

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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INTERNATIONAL TAXATION



SUBJECT

IRS IDENTIFIES NEW FOREIGN TAX CREDIT SPLITTER ARRANGEMENTS RELATING TO CERTAIN FOREIGN INITIATED ADJUSTMENTS

SUMMARY

On September 15, 2016, the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "Service") issued Notice 2016-52 (the "Notice") which provides that Treasury and the Service intend to issue regulations under Internal Revenue Code ("IRC") Section 909 to address the separation of related income from foreign income taxes paid by a "Section 902 corporation" pursuant to certain foreign-initiated adjustments.¹ The regulations detailed in the Notice are intended to apply to foreign income taxes paid on or after September 15, 2016.

DETAILS

IRC Section 909 is intended to prevent the separation of creditable foreign taxes from related income generally by deferring the right to claim credits until the related income is included in U.S. taxable income. The current Treasury Regulations under IRC Section 909 provide an exclusive list of foreign tax credit splitter arrangements and provide that split taxes are not taken into account for U.S. federal income tax purposes before the taxable year in which the related income is taken into account by the payor or, in the case of split taxes paid or accrued by a Section 902 corporation, a Section 902 shareholder of the Section 902 corporation.

¹ A "Section 902 corporation" is a foreign corporation with direct or indirect shareholders that includes at least one domestic corporation owning at least 10 percent of the foreign corporation's stock (a "Section 902 shareholder").

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The Notice provides that Treasury and the Service are aware that, in anticipation of a large foreign-initiated adjustment that relates to a prior taxable year, a taxpayer may take steps to separate the additional payment of foreign income tax from the income to which it relates. Such foreign-initiated adjustments may arise under European Union (“EU”) State aid law, to the extent EU State aid payments result in creditable foreign taxes.²

The Notice states that before a payment is made pursuant to a foreign-initiated adjustment, a taxpayer may attempt to change its ownership structure or cause the Section 902 corporation to make an extraordinary distribution so that the subsequent tax payment creates a high-tax pool of post-1986 undistributed earnings that can be used to generate substantial amounts of foreign taxes deemed paid, without repatriating and including in U.S. income the earnings and profits to which the taxes relate. The Treasury and the Service have determined that guidance to address these transactions is appropriate under IRC Section 909. Accordingly, the Notice provides that Treasury and the Service intend to issue regulations under IRC Section 909 that will identify two new splitter arrangements relating to Section 902 corporations that pay foreign income taxes pursuant to certain foreign-initiated adjustments. The regulations will apply similar rules to taxpayers that take the position that taxes paid by a U.S. person pursuant to certain foreign-initiated adjustments to the tax liability of a Section 902 corporation are eligible for a direct foreign tax credit under IRC Section 901. The Notice includes detailed rules (and certain exceptions) for when changes in ownership structures or certain distributions that, in connection with a foreign-initiated adjustment, will result in a foreign tax credit splitting arrangement.

BDO INSIGHTS

BDO can assist our clients with understanding the complexities of foreign tax credit splitter arrangements and also advise on how the rules described in the Notice may impact the ability to claim foreign tax credits in certain situations when there is a foreign-initiated adjustment.

² It should be noted, however, that the Notice specifically provides that no inference is intended to be made as to whether (1) payments made pursuant to any particular foreign-initiated adjustment, including those arising under EU State aid law, qualify as payments of creditable foreign income taxes, or (2) taxes paid by a U.S. person pursuant to a foreign-initiated adjustment to the tax liability of a Section 902 corporation are eligible for a direct foreign tax credit under IRC Section 901.

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