taxable years that end on or after date of filing in the Federal Register.
9. **Provisions related to insurance companies**. The 2019 Proposed FTC Regulations include two provisions related to insurance companies:

a. Application of exempt income/asset rule to insurance companies. In the case of an insurance company, exempt income includes, without regard to the proration rules, (i) dividends for which a DRD is provided by sections 243(a)(1) and (2) and 245; and (ii) exempt interest. In addition, an amount of reserve expenses of a life insurance company equal to the DRD that is disallowed because it is attributable to the policyholder's share of dividends received is treated as definitely related to such dividends. Prop. Reg. §1.861-8(d)(2)(ii)(B), (d)(2)(v), and (e)(16).

b. Treatment of section 818(f) reserve expenses for consolidated groups. The deduction for life insurance reserves and certain other deductions are allocated and apportioned on a separate company basis (rather than on a single entity or life subgroup method). Prop. Reg. §1.861-14(h)(1).

   i. ***Comments requested***. (1) whether a life subgroup method more accurately reflects the relationship between section 818(f) expenses and the income producing activities of the life subgroup as a whole and is less susceptible to abuse; (2) whether an anti-abuse rule may be appropriate to address concerns with the separate entity method; and (3) the appropriate application of §1.1502-13(c) to neutralize the ancillary effects of separate-entity computation of insurance reserves, such as the computation of section 904 limitations.

c. Applicability date. Taxable years that end on or after date of filing in the Federal Register.

10. **Application of section 904(b) to net operating losses**. A coordination rule provides that, for purposes of determining source and separate category of an NOL, the SLL and OFL rules of section 904(f) and ODL rules of section 904(g) are applied without taking into account the adjustments required by section 904(b). Treasury determined this rule is appropriate because the amount of an NOL eligible to be carried over under section 172 is not affected by section 904(b) adjustments. Prop. Reg. §1.904(b)-3(d)(2).

    a. Applicability date. Taxable years that end on or after date of filing in the Federal Register.

B. Foreign tax credit limitation under section 904.

1. **Definition of financial services entity**. The definition of "financial services entity" for purposes of section 904(d)(2)(C) is modified by adopting a definition of "predominantly engaged in the active conduct of a banking, insurance, financing, or similar business" and "income derived in the active conduct of a banking, insurance, financing or similar business" that is generally consistent with sections 954(h) (which requires more than 70 percent of the gross income be derived from transactions with unrelated customers), 1297(b)(2)(B), and 953(e). Prop. Reg. §1.904-4(e)(2).

   b. Principal significance of definition. According to the Treasury, the principal significance of this definition is that passive income of a financial services entity is not assigned to the passive category under section 904(d)(2)(C). Preamble at 31. Treasury notes that the preamble to the 2018 Proposed FTC Regulations stated that Treasury was considering modifications to the gross income-based test for determining financial services entity status and requested comments in this regard.

   c. Applicability date. Taxable years that end on or after date of filing of final regulations in the Federal Register.

d. ***Comments requested***. Treasury requests comments on whether additional guidance is needed with respect to section 954(h) (including in particular section 954(h)(2)(B)(ii), which provides regulatory authority regarding corporations not licensed as a bank in the United States) and section 952(c)(1)(B)(vi) (defining a qualified financial institution for purposes of the qualified deficit rules).

2. **Allocation and apportionment of foreign income taxes**. The general rules of §1.904-6 (which address allocating and apportioning taxes to separate categories) are moved to new Prop. Reg. §1.861-20 and generalized to apply for purposes of allocating and apportioning foreign income taxes to statutory and residual groupings in all contexts (not just for purposes of the FTC limitation). The proposed regulations are intended to provide increased certainty on how to match foreign income taxes with income, particularly where there is a difference between the US and foreign tax base with respect to the same transaction.

a. General rule. Each separate foreign income tax is allocated and apportioned separately among the statutory and residual groupings in three steps: (1) items of foreign gross income are assigned to the groupings; (2) foreign law deductions are allocated and apportioned to foreign gross income in the groupings; and (3) foreign income taxes are allocated and apportioned to the foreign taxable income in the groupings. Prop. Reg. §1.861-20(c).

b. Assigning items of foreign gross income. The amount of each item is determined under foreign law, but the character of each item is determined under Federal income tax law for purposes of assigning to groupings. Where there is a corresponding US item of gross income, it is assigned to the same grouping. If the corresponding US item is a loss (or zero), it is assigned to the grouping it would be assigned to if the corresponding item was a gain. Prop. Reg. §1.861-20(d).

i. *No corresponding US item – US nonrecognition event, or US recognition event in a different US tax year*. Foreign gross income is characterized and assigned as if the gross income or loss were recognized under Federal income tax law in that US tax year.

ii. *No corresponding US item – recognized but excluded from US income*. Except for base differences, foreign gross income is assigned as if it were included in US gross income.

iii. *No corresponding US item – base differences*. Foreign gross income attributable to a base difference is assigned to the residual grouping. An exclusive list of base differences is provided:

- Death benefits described in section 101;
- Gifts and inheritances described in section 102;
- Contributions to capital described in section 118;
- The receipt of money or other property in exchange for stock under section 1032 (including by reason of a section 351(a) transfer);
- The receipt of money or other property in exchange for a partnership interest under section 721;
- The portion of a distribution of property that is a return of capital under section 301(c)(2); and

- A distribution to a partner under section 733.
- ***<u>Comments requested</u>***. Whether (1) the list should be expanded to include other items that have no logical analogue to items included in US gross income, or (2) a different assignment of any of these types of foreign gross income would be more appropriate.

iv. *Items of foreign gross income included by a taxpayer in its capacity as a shareholder*. Special rules are provided for characterizing and assigning items of foreign gross income from a distribution, a foreign law distribution, an inclusion, or stock gain (as determined under foreign law).

- <u>Distribution – dividend</u>. If recognized for both foreign and US law purposes, the foreign dividend amount is, to the extent of the US dividend amount, assigned to the same groupings from which a distribution of the US dividend amount is made under Federal law. Any excess is, to the extent of the US return of capital amount, attributable to a base difference. Any additional excess is assigned to the category to which the US capital gain is assigned.
- <u>Distribution – capital gain</u>. If recognized for both foreign and US law purposes, the foreign capital gain amount is, to the extent of the US capital gain amount, assigned to the groupings to which the US capital gain amount is assigned under Federal law. Any excess is, to the extent of the US return of capital amount, attributable to a base difference. Any additional excess is assigned ratably to the groupings to which the US dividend amount is assigned.
- <u>Foreign law distribution</u>. If treated as a distribution for foreign law purposes, but not US law purposes (e.g., a section 305 stock dividend or a foreign law consent dividend), the gross income is assigned under the above distribution rules as if it was treated as a distribution under US law in the US taxable year in which the foreign income tax is paid or accrued.
- <u>Foreign law subpart F regime</u>. CFC income inclusions under a foreign subpart F regime are assigned to the same groupings as the CFC income that gave rise to the foreign law subpart F inclusion, determined by treating the CFC as the taxpayer.

v. *Disregarded payments made by a foreign branch*. In general, foreign gross income arising from a payment made by a disregarded entity or other foreign branch is assigned to the grouping to which the income out of which the payment is made is assigned. A disregarded payment is considered to be made ratably out of all of the accumulated after-tax income of the foreign branch.

- <u>Accumulated after tax income of the foreign branch</u>. The income is deemed to have arisen in the groupings in the same ratio as the tax book value of branch assets in the groupings, based on §1.987-6(b)(2), unless the payment was made with a principal purpose of avoiding the purposes of an operative section or results in a material distortion. Foreign branch assets include stock held by the foreign branch.

vi. *Disregarded payments made by an owner*. In general, foreign gross income arising from a disregarded payment made to a foreign branch by a foreign branch owner is assigned to the residual grouping. Where section 904 is the operative section, see §1.904-6(b)(2)(ii), which assigns certain items to foreign branch category.

vii. *Disregarded payments in connection with disregarded sales or exchanges of property*. Foreign gross income attributable to gain recognized under foreign law arising from a disregarded payment in exchange for property is characterized and assigned under the rules for US nonrecognition events, above.

viii. *Reverse hybrids*. Items of foreign gross income received in the capacity as the owner of a reverse hybrid is assigned to categories by treating such items as the foreign gross income of the reverse hybrid, and treating the reverse hybrid as the taxpayer.

- ***<u>Comments requested</u>***. Whether additional rules are needed to address other fact patterns in which the US and foreign country tax different persons on the same item of income, for example, in the case of a sale-repurchase agreement.

ix. *Gain on sale of disregarded entity*. Foreign gross income arising from gain on the disposition of a disregarded entity that is characterized as an asset disposition for Federal tax purposes is assigned to groupings in the same proportion as the gain would be assigned if the transaction were treated as an asset disposition for foreign tax purposes.

e. <u>Allocating and apportioning foreign law deductions to foreign gross income</u>. Foreign law tax deductions are allocated to foreign gross income in each group based on foreign law that (1) specifically allocates deductions to foreign gross income; or (2) provides principles to allocate and apportion deductions among the groupings. If foreign law does not provide any rules, then the principles of the section 861 regulations apply in the same manner as the taxpayer applies such principles. Prop. Reg. §1.861-20(e).

f. <u>Apportionment of foreign income tax among groupings</u>. Foreign income tax is ratably allocated among the groupings. If foreign law (including by treaty) exempts certain types of income from tax, or if foreign taxable income is reduced to or below zero by deductions, then no foreign income tax is allocated and apportioned to that income. Withholding tax is allocated and apportioned to the foreign gross income from which it was withheld. Specific foreign tax rates or credits are taken into account. Prop. Reg. §1.861-20(f).

g. <u>Application of rules for purposes of sections 904 and 960</u>. Proposed rules clarify or modify the application of Prop. Reg. §1.861-20 for purposes of determining the foreign tax credit limitation under section 904 and foreign taxes deemed paid under section 960.

i. *Base differences*. Foreign gross income and the associated tax are assigned to the section 904(d)(2)(H)(i) category (foreign branch income) and to foreign source income in that category. Prop. Reg. §1.904-6(b)(1).

ii. *Disregarded payments made by foreign branch*. If §1.904-4(f)(2)(vi)(A) attributes US gross income to another foreign branch or foreign branch owner, the item of foreign gross income that arises from the disregarded payment is assigned to the same category as the reattributed US gross income. Prop. Reg. §1.904-6(b)(2)(i).

iii. *Disregarded payments made by a foreign branch owner*. Payments made by a foreign branch owner to a foreign branch is assigned to the foreign branch category. Prop. Reg. §1.904-6(b)(2)(ii).

iv. *Disposition of property resulting in reattribution of US gross income to or from a foreign branch*. If §1.904-4(f)(2)(iv)(A) reattributes US gross income, any foreign gross income arising from the disposition of property under foreign law is assigned to the category under the rule of §1.861-20(d)(1) applied without regard to the reattribution of US gross income. Prop. Reg. §1.904-6(b)(3).

v. *Allocating and apportioning deductions*. Before applying the rules of §1.861-20(e), foreign gross income in the passive category is first reduced by any related person interest expense under the principles of section 954(b)(4) and §1.904-5(c)(2)(ii)(C). Prop. Reg. §1.904-6(c).

vi. *Apportionment of taxes for purposes of applying the high-taxed income tests*. Taxes allocated and apportioned to passive income must be further apportioned to the groups of income described in §1.904-4(c)(3), (4), and (5) for purposes of determining if the group is high-taxed income recharacterized as income in another category. Prop. Reg. §1.904-6(d).

vii. *Treatment of certain foreign income taxes paid or accrued by US shareholders*. Where a US shareholder pays or accrues foreign tax on foreign gross income recognized because it owns a foreign law CFC or reverse hybrid, the foreign gross income is reassigned to the section 951A category if the income would be assigned to the general category tested income group had the foreign law CFC or reverse hybrid recognized the foreign gross income. The amount reassigned is based on the US shareholder's inclusion percentage under §1.960-2(c)(2). Prop. Reg. §1.904-6(f).

- ***Comments requested***. Treasury continues to study the allocation and apportionment of foreign income tax that is imposed on foreign gross income that is associated with the general category tested income group of a foreign law CFC or reverse hybrid. Comments requested on the proper treatment of such foreign income tax in the circumstance in which some or all of the tax is not assigned to the section 951A category under Prop. Reg. §1.904-6(f) because no inclusion is attributable to the tested income group, or the inclusion percentage of the US shareholder is less than 100 percent. In particular, comments are requested on the interaction of Prop. Reg. §1.904-6(f) with sections 245A and 909.

h. Applicability date. Taxable years beginning after December 31, 2019.

i. ***Comments requested***. Whether (1) additional guidance should be provided on allocating and apportioning section 903 taxes (tax in lieu of foreign income tax), and foreign income taxes for which the taxable base is computed formulaically with respect to a unitary business; and (2) the rules in §1.861-8(e)(6) for allocating and apportioning state income taxes should be revised in light of changes made by the TCJA and changes to state rules for taxing foreign income.

3. **Overall foreign loss recapture on property dispositions**. Portions of the 2012 OFL proposed regulations are clarified to provide that additional income amounts recognized by reason of branch loss recapture (now US source under section 91, so subject to ODL recapture rules) and dual consolidated loss recapture are not taken into account for purposes of the ordering rules until after the section 904(f) amounts are determined, and such additional income amounts are offset by a section 904(f)(3) recapture amount. Prop. Reg. §1.904(g)-3(j).
    a. Applicability date. Taxable years that end on or after date of filing of final regulations in the Federal Register.

C. Foreign tax redeterminations under section 905(c).

1. **Definition of foreign tax redetermination**. A foreign tax redetermination means a change in the liability for foreign taxes, or certain other changes that may affect a taxpayer's US tax liability, including by reason of a change in the amount of its foreign tax credit, the amount of its distributions or subpart F, GILTI or PFIC inclusions, or the application of the subpart F high-tax exception (including for purposes of determining tested income). Prop. Reg. §1.905-3(a).
2. **Adjustments to foreign taxes paid by foreign corporations**. A redetermination of US tax liability is required to account for the effect of a foreign corporation's foreign tax redetermination. Prop. Reg. §1.905-3(b)(2).
    a. Required adjustments. The foreign corporation's taxable income, earnings and profits, and current year taxes must be adjusted in the year to which the redetermined tax relates, and the redetermined US tax liability is made by treating the redetermined foreign tax as the amount paid or accrued by the foreign corporation for such year, which affects –
        i. The foreign corporation's subpart F income, tested income, and earnings and profits;
        ii. The characterization and amount of distributions or inclusions under sections 951, 951A, or 1293 taken into account by US shareholders;
        iii. The application of the high-tax exception described in section 954(b)(4) (including for purposes of determining tested income under section 951A(c)(2)(A)(i)(III)); and
        iv. The amount of tax deemed paid under sections 960 and 1291 in such year.

    In addition, a redetermination of US tax liability is required for any subsequent year that is affected by the US shareholder's distribution or inclusion, up to and including the taxable year in which the foreign tax redetermination occurs, as well as any year to which unused foreign taxes from such year were carried under section 904(c).
    b. Reduction of corporate level tax on distribution of earnings and profits. If a US shareholder receives a distribution out of section 959(c)(1) or (2) PTEP, and a foreign tax imposed on the distributing CFC is reduced on such distribution (resulting in a

foreign tax redetermination), then the US shareholder must redetermine its US tax liability for the year(s) affected.

c. Foreign tax redeterminations relating to pre-2018 taxable years. See Prop. Reg. §1.905-5 for a transition rule for redeterminations of pre-2018 foreign tax liability that occur post 2017 (see part II.C.5. below).

3. **Foreign tax redeterminations of successors or transferees**. If the person legally liable for tax at the time of the foreign tax redetermination is different than the person that was legally liable in the year to which the redetermined tax relates, the required redetermination of US tax liability is made as if the foreign tax redetermination occurred in the hands of the original taxpayer. Prop. Reg. §1.905-3(b)(3).

    a. ***Comments requested***. Whether additional rules are required to address situations involving predecessors or successors.

4. **Notification to the IRS of foreign tax redeterminations and related penalty provisions**. The 2019 Proposed FTC Regulations generally follow the 2007 temporary regulations, but clarify that, if more than one foreign tax redetermination requires a redetermination of US tax liability for the same affected year and those redeterminations occur within the same taxable year or within two consecutive taxable years, the taxpayer may file one amended return and one required statement for the affected year. The due date of the amended return depends on whether the net effect is an increase or decrease in US tax liability. Prop. Reg. §1.905-4(b)(1)(iv).

    a. No change to US tax liability. If a foreign tax redetermination (alone or in combination with others) does not result in a change to US tax liability (e.g., because of a carryover or carryback of FTCs), an amended return is not required. Instead, adjustments are made to the amounts carried over from that year, and the taxpayer must attach a statement to its original return for the year in which the foreign tax redetermination occurs. Prop. Reg. §1.905-4(b)(1)(v).

    b. Foreign tax redeterminations of pass-through entities. A pass-through entity that reports creditable foreign income tax to its partners, shareholders, or beneficiaries is required to notify and provide certain information to the IRS and its owners/beneficiaries if there is a foreign tax redetermination. Prop. Reg. §1.905-4(b)(2).

        i. ***Comments requested***. Any further coordination that may be required between sections 905(c) and 6227 in order to carry out the purposes of the foreign tax credit and the centralized partnership audit regime.

    c. Alternative notification requirements. Amended Forms 1118 or 1116 are not required if the taxpayer satisfies alternative notification requirements that may be prescribed. Treasury intends to issue regulations providing for alternative procedures in the case of tax refunds received by regulated investment companies making the election to pass through foreign tax credits under section 853.

        i. ***Comments requested***. Treasury requests comments on additional alternative approaches to complying with the notification requirements of section 905(c) that minimize burdens to both taxpayers and the IRS.

    d. Foreign tax redeterminations of LB&I taxpayers. Such taxpayers are required, in limited circumstances, to provide to IRS examiners notice of a foreign tax redetermination in lieu of filing an amended return. The 2019 Proposed FTC Regulations are generally the same as the rules in the 2007 temporary regulations, but (1) simplify the statement requirements; and (2) reorganize them to provide a list of conditions, all of which must be met in order for the rule to apply. Prop. Reg. §1.905-5(b)(4). Conditions are –

i. A foreign tax redetermination occurs while the taxpayer is under the jurisdiction of LB&I (or a successor division);

ii. The foreign tax redetermination results in a downward adjustment to the amount of foreign tax paid or accrued, or included in the computation of foreign taxes deemed paid;

iii. The foreign tax redetermination requires a redetermination of US tax liability and accordingly, but for §1.905-4(b)(4), the taxpayer would be required to notify the IRS by filing an amended return;

iv. The return for the taxable year for which a redetermination of US tax liability is required is under examination; and

v. The due date for providing notice of such foreign tax determination is not before the latest of the opening conference or the hand-delivery postmark date of the opening letter concerning the examination of the return for the taxable year for which a redetermination of US tax liability is required.

e. Penalty provisions. The 2019 Proposed FTC Regulations clarify the 2007 temporary regulations related to penalties for failure to notify the IRS, in the time and manner prescribed by regulations, for giving such notice. Prop. Reg. §301.6689-1.

5. **Transition rule relating to the TCJA**. Under a transition rule, post-2017 redeterminations of pre-2018 foreign income tax must be accounted for by adjusting the foreign corporation's taxable income, earnings and profits, post-1986 undistributed earnings, and post-1986 foreign income taxes (or pre-1987 earnings and taxes, as applicable) in the pre-2018 year to which the redetermined foreign taxes relate. Prop. Reg. §1.905-5.

a. Redetermination of US tax liability. Each US shareholder takes into account effect of the foreign tax redetermination for the relation-back year on its taxable income (i.e., characterization and amount of distributions or inclusions under sections 951 or 1293), the amount of taxes deemed paid under pre-2018 sections 902, 960, or 1291, and on the application of the high-tax exception under section 954(b)(4). In addition, a redetermination of US tax liability is required for any subsequent year, up to and including the taxable year in which the foreign tax redetermination occurs, as well as any year to which unused foreign taxes from such year were carried under section 904(c).

b. Notification requirements. The general notification requirements of Prop. Reg. §1.905-4 apply. In addition, a taxpayer is required to provide the balances of post-1986 undistributed earnings and tax pools before and after adjustment, dates and amounts of any dividend distributions or inclusions made out of the pools for the affected year(s), and the amount of earnings and profits from which such dividends or inclusions were made for the affected year(s). Certain requirements also apply to foreign tax redeterminations with respect to pre-1987 years.

c. Adjustments to pools of post-1986 foreign income taxes. The redetermination of US tax liability is made in accordance with pre-2018 section 905(c), but excluding the rules that required prospective adjustments to a foreign corporation's post-1986 earnings and tax pools in lieu of redeterminations of US tax liability.

d. Redeterminations with respect to pre-1987 years. Certain notification requirements and currency translation rules apply for adjustments to pre-1987 foreign income taxes. Prop. Reg. §1.905-5(b)(3) and (c).

e. ***Comments requested***. Treasury requests comments on whether an alternative approach to account for post-2017 foreign tax redeterminations with respect to pre-2018 taxable years of foreign corporations may provide for a simplified and reasonably accurate alternative. For example, an adjustment to the foreign corporation's taxable income and earnings and profits, post-1986 undistributed earnings, and post-1986 foreign income taxes as of the foreign corporation's last taxable year beginning before January 1, 2018.

6. **Applicability date for section 905(c) regulations**. Foreign tax redeterminations occurring in taxable years ending on or after date of filing in the Federal Register. Prop. Reg. §1.905-3 is limited to foreign tax redeterminations that related to taxable years of foreign corporations beginning after December 31, 2017. Prop. Reg. §1.905-5 is limited to foreign tax redeterminations that relate to taxable years of foreign corporations beginning before January 1, 2018.

D. Other proposed rules.

1. **Foreign income taxes taken into account under section 954(b)(4)**. The subpart F high tax exception is applied by taking into account the redetermined foreign tax in the adjusted year.

   a. Taxes contingent on distribution. Foreign income taxes that have not accrued because they are contingent on a future distribution are not taken into account in determining whether the high-tax exception applies. If a redetermination of US tax liability is required when a tax is imposed on a foreign corporation with respect to a distribution, the redetermined foreign tax is taken into account in the adjusted year. Prop. Reg. §1.954-1(d)(3)(iii).

   b. Applicability date. Taxable years that end on or after date of filing in the Federal Register. Treasury is aware that taxpayers have applied the high tax exception by treating taxes contingent on distribution as paid or accrued, even in the absence of any distribution triggering the foreign tax. IRS may challenge this position under current law. Preamble at 61.

2. **Disallowance of foreign tax credits under section 965(g)**. The principles of §1.904-6 apply to determine the extent to which foreign taxes are attributable to distributions of section 965 PTEP. Accordingly, the section 965(g) disallowance of the applicable percentage of foreign taxes may apply to foreign taxes imposed on amounts recognized as a dividend for foreign tax purposes, but not for Federal income tax purposes (e.g., consent dividends). Prop. Reg. §1.965-5(b)(2).

   a. Applicability date. Taxable years of foreign corporations that end on or after date of filing in the Federal Register and taxable years of a US person in which such taxable years of the foreign corporations end. IRS may challenge contrary positions taken in prior years. Preamble at 63.

3. **Updates to consolidated foreign tax credit rules**. Amendments to section 1502 regulations relating to the computation of the consolidated foreign tax credit are proposed to reflect changes in law, such as eliminating out of date references to the per country limitation. Prop. Reg. §1.1504-4. Other changes include:

   a. Group-wide application. The amount of foreign source income in each separate category (numerator in FTC limitation fraction), is determined by applying the rules of §1.1502-11 and sections 904(f) and (g) on a group-wide basis, rather than on a separate member basis and combining the results.

   b. Consolidated NOL. New rules provided for purposes of determining source and separate category of a consolidated NOL and the portion of a consolidated NOL that is apportioned to a separate return year of a member.

   c. Applicability date. Taxable years for which the original consolidated Federal income tax return is due (without extensions) after date of publication in the Federal Register.

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