

US Outbound Tax Newsalert

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IRS issues final technical taxpayer regulations

The IRS today issued final regulations which provide guidance relating to the determination of who is considered to pay a foreign income tax for purposes of the foreign tax credit. The regulations provide rules for identifying the person with legal liability to pay the foreign income tax in certain circumstances. The regulations make some revisions to proposed regulations issued in August 2006.

Taxes imposed on combined income

The 2006 proposed regulations provided that foreign tax must be apportioned among the persons whose income is included in the combined base pro rata based on each person's portion of the combined income, as computed under foreign law. Because failure to allocate appropriately the consolidated tax among the members of the group may result in the separation of foreign income tax from the related income as described in Section 909, comments recommended that the proposed rules be finalized in lieu of treating these arrangements as foreign tax credit splitting events under Section 909, which would require suspension of split tax until the related income is taken into account. The IRS agreed with the comments and adopted the proposed regulations with minor modifications. As the regulations are generally effective for foreign taxes paid or accrued during tax years beginning after February 14, 2012, a foreign tax credit splitting event will not occur with respect to foreign taxes paid or accrued on combined income in such years. However, with respect to foreign income taxes paid or accrued on combined income during tax years beginning after December 31, 2010, and on or before February 14, 2012, temporary regulations under Section 909 provide that a foreign tax credit splitting event occurs to the extent



that a taxpayer does not allocate the foreign consolidated tax liability among the members of the foreign consolidated group based on each member's share of the consolidated taxable income included in the foreign tax base under the principles of Reg. Sec. 1.901-2(f)(3) prior to its amendment by the Treasury decision.

Also, in response to practitioner comments, the final regulations provide that combined income with respect to each foreign tax that is imposed on a combined basis, and combined income subject to tax exemption or preferential tax rates, is computed separately, and the tax on that combined income base is allocated separately.

Section 1.901-2(f)(2)(ii) of the 2006 proposed regulations provided that for purposes of Reg. Sec. 1.901-2(f)(2) of the proposed regulations, foreign tax is imposed on the combined income of two or more persons if such persons compute their taxable income on a combined basis under foreign law. The final regulations adopt the 2006 proposed regulations which provide that foreign tax is imposed on the combined income of two or more persons if such persons compute their taxable income on a combined basis under foreign law, with several modifications. The final regulations provides that tax is considered to be computed on a combined basis if two or more persons that would otherwise be subject to foreign tax on their separate taxable incomes add their items of income, gain, deduction, and loss to compute a single consolidated taxable income amount for foreign tax purposes. In addition, foreign tax is not considered to be imposed on the combined income of two or more persons if, because one or more of such persons is a fiscally transparent entity under foreign law, only one of such persons is subject to tax under foreign law (even if two or more of such persons are corporations for US tax purposes).

The final regulations also adopt proposed regulations with modifications reflecting that certain hybrid instruments and certain disregarded payments are treated as splitter arrangements subject to Section 909. In particular, the regulations provide that in determining separate taxable income of members of a combined income group, effect will be given to intercompany payments that are deductible under foreign law, even if such payments are not deductible or purposes of US tax law.

In another modification to the 2006 proposed regulations, the final regulations provide that US tax principles apply to determine the tax consequences if one person remits a tax that is the legal liability of another person.

Taxes imposed on partnerships and disregarded entities

The final regulations apply the same foreign tax allocation rules to Section 708 terminations that arise under Section 708(b)(1)(A) in the case of a partnership that has ceased its operations, including a change in ownership in which a partnership becomes a disregarded entity. The regulations also apply the same allocation rules if there are multiple ownership changes within a single foreign tax year.

The 2006 proposed regulations defined a hybrid partnership as an entity that is treated as a partnership for US income tax purposes but is taxable at the entity level under foreign law. Because the IRS believes that a special definition of the term hybrid partnership is unnecessary and could cause confusion, references to the term hybrid partnership are replaced in the final regulations with references to the term partnership.

Effective date

The regulations are generally effective for foreign taxes paid or accrued in tax years beginning after February 14, 2012. The regulations permit taxpayers to apply the combined income rules to tax years beginning after December 31, 2010, and on or before February 14, 2012.

To access final technical taxpayer regulations, click [here](#).

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