NFTC
NATIONAL FOREIGN TRADE COUNCIL
SINCE 1914

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Internal Revenue Service
CC:PA:LPD:PR (Notice 2023-80)
Office of Associate Chief Counsel (International)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: National Foreign Trade Council Comments on Notice 2023-80

The National Foreign Trade Council (the "NFTC") is writing to provide comments on Notice 2023-80, "Guidance Regarding the Foreign Tax Credit and Dual Consolidated Losses in Relation to the GloBE Model Rules, and Extension and Modification of Temporary Relief in Notice 2023-55" (the "Notice") released by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on December 11, 2023.

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members support establishing and maintaining international tax norms that provide certainty to enterprises conducting cross-border operations.

We agree with the extension of relief provided in Notice 2023-55 with respect to (i)§ 1.901-2(a) and (b) (the definition of a foreign income tax and the net gain requirement),(ii) § 1.903-1(c)(1)(iv) (jurisdiction to tax excluded income) and (iii) § 1.903-1(c)(2)(iii) (source-based attribution requirement) of the 2022 Final Foreign Tax Credit ("FTC") Regulations (the "2022 FTC Final Regulations") as requested in our previous comments including those in March 2022, September 2022, January 2023 and September 2023. This relief provides parity to calendar year and fiscal year taxpayers while Treasury reviews and revises the 2022 FTC Final Regulations. As Treasury works to reevaluate and re-propose the 2022 FTC Final Regulations, we request a delayed effective date, ideally at least one year from when the revised 2022 FTC Final Regulations are published in final form to allow companies to transition to any new methodology for FTCs. We urge Treasury to continue to prioritize and expedite guidance that is clearly aligned with the statutory text of sections 901 and 903, and that addresses the broad needs of business and individual taxpayers.

The Notice also announced that Treasury and the IRS are contemplating the intersection of the Pillar Two rules with the Dual Consolidated Loss ("DCL") rules including whether jurisdictional blending of income and losses should result in a "foreign use" of a DCL. As Treasury develops permanent rules to address the interaction of the DCL rules with the Pillar Two Rules, the Notice detailed interim guidance on the treatment of legacy DCLs.

Pillar Two and Dual Consolidated Losses

In general, the Notice provides that the "foreign use" of a legacy DCL would not be considered to occur solely because all or a portion of a legacy DCL is taken into account in determining GloBE income or in determining whether the transactional CbCR safe harbor applies. A legacy DCL is one arising in a taxable year ending on or before December 31, 2023, or certain fiscal years beginning before January 1, 2024, and ending after December 31, 2023. In other words, for a calendar year taxpayer, neither Pillar Two blending nor applying the CbCR safe harbor will constitute a triggering event with respect to any pre-2024 DCL for which a domestic use election was made.

Relief for Legacy DCLs provided in Notice 2023-80 should be extended through at least 2024

While guidance is welcome with respect to legacy DCLs, taxpayers are now facing uncertainty on how to treat post-2023 DCLs as a result of Pillar Two rules. The lack of Treasury guidance and the lack of consensus among advisors and tax practitioners with respect to the correct interpretation of the rules will likely lead to financial statement risk for US multinational enterprises ("MNEs"). These US MNEs may be required to reverse their financial statements to the extent that their DCL position is (or is not) available for foreign use and is later rejected by the IRS and Treasury. As a result, a significant compliance burden may be put on taxpayers to the extent that they are required to file amended returns in a later year. For these reasons, NFTC recommends that Treasury and the IRS extend the relief provided in Notice 2023-80 through at least 2024.

The IRS and Treasury should provide guidance that the application of the Pillar Two rules is not a foreign use for purposes of the DCL rules

Based on the legislative history, Congress was primarily concerned with and intended to address mismatches in tax residency rules when designing the DCL framework. These mismatches could allow losses to be shared under foreign tax consolidation rules that resemble U.S. consolidation or group-relief. However, the application of a foreign minimum tax under Pillar Two was not a consideration when the DCL rules were implemented. This new tax regime simply imposes an additional levy on a jurisdiction that does not meet the minimum rate of tax under the GloBE rules. Many foreign countries are now implementing the Pillar Two rules as a separate tax outside their long-standing corporate income tax rules. There is no item of deduction or loss taken into account in computing the DCL that is used to offset or reduce an item that is recognized as income or gain under the foreign corporate income tax law. We believe this supports the position that there should be no foreign use under the "Income Inclusion Rule" or "IIR" or UTPR. Thus, we recommend that regulations provide that blending of income and losses for purposes of deriving IIRs and UTPRs under Pillar Two does not result in "foreign use" for DCL purposes.

The IRS and Treasury should clarify that the CbCR Safe Harbor does not trigger a foreign use of DCLs

The Pillar Two Country-by-Country Transitional rules exclude from the scope of Pillar Two operations in lower-risk jurisdictions through the application of quantitative tests, all of which leverage the MNE group's Country-by-Country Report. If the MNE qualifies under one of the tests, relief is provided in respect of the MNE's compliance obligations with respect to Pillar Two. NFTC believes that the application of the safe harbor does not trigger a foreign use for various reasons. First, because unlike the

IIR, QDMTT, and UTPR, the safe harbor is not a collection mechanism under Pillar Two. Rather, the purpose of the safe harbor is to determine whether taxpayers are subject to the Pillar Two collection mechanisms. In other words, we examine whether taxpayers are subject to a foreign income tax. As noted above, to the extent the MNE meets the safe harbor, it will not be subject to Pillar Two top-up tax liability, which excludes the possibility of a foreign use of the DCL. In addition, the determination of income and/or expenses under the CbCr Safe Harbor is substantially different from the calculations under Pillar Two Rules and generally accepted accounting principles. The reasons above support that the CbCR Safe Harbor is not a "foreign income tax" for purposes of DCL rules. The IRS and Treasury should clarify that the CbCR Safe Harbor does not trigger a foreign use of DCLs.

The IRS and Treasury should issue guidance providing that the Pillar Two rules will not result in a foreign use in jurisdictions with an aggregate statutory corporate tax rate of at least 15%

In the event that Treasury plans to adopt rules accounting for Pillar Two when there is a foreign use of a DCL, the rules should exclude a loss incurred in any jurisdiction with an aggregate statutory rate of at least 15 percent (i.e., equal to or exceeding the Pillar Two minimum rate of 15 percent). The result would prevent reduction of a loss that is incurred, for example, by a disregarded entity or dual-incorporated entity. In the alternative, we recommend an anti-abuse rule providing that the Pillar Two jurisdictional blending will cause a foreign use of the excluded losses if the excluded losses are created for a tax abusive purpose.

To the extent that Treasury does not agree that there is no foreign use, we believe Treasury should immediately work with the OECD to arrive at a solution that allows both systems to co-exist. One potential solution would be OECD guidance allowing impacted taxpayers to exclude relevant book losses from the computation of GloBE income, paired with Treasury guidance providing that such rules do not constitute a "mirror legislation" for DCL purposes and there is no foreign use by reason of reversing the book losses.

Creditability of IIRs

The guidance on the eligibility of new Pillar Two taxes for FTCs provides needed clarity as these rules are in effect in foreign jurisdictions.

The NFTC recognizes that Treasury is contemplating an allowance of FTCs with respect to certain applications of foreign taxes which generally conform to the OECD common approach to implementing an "Income Inclusion Rule" or "IIR." Such allowance is dependent, first and foremost, upon an analysis of whether such a foreign tax is a foreign income tax or a tax in lieu of an income tax, which the Notice does not attempt to address. Under sections 901 and 903, such taxes are creditable. We recommend that Treasury expedite guidance which clarifies for all taxpayers how sections 901 and 903 may be applied to determine the creditability of relevant foreign taxes. Furthermore, we recommend Treasury align regulatory guidance concerning both creditability and any limitations on that creditability with the statutory text which authorizes the proposed regulations, inclusive of all court cases interpreting such guidance, and provide taxpayers with a thorough explanation of such alignment. Specifically, we recommend that the Treasury consider the requirement under section 901, as interpreted by the Supreme Court in *PPL v. Comm'r*, that a foreign tax that is a foreign income tax (or in lieu of tax) be considered a foreign income tax, and therefore creditable for all taxpayers, subject to limitations such as those provided for in sections 901, 904, 907 and 960. The current paradigm of assuming away the issue of whether a relevant tax is a foreign income tax appears to be an attempt to circumvent the will of the courts without any grant of authority from the relevant statutory text, which creates considerable uncertainty for all impacted taxpayers.

Allowance of Foreign Tax Credit for IIRs to U.S. Individuals that Hold MNE Groups through U.S. Passthroughs

The NFTC notes the allowance of FTCs to U.S. individuals that hold investments in an MNE Group through a U.S. passthrough entity such as a partnership or an S corporation that is subject to a foreign tax that is an IIR. We recommend the inclusion of an example to further clarify this proposed rule. Section 2.02(3) of Notice 2023-80 provides that no FTC is allowed to a person for a final top-up tax such as an IIR if, under the foreign law, any amount of U.S. income tax liability of that person would be taken into account in computing the final top-up tax. Accordingly, an FTC may be allowed to a person for a final top-up tax if no amount of U.S. income tax liability of that person would be taken into account in computing the final top-up tax. This result is illustrated by Example 2 of Section 2.02(6). Example 2 concludes that a 30% U.S. corporate shareholder of a series of CFCs may be allowed an FTC with respect to an IIR imposed on one of the CFCs with respect to the income of another CFC because, under the law of the country imposing the IIR, no amount of the U.S. income tax liability of the 30% corporate shareholder can be taken into account in computing the IIR as the shareholder is not considered part of the same MNE Group as the CFCs.

The result illustrated Example 2 of Section 2.02(6) as applied to the 30% corporate shareholder extends equally to U.S. individuals that hold investments in an MNE Group through a U.S. passthrough entity such as a partnership or an S Corporation. Like the minority corporate shareholder in Example 2, no amount of the U.S. income tax liability of individuals can be taken into account in computing IIRs as individuals are not considered part of an MNE Group. Under the GloBE Model Rules, a natural person is not an entity, and only entities can be part of an MNE Group.[1] Section 2.02(4) further confirms this result by providing that a final top-up tax imposed on a partnership may be eligible to be credited by one partner of a partnership (e.g., a partner that is not part of the MNE Group that includes the partnership), but not as to another partner. The NFTC recommends that the application of Section 2.02(3) to U.S. individuals be illustrated in an example along the following lines:

Example x—Individual U.S. owners.

(i) Facts. Country X imposes an IIR on certain entities resident in Country X. The IIR imposed by Country X is a foreign income tax within the meaning of § 1.901-2(a) and (b). Under Country X tax law, in computing the amount of the IIR, the foreign tax liability of the direct and indirect owners of the Country X taxpayers that relates to income subject to the IIR is taken into account if those owners are part of the same MNE Group (as defined under Country X tax law) as the Country X taxpayers. Individuals A, B, and C are U.S. residents that are partners in USP, a domestic partnership. USP owns all the stock of DRE X, a disregarded entity that is organized in, and is a tax resident of, Country X. DRE X owns all of the stock of DREY, a disregarded entity that is organized in and is a tax resident of Country Y. Under Country X tax law, USP is considered part of the same MNE Group as DRE X and DRE Y, but A, B, and C are not considered part of any MNE Group. In 2024, DRE X is liable for 5u of the Country X IIR.

[1] *See* GloBE Model Rules Article 1.2.2 and Article 10.1.

(ii) Analysis. The Country X IIR is a final top-up tax. However, each of A, B, and C may be allowed a credit under § 901 for their distributive share of the foreign taxes paid or accrued by DRE X (an entity disregarded as separate from USP) with respect to the Country X IIR because under Country X tax law, no amount of the U.S. federal income tax liability of A, B, or C can be taken into account in computing the Country X IIR as natural persons are not considered part of the same MNE Group as DRE X. The fact that USP may be considered part of the same MNE Group as DRE X is not relevant to the issue of whether A, B, or C is allowed a credit for the Country X IIR.[2] The same result would apply if USP was an S corporation.[3]

Allowance of FTC for IIR When No U.S. Tax is Actually Imposed on Income Subject to IIR

The Notice addresses the allowance for a hypothetical foreign tax credit in the instance of certain top-up taxes paid under the Pillar Two IIR and provides that no such FTC is allowed if any amount of U.S. federal income tax liability would be taken into account in computing an IIR top-up tax, without regard to whether any amount of U.S. federal income tax liability is actually taken into account in such computation. We recommend that in situations where in actuality there is no U.S. tax liability that is taken into account in computing the final top-up tax (i.e., in cases where there is no calculable U.S. tax liability) the final top-up tax expense paid, if otherwise eligible for a foreign tax credit, should be provided an allowance under the logic proposed by the Notice.

This is because the concerns that are triggered in certain cases where an FTC is allowed for a final top-up tax (i.e., pertaining to circularity and the potential for a soak-up tax-like outcome) are not present in such instances. In other words, it would be appropriate to allow an FTC in cases where providing the FTC would not actually increase the IIR under the laws of the relevant foreign jurisdiction, and would reduce the potential for double taxation.

Allocation and Apportionment

The Notice provides helpful rules detailing the interaction of Pillar Two with the US FTC regime; however, we request that Treasury provide further guidance concerning the proper allocation and apportionment of relevant foreign tax expenses under Treas. Reg. §§ 1.861-20 and 1.904-6. The allocation and apportionment of foreign taxes designed to conform to the OECD common approach presents novel issues. For instance, to the extent that the OECD common approach appears to create tax expenses which are borne by entities which never have an actual or deemed item of income which corresponds to the expense (e.g., the tax liability is computed by reference to the ETR of another entity in the group which is not deemed to remit any item of income to the taxpayer, unlike US CFC rules) the contemplated tax base determined under foreign accounting principles may vary significantly from the US concept of net income and therefore the income to which such a tax expense relates may be difficult to identify for US tax purposes.

[2] *See* Treas. Reg. § 1.703-1(b)(2)(i) (providing that a partner of a partnership may elect to use their distributive share of foreign taxes that are paid or accrued by the partnership as a credit against their U.S. tax liability).
[3] *See* section 1373.

Specifically, we recommend the Constituent Entity whose low tax income gives rise to payment of a QDMTT, IIR, or UTPR liability that is then imposed upon another entity in the group structure be deemed as the proper entity for the tax expense. This recommendation is generally consistent with rule in Section 2.04 of the Notice, which is limited to QDMTTs. Matching the Pillar Two liability with the low-taxed income would help ensure that a U.S. shareholder's inclusion percentage, share of a CFCs QBAI, and share of other taxes be appropriately taken into account in computing a GILTI liability under section 951A. We also recommend that in cases where the payor of the Pillar Two tax is not the Constituent Entity with the associated income, any reimbursement the payor receives should have limited or no U.S. federal income tax consequence.

Without proper guidance concerning the allocation and apportionment of these foreign income taxes, the operation of the rules proposed in the Notice will remain incredibly uncertain (e.g., expenses must be allocated to subpart F income and GILTI net income for purposes of section 960 as contemplated by the Notice).

Conclusion

Again, we welcome the interim guidance in the Notice while Treasury and the IRS complete their analysis of the impact of Pillar Two with FTCs. As discussed in our previous letter on Notice 2023-55, we endorse the intent for any amendments to the 2022 FTC Final Regulations to be issued in the proposed form to ensure an adequate notice and comment process. We appreciate the continued dialogue with the business community and thank you for your consideration of our comments.

Sincerely,

Anne N Gordon

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