

*FTC Planning*  
35th Annual TEI-SJSU High Tech Tax Institute  
November 4, 2019

Anne Devereaux  
Internal Revenue Service

Will Skinner  
Fenwick & West

Adam Halpern  
Fenwick & West

Kristen Proschold  
Intuitive Surgical, Inc.

Connect. Engage. Innovate.

Rob Morris  
Norton Rose Fulbright

Section 901 is basically unchanged. Withholding taxes and branch taxes remain fully creditable (subject to the new § 904).

Section 902 is repealed





Two provisions of the proposed FTC regulations (Dec. 2018) were finalized in the GILTI final



## 4 Withholding Taxes

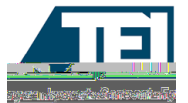
USP

Withholding taxes on “live E&P” dividends will likely not be creditable, § 245A(d).

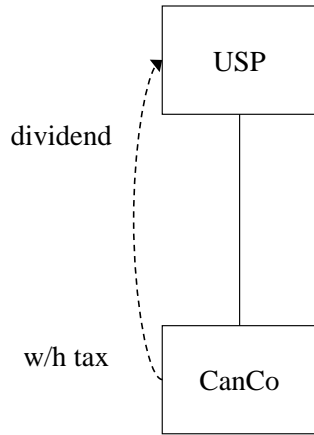
For PTEP distributions, different creditability rules will apply for taxes imposed on PTEP in different “groups”-- § 965(a), 965(b), GILTI, etc.

Taxes imposed on non-dividend distributions should be creditable.

Companies will also need to navigate § 904 limitation and basketing issues.

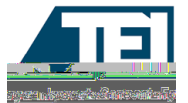


# 5 Withholding Taxes



Proposed § 1.960-3(c) provides that PTEP is assigned to a PTEP account at the CFC level that corresponds to the inclusion year and the § 904 basket of the inclusion at the U.S. shareholder level.

For example, a CFC could have a GILTI basket PTEP account, even though the CFC's income cannot initially be assigned to the GILTI basket.



## Deemed Paid Taxes

Proposed § 1.960-2 provides for separate calculation of the deemed paid taxes from a CFC in each separate basket and in each separate “income group” within a basket:

- Multiple Subpart F income groups based on § 1.954-1(c)

- A single tested income group

- A single “residual” income group

In a Subpart F group, deemed paid taxes are equal to the U.S. shareholder’s proportionate share of the CFC’s “current year taxes” in that group.

In the tested income group, deemed paid taxes are similarly equal to the proportionate share of current year taxes, but are also adjusted for the § 960(d) 20% haircut and inclusion percentage.



## Deemed Paid Taxes

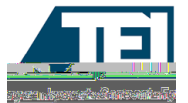
Foreign taxes assigned to the residual income group are never deemed paid, and effectively disappear.

Current year taxes attributable to a “base difference” are treated as related to the residual group, and effectively disappear.

Foreign taxes are never deemed paid with respect to an amount included under § 956.

Foreign taxes other than current year taxes are not deemed paid in the current year under § 960(a) or (d), but may be deemed paid in another year if they are attributable to a timing difference.

PTEP distributions and § 960(b) deemed paid taxes are carved out from this system and treated separately under proposed § 1.960-3.



## GILTI Basket Issues & Planning

Companies with an effective foreign tax rate below 13.125% will have excess limitation in the GILTI basket.

Tax on GILTI will equal the residual percentage of GILTI as contemplated by the Conference Report; allocation of expenses to the GILTI basket will likely have no effect.

GILTI basket PTEP distributions will carry tax consequences.

Section 986(c) FX gain or loss will result in a corresponding increase or decrease in tax liability

Section 960(b) foreign taxes will reduce tax liability dollar-for-dollar

Additional foreign taxes on GILTI (resulting from a foreign audit, for example) will generally be creditable, subject to the 20% haircut under § 960(d), but will require an amended return.



## GILTI Basket Issues & Planning

Companies with sufficient taxable income and an effective foreign tax rate above 13.125% will be in limitation in the GILTI basket.

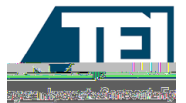
Tax on GILTI will equal 21% of allocated expenses.

GILTI basket PTEP distributions will likely have no effect.

Unless it is very large, § 986(c) FX gain or loss will merely increase or decrease FTC limitation correspondingly

Section 960(b) foreign taxes will be caught in limitation

Additional foreign taxes on GILTI will be an absolute cost.





## GILTI Basket Issues & Planning

Proposed GILTI high-tax exception might be helpful

Reducing the GILTI inclusion in most cases will reduce the expense allocations to GILTI basket income. But remaining CFC income subject to GILTI could be taxed at an average foreign rate below 13.125%, resulting in residual U.S. tax.

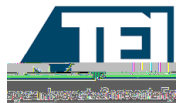
Planning into Subpart F income might be more helpful

Similar to proposed HTE, but can be done selectively

Can elect high-tax exception or take general basket Subpart F inclusion and credits

Need to consider difficulty of transforming non-Subpart F income into Subpart F income

No cookie-cutter solutions; modeling will be important





## The Branch Basket –

Under the proposed regulations, the branch basket is determined based on the books and records of the disregarded entity that owns the branch, as adjusted to apply US tax principles.

Disregarded payments to/from a branch must be reallocated between baskets based on the allocation of expense under Reg 1.861-8, *as it would apply if the payment were regarded*.

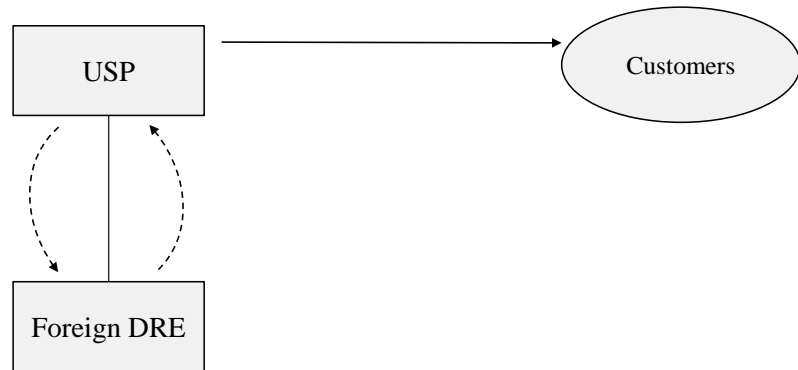
Sales of property between the branch and its owner also give rise to reallocation based on how cost of goods on a regarded sale would have been allocated .

Licenses or transfers of intangible property between branch and its owner give rise to reallocations under the same principles. Section 482 and Section 367(d) principles apply to determine the consequences of a branch to owner license or transfer of property.



15

## Branch as a Service Provider



Cost-plus service fees are disregarded payments. Assume under Section 1.861-8 that service fees would be apportioned 80%/20% US/Foreign.

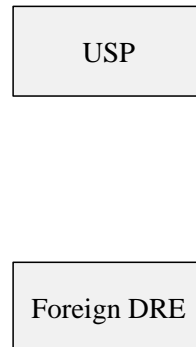
\$200 of USP's income is allocated to branch basket. That gross income would seem to be \$160 US source and \$40 foreign source.

USP may need to invoke Treaty resourcing to claim FDRE's taxes as a credit.



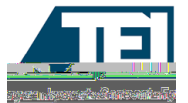
16

## IP Transfer Involving a Branch



Under the proposed regulations, the IP transfer from branch to owner is treated as if it were a regarded transaction subject to Sections 482 and 367(d). Income equal to the arm's length payment for the IP is attributed to the branch basket.

Consider FDII implications due to branch basket carve out from FDII.





## FDII / Source of Income Overlap

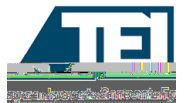
The foreign tax credit operates based on source of income rules found primarily in Sections 861-865 of the Code: e.g., the title passage rule, “place of use” for IP, and the residence of the seller rule for non-inventory property.

The foreign derived intangible income (FDII) deduction is based on sales, leases or licenses of property to a foreign person for use, consumption or disposition outside of the US, and provision of services to a person or with respect to property located outside of the United States.

Foreign use / consumption for FDII purposes and foreign source for FTC limitation purposes are overlapping and different concepts.



Under FDII proposed regulations, CFC’s “foreign use” of the IP depends on the location of the end

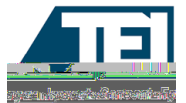


## 19 Source of Income from Inventory Property

TCJA amended IRC Section 863(b) for “producers” of inventory property, to repeal the longstanding 50/50 source of income rule and instead source income solely to the location of the taxpayer’s production assets.

Sections 861(a)(6)/862(a)(6) remained in place for property purchased and resold by the taxpayer without manufacture or production. Title passage continues to govern source of income there.

For software transactions, new Prop. Reg. 1.861-18 would repeal title passage rule for downloaded products and source income based on the customer’s location.

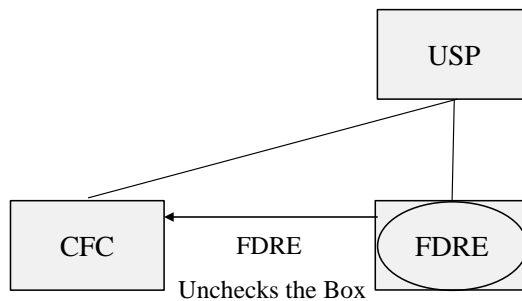


For FTC basket purposes, proposed regulations state that gain or loss on the sale of a DRE or partnership interest is generally not allocated to the branch basket. I.e



22

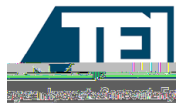
## Dispositions of Branches



What is the source, basket and FDII treatment of the following items of income:

- Section 367(a) gain
- Section 367(d) royalty income
- OFL/ DCL recapture income

Does the answer differ with a sale of FDRE's interests to CFC vs. unchecking the box?

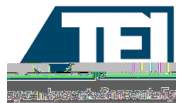
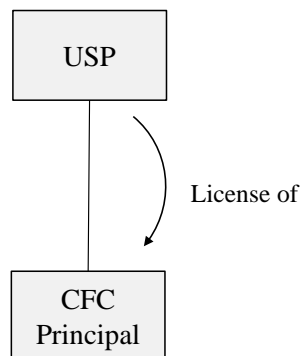


Current Reg. 1.861-17 includes complex rules that were the product of a careful compromise.  
Proposed Regulations released in 2018 did not yet update R&E regulations for post-TCJA



24

## R&E Expense Allocation – Example



## Expense Allocation Issues- Interest Expense

Proposed regulations adopt new rules for allocation of interest expense that reflect the reduced rate of tax on GILTI and the treatment of earnings eligible for Section 245A.

Repeal of FMV method of apportionment makes tax book value method mandatory, requiring consideration of the stock basis of CFCs, as adjusted for PTI.

Other changes in the Proposed FTC Regulations:

- Special rules for Specified Partnership Loans (SPLs) between a partner and a partnership

- Special rules for hybrid instruments in the debt-netting rules of 1.861-10



# The “Compulsory” Requirement

The foreign tax payment must be “compulsory” to be creditable.

“An amount paid is not a compulsory payment to the extent that the amount paid exceeds the

“A taxpayer need not undertake extraordinary efforts to contest a foreign tax liability before the tax will be allowed as a credit.” *Brack (Bx 27.88 g 05(t)14.i)2(ni)z*

“A t will

“Although defendant presents sound policy reasons for requiring a taxpayer to exhaust all litigation remedies before being entitled to a foreign tax credit, the statute, the regulations, and the applicable revenue rulings do not reflect defendant’s policy concerns.” *International Business Machine Corp. v. United States*, 38 Fed. Cl. 661 (1997).



An amount paid is not a compulsory payment, and thus is not an amount of tax paid, to the extent that the amount paid exceeds the amount of liability under foreign law for tax. An amount paid does not exceed the amount of such liability if the amount paid is determined by the taxpayer in a manner that is consistent with a reasonable interpretation and application of the substantive and procedural provisions of foreign law (including applicable tax treaties) in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for tax, and if the taxpayer exhausts all effective and practical remedies, including invocation of



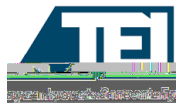
## Reasonably Interpreting And Applying Foreign Law


Taxpayers may rely on advice obtained in good faith from foreign tax advisors.

Be prepared to provide evidence of the advice.

Taxpayers need not alter its form of doing business, its business conduct, or the form of any business transaction.

Does the taxpayer have actual or constructive notice regarding the interpretation or application of foreign law?



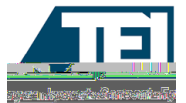


Must pursue remedies that are “effective and practical” considering “the amount at issue and likelihood of success.”




Must a taxpayer request Competent Authority Assistance?

The IRS view is that there are “few exceptions” to the “rule” that taxpayers must pursue competent authority assistance to exhaust their remedies idiancmmecrounc.?

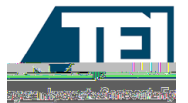






Procedures set forth in Rev. Proc. 2015-40.

- y Taxpayers are encouraged to file request after a competent authority issue arises or is likely to arise. - 40.



## Field Service Advice 1998-293

“[T]here is authority that taxpayer may not claim a credit for the tax that Japan is willing to concede in a competent authority settlement but which taxpayer is unwilling to accept.”

“It is possible that the Government would have an argument that [redacted text] in refusing to accept a competent authority settlement . . . has made a voluntary payment to Japan in the amount of tax that the Japanese competent authority is willing to concede.”

## Field Attorney Advice 20125202F

“Although the proposed CA settlement was based on a smaller amount of constructive



## Foreign Tax Advisors

Make sure your documentation is in order.

Settlements of more than one issue are evaluated on an overall basis.

What are other companies doing?

Revenue Ruling 77-267 (“[s]ince the monetary settlement reached is comparable to a  
43.r.224 and obtaine54t(43 4r)08(( )-08good (f)0.7(a)3.9(i)5.6bt y asiary state54t(43nt)5.6(a)3.9xp(a)3.9(y)



## Making Protective Claim For Refund In Competent Authority Request

Protective claim for refund may be made by either: (a) including the claim in Competent Authority Request, or (b) filing a letter making a protective claim under Rev. Proc. 2015-40 in relation to an issue on which competent authority assistance may be requested. See Rev. Proc. 2015-40, Sections 11, 2.02, Tab 3 of Appendix.

A protective claim must: (a) fully advise the IRS of the grounds on which credit or refund is claimed; (b) contain sufficient facts to apprise the IRS of the exact basis of the claim; (c) describe and identify the contingencies affecting the claim; (d) state the year for which the claim is being made; (e) be verified by a written declaration under penalties of perjury, and (f) be filed before the expiration of the period of limitations. Rev. Proc. 2015-40, Section 11.



## Protective Claims For Refund Outside Of Request For Competent Authority Assistance

### Field Attorney Advice 20125202F

“[A] valid protective claim need not state a particular dollar amount or demand an immediate refund, but it must be sufficient to put the Service on notice that a tax refund is sought, focus the Service’s attention on the merits of the claim, and identify the specific years for which a refund is sought.”

### Sample Language

The amount of the refund requested by the company is contingent upon the resolution of the foreign tax assessments. After the dispute with the foreign tax authority regarding the foreign tax assessments is ultimately resolved, the company will file an additional refund claim that amends this protective claim to account for any additional foreign tax credit for which the company is entitled for the 20XX tax year.



## Issues To Consider When Preparing The Refund Claim

### Variance Doctrine

Claim for refund must state the basis for the refund sufficient to apprise the IRS of the exact basis thereof.

Refund suit can’t be brought on a ground that IRS has never had an opportunity to consider at administrative level.

### Joint Committee Review



