October 7, 2024

Internal Revenue Service
CC:PA:01:PR (REG-105128-23)
Office of Associate Chief Counsel (International)
Room 5203
P.O. Box 7604
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Washington, DC 20044

Re: National Foreign Trade Council Comments on REG-105128-23

The National Foreign Trade Council (the "NFTC") is writing to provide comments on REG-105128-23, "Rules Regarding Dual Consolidated Losses and the Treatment of Certain Disregarded Payments" ("Proposed Regulations") released by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on August 7, 2024, and a correction released on September 3, 2024.

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.

NFTC provided comments in response to Notice 2023-80 on February 9, 2024, in regard to the treatment of the Dual Consolidated Loss ("DCLs") rules and Pillar Two of the Inclusive Framework. While we appreciate the responsiveness to the provision of guidance, we are dismayed by the lack of consideration for our prior comments. We urge Treasury and the IRS to review our previous comments in addition to the comments and examples provided in this letter.

Overview

The DCL rules contained in section 1503(d) and the regulations thereunder generally apply to prevent a single economic loss of an entity or separate business unit from reducing both U.S. taxable income (a "domestic use") and foreign taxable income (a "foreign use"). If there is a foreign use of a DCL, then a domestic use is disallowed. The current rules permit a taxpayer with a DCL to make a domestic use election if there is not a foreign use, subject to recapture in the event of a future foreign use.

A DCL is defined as a net operating loss of either (i) a domestic corporation subject to foreign income tax on a residency basis (a dual-resident corporation) or (ii) a separate business unit of a domestic corporation that is similarly subject to a foreign income tax (e.g., a foreign disregarded entity owned by a domestic corporation).

The Senate Finance Committee Report on the Tax Reform Act of 1986 provided the reason for enacting section 1503(d). The report stated, "*Losses* that a corporation uses to *offset foreign tax* on income that the

United States does not subject to tax should not also be used to reduce any other corporation's U.S. tax."[1] The Proposed Regulations provide guidance in two main areas. First, the Proposed Regulations provide guidance with respect to the interplay between the DCL Rules and the Pillar Two Global Minimum Tax rules, generally providing that there is a foreign use of a DCL where the DCL is taken into account in reducing income under those rules even where there is no reduction of foreign tax. Second, the Proposed Regulations create new rules to address "disregarded payment losses," applying the DCL rules in cases where they were not intended to apply because there is no net operating loss of a domestic entity or separate business unit that can be used to offset foreign tax. The intent of Congress should guide Treasury in promulgating regulations. Accordingly, we urge Treasury and the IRS to revisit the Proposed Regulations and not finalize them as drafted.

Proposed Regulations and the Pillar Two Model Rules

In General

The apparent intent of the Proposed Regulations is to address the interplay between the DCL Rules and the Pillar Two Global Minimum Tax as a number of jurisdictions have or are in the process of adopting the Pillar 2 GloBE Model Rules (together with the related Administrative Guidance, the "Model Rules"). The Model Rules generally require an in-scope multinational entity to calculate an effective tax rate ("ETR") in each jurisdiction and, to the extent the ETR is below 15% in any jurisdiction, one of three top-up taxes ("GloBE top-up taxes") is imposed in the following order: (i) Qualified Domestic Minimum Top-up Tax ("QDMTT"); (ii) Income Inclusion Rule ("IIR"); and (iii) Undertaxed Profits Rule ("UTPR"). The U.S. Treasury Department has been a lead negotiator of the Model Rules.

In the preamble to the Proposed Regulations, Treasury and IRS rejected numerous stakeholder comments on earlier guidance (Notice 2023-80), arguing that the DCL rules generally should not apply with respect to top-up taxes for a variety of reasons. A foreign income tax should not include a QDMTT or an IIR as the Proposed Regulations put forth unless tax is actually collected under the QDMTT or the IIR. It is highly problematic that the Proposed Regulations deem a foreign use to occur if a DCL is merely included in (i) the calculation of GloBE income for a QDMTT or IIR or (ii) the calculation of an ETR to qualify for the Transitional CbCR Safe Harbour, even if the DCL has no impact on the amount of any QDMTT or IIR (or on the qualification for the Transitional CbCR Safe Harbour). We are concerned that the Proposed Regulations take what appears to be the broadest and most anti-taxpayer approach possible without relying on clear legislative intent from Congress.

The result of the Proposed Regulations is to turn section 1503(d) into an automatic loss disallowance rule for most DCLs because the GloBE rules are mandatory and require jurisdictional aggregation of GloBE income or loss (as compared to traditional foreign income taxes that may or may not include a consolidation regime and that generally provide a taxpayer with an election to forego consolidation or loss sharing). The only limited exception to a foreign use provided in the Proposed Regulations is where another provision of the Model Rules applies (the duplicate loss arrangement rules provided in the December 2023 Administrative Guidance).

By taking this broad approach, Treasury and IRS are exceeding their statutory authority, effectively elevating the Model Rules above U.S. tax law, and addressing novel issues to force adverse consequences on U.S. taxpayers in connection with foreign GloBE top-up taxes.

We provide examples that demonstrate cases where a DCL reduces GloBE income but has no effect on the jurisdictional GloBE ETR (and, more importantly, GloBE tax liability). This is the case because of the

[1] S. Rept. No.99-312 at 320 (emphasis added).

way deferred taxes apply under the Model Rules to (i) reduce covered taxes in the year a loss arises and (ii) increase covered taxes in the year the loss is utilized. Even in cases where there is an effect on Effective Tax Rate for a jurisdiction, the Effective Tax Rate for a jurisdiction with respect to an MNE Group often will exceed the Minimum Rate because the jurisdiction has a statutory corporate tax rate substantially in excess of the Minimum Rate and does not provide material broad-based or taxpayer-specific incentives that lower the effective rate below the Minimum Rate. Without change, the Proposed Regulations will require a U.S. loss disallowance even when there is no reduction in foreign tax, including foreign top-up tax.

Deeming there to be a foreign use when a DCL is merely included in the calculation of GloBE income, but there is no GloBE top-up tax reduction, is inconsistent with the legislative intent of section 1503(d) as provided in the Senate Report. The focus of Congressional intent on an actual reduction of foreign tax is also reflected in the Tax Reform Act of 1986 Conference Committee Report. In explaining the regulatory authority provided in section 1503(d)(2)(B),[2] the conferees said, “Thus, for example, a U.S. corporation that resides in a foreign country…and whose losses do not otherwise *reduce foreign tax* of a foreign corporation, will not be subject to this provision.”[3]

Even if a GloBE top-up tax is considered to be a foreign income tax for purposes of section 1503(d), as the attached examples below demonstrate, there often will be no foreign tax reduction unless and until a DCL is used for non-GloBE income tax purposes.

We urge Treasury and the IRS to reconsider this approach. To the extent Treasury and the IRS are concerned that DCLs may be used to reduce foreign top-up tax imposed under the Model Rules, we suggest two alternative foreign use rules that are more appropriately tailored to the GloBE top-up taxes. First, Treasury and the IRS could adopt a with-or-without rule that tests where the DCL has actually resulted in the reduction of a taxpayer’s liability for a foreign top-up tax. This approach is justified given the special nature of top-up taxes under the Model Rules, which (1) require jurisdictional aggregation of GloBE income and (2) often result in zero incremental tax liability. Under a with-or-without rule, taxpayers would be required to determine whether a DCL has reduced its liability for top-up tax. A foreign use of the DCL would be considered to occur only to the extent that a taxpayer’s top-up tax liability would have been higher had the DCL not been taken into account in GloBE income. Second, if the with-or-without rule is too administratively burdensome, Treasury and the IRS could consider a safe harbor rule or presumption that could apply to a jurisdiction where it is very unlikely that a top-up tax would arise. For example, this safe harbor could apply mechanically where the jurisdiction has a rate of regular corporate income tax of 20% or greater (similar to the Transitional UTPR Safe Harbor).[4] The OECD publishes an annual report on Corporate Tax Statistics that includes both the statutory and effective corporate tax rates, along with jurisdictional data on Country by Country Reporting.

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[2] Section 1503(d)(2)(B) states: “To the extent provided in regulations, the term ‘dual consolidated loss’ shall not include any loss which, under the foreign income tax law, does not offset the income of any foreign corporation.”
[3] H. Rept. No. 99-841, at II-657 (emphasis added).
[4] OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosionrules-pillar-two-july-2023.pdf. The Transitional UTPR Safe Harbor applies only for two years. It is likely that the rule is not permanent because the drafters believe a jurisdiction could increase its corporate statutory rate while reducing the effective rate of tax through special deductions, credits or other mechanisms that the Model Rules are intended to prevent. While a jurisdiction might be inclined to modify its entire corporate income tax regime in reaction to the Model Rules, it seems exceedingly unlikely it would be inclined to do so to adapt to a safe harbor in the DCL regulations.

Calculation Examples

The GloBE rules in their general construction and how they apply to the incurrence of an item that generates a Deferred Tax Asset ("DTA)—like a Net Operating Loss Carryforward—make the Proposed DCL Regulations incompatible with the economics of the GloBE calculation in many cases.

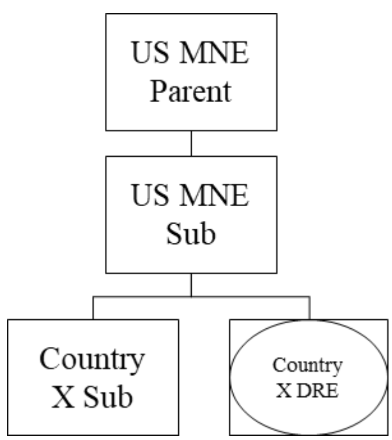
The basic computation of GloBE tax liability is (Pre-Tax Book Income *15%) - Adjusted Covered Taxes). Article 4.1 of the GloBE rules provides the computation of Adjusted Covered Taxes for this purpose. Article 4.1.1(b) includes in this amount the Total Deferred Tax Adjustment Amount as defined in Article 4.4.2, which would require that Covered Taxes are decreased for the tax benefit of a loss at a rate of 15% in the case where a Constituent Entity in the jurisdiction incurs a loss that is carried forward. The policy here is to prevent the offsetting of permanent and temporary tax items, so the rules require that the DTA be paid for in the year of incurrence, regardless of whether it is ever used by the taxpayer against non-GloBE income. In a later year, if the Constituent Entity uses the DTA—by using the Net Operating Loss Carryforward—the GloBE calculation for the Constituent Entities would increase Covered Taxes in the subsequent year for the same amount of Covered Taxes as the prior reduction. If the Constituent Entities in the jurisdiction are above the minimum 15% rate in this year, the Covered Taxes from the reduction of the DTA produce no benefit. Indeed, because the DTA is carried at the rate of 15% for GloBE purposes, even if the entity were low-taxed for GloBE purposes in the subsequent year from items other than the loss utilization, the increase in Covered Taxes by the reduction of the DTA produces no blending benefit because it is set to 15% of the pre-tax income generated by the use of the tax asset. This is the GloBE mechanism for preventing the blending of permanent and temporary items in the first year and keeping the rate impact on the temporary item flat over multiple years. And even in cases this mechanism permits an effect on Effective Tax Rate for a jurisdiction, there often will be no reduction in top-up tax liability where the Effective Tax Rate for a jurisdiction with respect to an MNE Group exceeds the Minimum Rate. The rules here are the same for either a QDMTT or an IIR computation.

These examples consider only a QDMTT for the sake of simplicity, but nothing in the rules or results would change for an IIR tax.

Examples

These rules and how they impact the GloBE calculation can be seen in the following examples.

Example 1:



Facts:

- A U.S. Multinational Entity has two U.S. domestic corporations (U.S. MNE Parent and U.S. MNE Sub) that form a U.S. consolidated group.
- U.S. MNE Sub owns 100% of the stock of Country X Sub X, a Country X entity that is a corporation for U.S. tax purposes.
- U.S. MNE Sub owns 100% of the stock of Country X DRE, a Country X entity that has elected to be treated as a disregarded entity for U.S. tax purposes.
- The U.S. MNE group is profitable in the U.S..
- Country X DRE has the ability to carry-forward losses of Country X DRE but cannot surrender those losses to Country X Sub in the current year.
- In Year 1
    - Country X Sub earns 100X of pre-tax book income and pays 20X of tax in Country X.
    - Country X Branch loses 50X of pre-tax book income and is also subject to a 20% income tax rate.
- In Year 2
    - Country X Sub earns 100X of pre-tax book income and pays 20X of tax in Country X.
    - Country X Branch earns 50X of pre-tax book income and is also subject to a 20% income tax rate.

For the purposes of the GloBE computation, the following would occur:

		Year 1	
	Country X Sub	Country X DRE	Total
Pre-Tax Net Book Income	100	(50)	50
Covered Taxes	20	(7.5)	12.5
Pillar 2 ETR	20%	15%	25.00%
Pillar 2 Tax Liability			0
		Year 2	
	Country X Sub	Country X DRE	Total
Pre-Tax Net Book Income	100	50	150
Covered Taxes	20	7.5	27.5
Pillar 2 ETR	20%	15%	18.33%
Pillar 2 Tax Liability			0.00

Thus, in the year when the Net Operating Loss is incurred, it produces no tax benefit in the GloBE calculation for a QDMTT.

Example 2:

Consider the same facts as Example 1, except that in Year 1, Country X Sub only pays 10 of Covered Taxes because of a permanent tax benefit in its result. For the purposes of the GloBE computation, the following would occur:

	Year 1			
	Country X Sub	Country X DRE		Total
Pre-Tax Net Book Income	100	(50)		50
Covered Taxes	10	(7.5)		2.5
Pillar 2 ETR	10%	15%		5.00%
Pillar 2 Tax Liability				5.00
	Year 2			
	Country X Sub	Country X DRE		Total
Pre-Tax Net Book Income	100	50		150
Covered Taxes	20	7.5		27.5
Pillar 2 ETR	20%	15%		18.33%
Pillar 2 Tax Liability				0.00

This demonstrates that the Country X DRE Net Operating Loss is producing no benefit for the Country X Sub. Instead, in Country X, there would still be 5 of GloBE Top-up tax, which is solely related to the fact that Country X Sub has a GloBE rate below the 15% minimum, i.e. 100 x (15%-10%).

Example 3:

Consider the same facts as Example 1, except that in Year 2, Country X Sub only pays 10 of Covered Taxes because of a permanent tax benefit in its result. For the purposes of the GloBE computation, the following would occur:

	Year 1			
	Country X Sub	Country X DRE		Total
Pre-Tax Net Book Income	100	(50)		50
Covered Taxes	20	(7.5)		12.5
Pillar 2 ETR	20%	15%		25.00%
Pillar 2 Tax Liability				0.00
	Year 2			
	Country X Sub	Country X DRE		Total
Pre-Tax Net Book Income	100	50		150
Covered Taxes	10	7.5		17.5
Pillar 2 ETR	10%	15%		11.67%
Pillar 2 Tax Liability				5.00

This demonstrates that the Country X DRE Net Operating Loss is producing no benefit for the Country X Sub even if Country X Sub was low taxed in the year that the Covered Taxes were increased by the GloBE rules. Instead, in Country X there would still be 5 of GloBE Top-up tax in a QDMTT, which solely relates to the fact that Country X Sub has a GloBE rate below the 15% minimum, i.e. 100 x (15%-10%).

Disregarded Payment Loss Rules

The Proposed DCL Regulations also create new "disregarded payment loss" rules ("DPL Rules"). In general, the DPL Rules apply where a U.S. corporation owns a foreign disregarded entity ("DRE"), the DRE makes a royalty payment, an interest payment, or structured payment that is deductible for foreign tax purposes but disregarded for U.S. tax purposes, and the total disregarded royalty, interest, and structured payment expense exceed disregarded royalty, interest, and structured payment income.

The DPL rules require a U.S. corporation to include a "DPL inclusion amount" in income upon the occurrence of certain triggering events. A DPL inclusion amount is generally a net loss of a foreign DRE determined solely by taking into account disregarded payments received and paid of royalties, interest, and structured payments. The effect of the DPL Rules is, therefore, to give effect to certain transactions that would otherwise be disregarded for U.S. income tax purposes. This will require U.S. taxpayers to implement a new burdensome process to isolate and track DPLs without any clear connection to a U.S. tax policy.

According to the preamble, the DPL Rules are intended to address what Treasury and IRS view as "significant policy concerns that are similar to those arising under sections 245A(e), 267A, and 1503(d)" related to transactions that "can produce a deduction-no inclusion ('D/NI') outcome." The preamble also notes that "the OECD/G20 recommends defensive rules that require income inclusions to neutralize D/NI outcomes." Those statutory provisions, however, provide no specific authorization for the DPL rules. Neither section 245A(e) nor section 267A apply to payments that are disregarded for U.S. tax purposes. Further, section 1503(d), by its terms, only applies where there is a net operating loss of an entity or separate business unit that offsets income of other entities or business units. The proposed DPL rules can apply even where a foreign DRE generates net positive income and where, in many cases, all of that income is already subject to tax in the United States. In other words, the DPL rules could apply even in cases where the disregarded payments would not, if regarded, have given rise to a DCL or otherwise implicate the policies underlying the DCL rules. This goes beyond the statutory language and intent of section 1503(d), which only authorizes rules to address net operating losses.

The DPL rules reside outside the statutory boundaries drawn by Congress in section 1503(d). Section 1503(d) addresses net operating losses of entities or separate units that are used to offset taxable income of one set of entities or units for U.S. tax purposes and another set of entities or units for foreign tax purposes. In enacting section 1503(d), Congress did not seek to address all circumstances in which amounts are treated differently under U.S. tax law and foreign tax law. That is the case for sections 245A(e) and 267(A) as well. These statutes depart from the general principle that U.S. tax consequences should not depend on foreign tax treatment. Proposals to extend the extent to which U.S. tax consequences should depend on foreign tax treatment raise complex tax policy issues that are rightfully addressed by Congress. There simply is no grant of authority under the DCL framework or anywhere else in the Internal Revenue Code for creating a U.S. income inclusion solely because a foreign jurisdiction allows a deduction under its own law with respect to a payment that is disregarded for U.S. tax purposes.

Due to this absence of specific statutory authority, Treasury and IRS propose to implement the DPL Rules by attaching a new condition to an entity classification election to treat a foreign entity as a DRE – a domestic corporation must consent to be subject to the DPL Rules. Under a "deemed consent" rule, a domestic corporation that already owns a DRE is deemed to consent to be subject to the DPL Rules.

In effect, Treasury and IRS are attempting to modify the entity classification regulations under section 7701 to force taxpayers to consent to new extra-statutory rules that turn-off the entity classification election for specific transactions for the purpose of addressing perceived policy issues on which Congress has not legislated. Aside from the lack of authority, it is not clear that the DPL Rules further U.S. revenue or other tax policy interests. It is unclear what U.S. interest is served by targeting arm's-length royalties and interest charged by U.S. corporations to foreign DREs. These arm's-length expenses reduce foreign taxable income and foreign tax, resulting in fewer foreign tax credits that can be claimed in the United States against the U.S. taxable income produced by the foreign DRE. We urge Treasury and the IRS to consider U.S. revenue considerations in determining whether to regulate in an area that has not been addressed by Congress. The "consenting approach" was utilized for the domestic reverse hybrids, but in that case, it was clearly within the scope of section 1503(d). The DPL rules are not.

If Treasury and the IRS decide to move forward with the DPL Rules in some form, we suggest that the DPL Rules should only apply when double deduction or non-inclusion in any jurisdiction occurs. In many circumstances, a U.S. corporation will license technology, copyright rights or other intangibles to a separate unit, which in turn will use those intangibles in its trade or business or embed those intangibles in products or services sold to customers. In that case, while the royalty income from the license is not itself included in the income of the U.S. corporation, the customer income is dual inclusion income. That is, it is included in income for both local income tax and U.S. income tax purposes. Applying the DPL Rules in such circumstances is particularly inappropriate. To the extent Treasury and IRS are concerned that this dual inclusion income might be double counted by both reducing a DPL and a DCL, these regimes could be partially combined by treating regarded income as reducing a DPL only to the extent the income does not reduce the amount of a DCL (for example, through another separate unit) and does not prevent foreign use of a DCL (for example, a DCL of a dual resident corporation that is treated as used against the income of a separate unit under Treas. Reg. §1.1503(d)-3(c)(3)).[5] It should be noted that this approach is consistent with the 2015 BEPS Action 2 report, which recommends primary and secondary responses to deduction/non-inclusion outcomes only to the extent they are not offset by dual inclusion income.[6]

If the DPL rules are nevertheless finalized in some form, the effective date should be delayed to provide sufficient lead time to implement the necessary processes and systems necessary to comply with these rules.

Modification of the Inclusions-on Stock Rule.

The existing regulations under section 1503(d) take into account income, gain or loss from stock (including dividends, gains and inclusions of subpart F income and GILTI) for DCL purposes. However, the Proposed Regulations modify this rule and would exclude these items, except in the case of certain portfolio stock.

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[5] *See* Treas. Reg. §1.1503(d)-7(c)(11) *Example 11*. Further modifications would likely be necessary to address the "SRLY register" maintained for DCL purposes as described in Treas. Reg. §1.1503(d)-4(c)(3).

[6] OECD recommended that: The following rule should apply to a disregarded payment made by a hybrid payer that results in a hybrid mismatch: (a) The payer jurisdiction will deny a deduction for such payment to the extent it gives rise to a D/NI outcome. (b) If the payer jurisdiction does not neutralise the mismatch then the payee jurisdiction will require such payment to be included in ordinary income to the extent the payment gives rise to a D/NI outcome. (c) No mismatch will arise to the extent that the deduction in the payer jurisdiction is set-off against income that is included in income under the laws of both the payee and the payer jurisdiction (i.e. dual inclusion income). (d) Any deduction that exceeds the amount of dual inclusion income (the excess deduction) may be eligible to be set-off against dual inclusion income in another period. [emphasis added]

The approach of the Proposed Regulations is inconsistent with the statute. Section 1503(d) applies where there is a net operating loss of a dual resident corporation ("DRC") or a separate unit. For this purpose, a net operating loss means a net operating loss under U.S. tax principles, which would take into account inclusions on stock. There is no suggestion that Congress intended the term net operating loss to be defined with respect to items of income that are subject to tax for foreign law purposes. Moreover, the assumption that foreign tax law routinely exempts from taxable income inclusions on stock seems particularly inappropriate given the widespread adoption of IIRs.

If Treasury and the IRS move forward with the approach of the Proposed Regulations, we suggest that serious consideration be given to a rule that takes into account "same country" inclusions. Under such a rule, inclusions on stock should remain attributable to DRCs or separate units to the extent that they are attributable to inclusions of GILTI or subpart F income attributable to the country in which the DRC or separate unit is tax resident.[7] Income could be treated as attributable to a jurisdiction to the extent it is attributable to a tested unit located in that jurisdiction, which attribution could be determined in the same manner as the GILTI high-tax exclusion rules. Treas. Reg. §1.951A-2(c)(7).

The preamble to the Proposed Regulations indicates Treasury and the IRS believe that attributing "same country" inclusions to DRCs and separate units may be appropriate from a policy perspective (in the case of a separate unit, regardless of whether the stock of the relevant foreign corporation is held through a separate unit),[8] but asserts that a rule that would permit taxpayers to identify and take into account such amounts as dual inclusion income:

> would require complicated rules, and raise related administrability concerns, to isolate the amount of dual inclusion income with respect to a particular foreign jurisdiction (for example, where a controlled foreign corporation owns one or more disregarded entities that are subject to tax in different foreign jurisdictions). Such an approach would also need to take into account rate disparities (for example, as a result of the deduction allowed under section 250(a)(1)(B) with respect to inclusions under section 951A) and other differences that may result between income earned directly by a domestic owner and earned indirectly through a controlled foreign corporation.

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[7] Treasury and IRS might consider reducing the amount of these inclusions by directly allocable expenses, like the section 250 deduction.

[8] Specifically, the NPRM provides that:

> The Treasury Department and the IRS recognize that certain amounts included in the income of a domestic owner arising from the ownership of stock in a foreign corporation (in the case of a separate unit, regardless of whether the stock of the foreign corporation is held through the separate unit) may reflect amounts that have been subject to tax, to some extent, by both the foreign jurisdiction and the United States. For example, where a domestic owner of a separate unit that is taxed as a resident in a particular foreign jurisdiction holds stock of a controlled foreign corporation that is also taxed as a resident in the same foreign jurisdiction, the controlled foreign corporation's income may be taxed, to some extent, under the income tax laws of the foreign jurisdiction and by the United States through inclusions under section 951(a) or 951A(a); this could occur regardless of whether the inclusion itself is taken into account by the same foreign jurisdiction. To the extent such amounts are taxed in the same manner and to the same extent as if they were earned directly by the domestic owner, they could be viewed as representing dual inclusion income (that is, items that are included in income in both the United States and the foreign country and not offset or reduced by certain amounts particular to the item) that could be taken into account when determining the dual consolidated loss attributable to the separate unit.

89 Fed. Reg. 65,756 (Aug. 7, 2024).

This concern about administrability is overblown. The current international rules already attribute GILTI and subpart F income inclusions to the CFCs and, within a CFC, to tested units to which they relate. For example, after QBAI, tested losses, high-tax exclusions and other adjustments are taken into account, the current rules allocate the net inclusion back to CFCs in the form of PTEP. As noted above, Treas. Reg. §1.951A-2(c)(7) attributes income to tested units for purposes of the GILTI high-tax exclusion rules.

Further, in the case of GILTI, the section 250 deduction is readily determinable and can be applied to all inclusions – 50% if there is no taxable income limitation and a smaller amount if there is. Further, as noted above, many provisions in the regulations require the attribution of income to a "tested unit," which includes a CFC or a foreign DRE. Finally, we reiterate that the approach of the Proposed Regulations is not aligned with the statute. To the extent Treasury and the IRS believe safeguards are needed to protect the DCL rules from abuse, such safeguards should be targeted at actual abuses and not be overbroad.

Clarification of the anti-avoidance rule

The Proposed Regulations added an anti-avoidance rule that applies if a "transaction, series of transactions, plan, or arrangement is engaged in with a view to avoid the purposes of section 1503(d) … we recommend using a "principal purpose" test which is a more commonly used anti-avoidance test within the Internal Revenue Code and regulations." We also request that Treasury clarify that this rule does not apply if taxpayers restructure their operations or legal entities to convert disregarded payments into regarded payments, such as by contributing disregarded entities to regarded corporations or partnerships.

Conclusion

We strongly encourage Treasury and the IRS to revisit the Proposed Regulations wholesale. Based on the legislative history, Congress was primarily concerned with and intended to address mismatches in tax residency rules when designing the DCL framework. The Administrative Procedures Act and recent Court rulings require alignment of regulatory actions with Congressional intent and statutory authority. Thus, we continue to believe the DCL rules should not apply to QDMTTs or IIRs, and, in particular, should not apply to QDMTTs or IIRs unless there is an actual foreign use of a DCL that results in a reduction of foreign tax liability. To the extent that Treasury and the IRS do not agree, we believe Treasury should immediately work with the OECD to arrive at a solution that allows both systems to co-exist. As we previously recommended, one potential solution would be OECD guidance allowing impacted taxpayers to exclude relevant book losses from the computation of GloBE income within a jurisdiction, 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.

Lastly, significant changes are needed to the Proposed Regulations including the re-evaluation of the disregarded payment rules and modification of the inclusions-on-stock rule. There is no explicit statutory authority for the DPL rules, and the proposed DPL rules go beyond the statutory intent and language targeting net operating losses and seem to work against U.S. revenue interests. Further, there are alternative approaches to the new inclusions-on-stock rule that would better align with the existing international tax rules without being unduly burdensome to taxpayers. We are happy to provide additional information or clarification of any of the recommendations in this or prior submissions. Please reach out to Anne Gordon, Vice President for International Tax Policy, with any questions.