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IRS expects to release new foreign tax credit guidance before the holidays

The IRS has signalled that it expects to issue several major pieces of foreign tax credit ("FTC") guidance this month. An IRS official publicly stated that the IRS and Treasury plan to release guidance under section 909, section 901(m), and (probably) regulations on legal liability (also known as the technical taxpayer rule), all "by the holidays."¹ This is more than originally anticipated, because the IRS had earlier indicated that it hoped to release section 901(m) guidance by year end, and that section 909 guidance might wait until 2012. In giving its more recent, updated timeline, IRS officials joked that the government will give so much guidance that practitioners will wish we hadn't asked - so much guidance that we'll be overwhelmed.² They said that the new guidance will be "mostly prospective." However, they also implied that the guidance could be retroactive at the taxpayer's election, but only if the taxpayer chooses to apply the entire regulation package.³

Section 909 is the FTC splitter rule, effective for foreign taxes paid or accrued (or deemed paid or accrued under sections 902(a) or 960) after 2010. In other words, it's effective now. So far, the IRS has issued Notice 2010-92 to provide guidance on section 909's application to foreign taxes paid or accrued by a foreign corporation before 2011, but not deemed paid under section 902(a) or 960 until after section 909's effective date. The Notice described only four types of transactions for which section 909 will apply to such deemed paid taxes: consolidated groups, certain loss-

¹ Remarks by Ronald Dabrowski, Deputy Associate Chief Counsel International (Technical), IRS, at Parker C. Fielder Oil and Gas Tax Conference, Houston, Texas, October 27, 2011.

² Remarks by Anne Devereaux, Senior Technical Reviewer (Branch 3), Office of the Associate Chief Counsel (International), IRS, and Ronald Dabrowski, at Parker C. Fielder Oil and Gas Tax Conference, Houston, Texas, October 27, 2011.

³ Remarks by Ronald Dabrowski, Deputy Associate Chief Counsel International (Technical), IRS, at Parker C. Fielder Oil and Gas Tax Conference, Houston, Texas, October 27, 2011.

sharing related to disregarded debt, reverse hybrids, and hybrid debt or equity. The notice states that these four fact patterns are also expected to be "foreign tax credit splitting events" (splitters) subject to section 909, under future guidance. See Notice 2010-92, ¶1. The tax community is anxiously awaiting further guidance on what constitutes a splitter and answers to other questions on section 909's application. The IRS previously indicated that it was considering creating either an "angel list" of transactions that are not splitters for section 909, or a "devil list" of transactions that are splitters. Guidance under section 909 should certainly be helpful, as it can be a little difficult to achieve certainty (at the moment) about what falls within section 909's ambit.

Section 901(m) addresses "covered asset acquisitions" ("CAA's"), and targets situations in which a foreign country taxes income that the US tax system does not, because the US system sees a higher basis than the foreign tax system. Treasury and the IRS have not yet issued any formal guidance on section 901(m). Among other things, future guidance is expected to address section 901(m)'s interaction with section 909, where both technically apply to the same transaction. Note that section 901(m) denies FTCs, but allows a deduction for the relevant foreign taxes (even if the taxpayer elects to credit its foreign taxes for the year). See section 901(m)(6). In contrast, section 909 defers credits and deductions for foreign taxes until the related income is taken into account (which might never occur, resulting in a permanent disallowance). Also, section 901(m) applies only to transactions after 2010, while section 909 could potentially apply to post-2010 foreign taxes with respect to CAA's that occurred in earlier years.

Section 909's interaction with future legal liability regulations has also caused some speculation. Proposed regulations on the legal liability rule have been hovering, unfinalized, since 2006. See Prop. Treas. Reg. §1.901-2(f). Notice 2010-92 states that the government does not intend to finalize the proposed regulations' rule on reverse hybrids, presumably because that rule will be superseded by guidance under section 909. See Notice 2010-92, ¶2.03. In addition, the proposed regulations contain a rule on consolidated groups, which are also addressed by section 909 and Notice 2010-92. The IRS has been publicly contemplating whether it has the authority to use the proposed regulations' approach to consolidated groups (pro rata distribution of legal liability based on each group member's portion of the tax base, basically) rather than the section 909 approach (suspension of foreign taxes until the related income is taken into account). It implies that taxpayers prefer the former alternative. The IRS and Treasury may allow taxpayers to elect one approach or the other, or they may make the choice for us to avoid potential, unforeseen whipsaws (even though both methods are expected to yield the same end result in most circumstances).

The IRS and Treasury have been known to miss self-declared time targets before. The IRS predicted guidance "by the holidays," but it could be delayed until the end of the year, or longer. Nevertheless, tax practitioners should be aware that the guidance could potentially be issued very soon - this month, before year end.

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