



BDO Seidman, LLP
Accountants and Consultants

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Subject:

Final Regulations Issued under Dual Consolidated Loss Provisions

International Tax Alert

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The Internal Revenue Service issued Treasury Decision 9315 on March 16, providing final regulations under the Dual Consolidated Loss (DCL) provisions of IRC § 1503(d).

Date/Timing

The final regulations are generally effective for taxable years beginning on or after April 18, 2007. A taxpayer may apply the final regulations, in their entirety to DCLs incurred in taxable years beginning on or after January 1, 2007.

There are several items in the proposed regulations that are effective for DCLs arising prior to the general effective date of the final regulations.

- The reduced certification period will apply to DCLs and closing agreements that were subject to the prior regulations.
- The reasonable cause procedures of the final regulations replace the current procedures (i.e., relief under §§ 301.9100-1 through 301.9100-3) under the prior regulations, except for requests for closing agreements.
- The elimination of the special basis adjustments provided for in the prior regulations is applied retroactively if such adjustments affect the tax basis that is relevant in an open taxable year.

Affecting

U.S. taxpayers that are subject to the DCL provisions of IRC § 1503(d).

Background

Section 1503(d) generally provides that a DCL for any dual resident corporation or separate unit is not allowed to reduce the taxable income of any other member of the affiliated group unless the loss

does not offset the income of any foreign corporation. The prior regulations promulgated under § 1503 addressed numerous issues of the DCL regime. In May of 2005, proposed regulations were issued (70 FR 29868) to update and amend the prior regulations in numerous areas. The proposed regulations addressed various concerns with the prior regulations, including: the scope of the application of the DCL provisions, updating the DCL regulations to address certain issues highlighted through the application of the entity classification regulations (§§ 301-7701-1 through 301-7701-3), and the administrative burden of the prior regulations.

Summary of Final Regulations

The final regulations include many of the provisions set forth in the proposed regulations, with some modifications. The changes are as follows:

- The combination rule is expanded to generally apply for all purposes of § 1503(d) to same-country separate units of multiple domestic corporations that are members of the same consolidated group. In addition, certain stock basis adjustments that are necessary as a result of the expanded combination rule are provided.
- The definition of a foreign branch is clarified by reference to § 1.367(a)-6T(g)(1) in addition to the clarification that home-country activities of a dual resident corporation or hybrid entity separate unit can qualify as a foreign branch separate unit.
- The consistency rule has been eliminated.
- New rules are provided that define and address transparent entities (and interest therein).
- Clarification is provided for the indirect foreign use of DCLs.
- The reasonable cause standard used to rectify certain DCL filings with certain modifications from the proposed regulations and Notice 2006-13 has been adopted.
- Additional exceptions to the definition of foreign use relating to de minimis use or instances where the transaction giving rise to the foreign use occurs as a result of actions largely outside the control of the taxpayer are provided.
- A stand-alone exception to the mirror legislation rule is included for instances where there is not a foreign affiliate of the dual resident corporation or separate unit that could provide a foreign use for the loss.
- The rules for attributing items of a domestic owner to a separate unit are modified.
- The special basis adjustments provided for in the prior and proposed regulations is eliminated and § 1.1502-32 shall apply without modification.
- Additional guidance on the application of the DCL rules to foreign insurance companies treated as domestic corporations is provided.
- The certification period is reduced to 5 years (from the 15 years provided for in the prior regulations and the 7 years suggested in the proposed regulations).
- Provision that gains or losses under § 987 are not considered in the computation of a DCL.
- Provide that Real Estate Investment Trusts (REITs) and Regulated Investment Companies (RICs) are not subject to the DCL provisions.

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