

January 23, 2023

The Honorable Douglas O'Donnell
Acting Commissioner
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Ms. Lily Batchelder
Assistant Secretary for Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Peter Blessing
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

SENT ELECTRONICALLY via <http://www.regulations.gov>

RE: Proposed Foreign Tax Credit Regulations Reg-112096-22

Dear Acting Commissioner O'Donnell, Mr. Blessing, and Ms. Batchelder:

Business Roundtable, which represents over 230 Chief Executive Officers (CEOs) of the largest American companies from all sectors of the economy, appreciates this opportunity to provide our comments on the Notice of Proposed Rulemaking on Guidance Related to the Foreign Tax Credit published in the Federal Register on November 22, 2022.

Business Roundtable promotes a thriving U.S. economy and expanded opportunities for all Americans through sound public policies. As major employers in every state, Business Roundtable CEOs lead companies that support 37 million American workers, and they take seriously the responsibility of continuing to create quality jobs.

Business Roundtable companies operate globally and produce and sell their goods and services both in the United States and in the foreign markets that are home to 95 percent of the world's consumers. Business Roundtable CEOs know firsthand that the ability of their companies to expand sales in foreign markets directly contributes to greater U.S. employment, U.S. investment, U.S. R&D and increased exports of goods and services from the United States.

General Comments

International tax law generally charges the residence country with the elimination of double taxation either through: (i) a territorial regime, which exempts all foreign income from tax in

the residence jurisdiction, or (ii) a tax credit if the resident jurisdiction includes the same income in the resident's tax base. The United States imposes tax on U.S. residents based on a quasi-territorial system of taxation. While certain income is exempt from U.S. tax via a dividends received deduction (section 245A), a significant amount of foreign income is included in the U.S. tax base and, therefore, subject to U.S. income tax. To alleviate double taxation on this taxable foreign income, the United States provides a potential foreign tax credit for the foreign taxes paid on that income. While it is true that not all foreign taxes are eligible for the U.S. foreign tax credit, since 1918, the United States has provided a foreign tax credit for "income, war profits, and excess profits" taxes (hereinafter referred to as "income taxes").

It is axiomatic that U.S.-based multinationals must be able to claim a foreign tax credit to remain competitive in the global marketplace. The final Foreign Tax Credit (FTC) regulations made significant changes to this long-standing tenet, and these regulations have resulted in double taxation that harms the competitiveness of U.S. companies operating abroad.

Business Roundtable welcomes the release of additional guidance to the final FTC regulations. We appreciate the government's interest in understanding the distortive effects of the FTC regulations. However, we have concerns that the proposed regulations do not adequately address certain issues.

Reattribution payments, remittance and the reattribution of assets

Issue:

In March 2022, Business Roundtable and several other associations outlined concerns with the rules for allocating and apportioning foreign income taxes with respect to certain disregarded transactions, including the use of the tax book value of assets as a proxy for the accumulated after-tax income from which a remittance is paid.¹ Business Roundtable members' experience applying Treas. Reg. §1.861-20(d)(3)(v)(C) confirms the warnings expressed in response to the proposed regulations: using the tax book value of assets as a proxy for accumulated earnings has a materially distortive effect that causes taxes to be separated from the income to which they relate, which can result in the permanent loss of foreign tax credits. This issue is especially acute for taxpayers that generate cash from the collection of receivables for goods or services sold into a foreign market. Such taxpayers often face practical and/or legal restrictions on the ability to make interim dividend payments such that they must maintain a significant amount of cash on their balance sheets throughout the year in order to do business in that market.

¹ Letter to US Treasury Department regarding final foreign tax credit regulations (March 4, 2022), available at <https://www.businessroundtable.org/business-roundtable-joins-trade-associations-in-letter-on-the-foreign-tax-credit-regulations>

Recommendation 1:

We appreciate the government’s interest in understanding our experience applying these rules and addressing their distortive effects. To that end, we recommend requiring (or allowing) taxpayers to use a more suitable proxy for accumulated earnings: a rolling three-year average of the annual earnings attributable to the remitting taxable unit. A proxy based on a three-year average of annual earnings would be at least as administrable as, and far more accurate than, a proxy based on the tax book value of assets method (particularly considering the requirement to reassign assets from taxable units that make disregarded payments). Using a three-year average of annual earnings as a proxy would also be more administrable than a requirement to trace a remittance to the specific accumulated earnings from which it was made, which would require new rules to facilitate tracking the accumulated earnings of a taxable unit. A three-year average of annual earnings method would also address concerns the government has around manipulation that could arise under an approach that only looks to current-year earnings.

Recommendation 2:

If the three-year rolling average is not adopted, then we recommend that the reattribution asset² rule should be elective. The reattribution asset rule greatly increases the complexity of the tax book value computation without meaningfully improving the accuracy of the calculation. Further, intellectual property-driven businesses may not have significant amounts of tax basis to move as a result of “reattribution payments,” and therefore, the requirement to transfer basis is a nuisance in the remittance rule computation and taxpayers ought to be able to elect out of applying the reattribution asset rule.

Issue:

The tax book value remittance rule does not match withholding taxes with the character of distributed earnings.

Recommendation:

We recommend replacing the tax book value rule applicable to remittances with a more suitable rule that matches withholding taxes with the character of the distributed earnings. A more suitable rule would look to accumulated earnings (with a limited look-back period). Alternatively, if the tax-book-value rule is retained, certain cash and receivables ought to be treated as nonpassive assets.

² Included within Treas. Reg. 1.861-20(d)(3)(v)(C)(1)(ii).

Determining insubstantiality

Issue:

The Proposed Treas. Reg. § 1.901-2(b)(4)(i)(C)(1) provides that “whether a foreign tax permits recovery of substantially all of each item of significant cost or expense is determined based solely on the terms of the foreign tax law.” Proposed Treas. Reg. § 1.901-2(b)(4)(i)(C)(2) then provides safe harbor rules for disallowances that are based on a “stated portion” of an item of significant costs or a receipts-based or income-based measure.

Recommendation:

We believe that additional guidance should be provided on how to determine insubstantiality of any disallowance that is not based on a “stated portion” of an item of significant costs or a receipts-based or income-based measure “based solely on the terms of the foreign law.” For example, a foreign tax law may generally allow the deduction of interest but only to an interest rate percentage set by the government or limit an interest deduction based on a specified debt-to-equity ratio.³ These limitations do not fall under the safe harbor but are limited disallowances similar to those in the safe harbor. As such, the regulations should provide guidance allowing taxpayers to determine when a foreign tax law allows substantially all of each item of significant cost or expense when such disallowances do not fall within the safe harbors provided.

Exceptions to cost recovery requirement

Issue:

Proposed Treas. Reg. § 1.901-2(b)(4)(i)(F) provides that “a disallowance of all or a portion of an item of significant cost or expense does not prevent a foreign tax from satisfying the cost recovery requirement if such disallowance is consistent with any principle underlying the disallowances required under the income tax provisions of the Internal Revenue Code, including the principles of limiting base erosion or profit shifting and addressing nontax public policy concerns similar to those reflected in the Internal Revenue Code.”

Recommendation:

The proposed regulations should clarify that when the principle or motivation for a disallowance under the foreign tax law was unclear (*e.g.*, not articulated in the foreign tax law

³ According to the OECD, the most common interest limitation rule, present in 43 jurisdictions in 2019, involves a thin capitalization rule where the permissible threshold is based on debt-to-equity or debt-to-asset ratios. OECD (2020) Corporate Tax Statistics, Second Edition.

or evidenced by its legislative history), such disallowance is “consistent with” a U.S. principle if the disallowance has a similar effect as a particular disallowance in the Internal Revenue Code (“Code”). For example, a foreign tax law may disallow payments to related parties outside of the country, but not provide a reason for such disallowance in its legislative history. This disallowance should be allowable under the cost recovery requirement because its effect is consistent with the U.S. principle of limiting base erosion or profit shifting.

Foreign disallowance should be allowed for all public policy reasons reflected under the Code and not just public policy supporting disallowance of deductions. Tax policy can effectuate public policy and encourage certain behaviors through one of two mechanisms: (i) allowance of credits or additional deductions or (ii) disallowance of a deduction. For example, the public policy of encouraging domestic content is found in the Code but is, generally, promoted through the Code’s credit mechanism (*e.g.*, the domestic content requirement found in the newly enacted Inflation Reduction Act of 2022). Foreign tax law may have the same public policy of promoting domestic content but lack the same credit mechanism and instead promote such public policy by limiting deductions for expenses incurred outside the country. The same public policy is affected regardless of the mechanism. As such, the regulations should allow foreign disallowances for all public policy reasons reflected under the Code and not just public policy supporting disallowance of deductions.

It is of significant importance for Treasury to clarify that the Mexican corporate income tax satisfies the cost recovery and realization requirements and that similar provisions in the corporate income tax systems of other countries would not cause the cost recovery and realization requirements not to be satisfied. Purchased goodwill (the excess of the acquisition price of a company over the fair market value of its assets) is nondeductible under the Mexican corporate income tax and no basis is provided upon disposition. This should not cause the Mexican corporate income tax to fail the cost recovery requirement. In addition, the Mexican corporate income tax has anti-abuse provisions that may result in a disallowance of interest expense. The public policy reasons for the interest expense disallowance should be viewed similarly to those in the Code. Further, the Mexican corporate income tax provides inflation adjustments for certain assets and liabilities. The absence of similar inflation adjustments in the Code should not be viewed as causing the realization requirement not to be satisfied. Given the significant importance of U.S. trade and investment with Mexico, clarification in particular with regard to the Mexican corporate income tax is necessary and examples illustrating the provisions discussed above would similarly clarify that other countries using similar provisions would not cause the cost recovery and realization requirements not to be satisfied.

Attribution requirement for service payments

Issue:

Business Roundtable members remain concerned about the impact of the FTC regulations on services. To alleviate this problem, we recommend that Treasury create a parallel safe harbor for services, similar to the safe harbor for royalties. Credits should be available for a reseller of services into a single country (all recipients of services should be resident in the same country).

Recommendation:

We recommend adding a new paragraph for services:

“Services. Under the foreign tax law, gross income from services must be sourced based on where the services are performed, as determined under reasonable principles (which do not include determining the place of performance of the services based on the location of the service recipient). If the recipient of the services is located in the jurisdiction imposing the tax and such recipient is the primary beneficiary of the service (for example, the recipient does not market or sell such services outside of such jurisdiction), the services shall be considered to be sourced to such jurisdiction under reasonable principles. Notwithstanding the preceding sentence, in the case of services provided over the internet or via similar medium, reasonable principles do not include sourcing income based on the location of users of a social media platform, viewers of online content (including online advertising), users of online search engines, or purchasers or sellers of goods or services on online intermediation platforms.”

Definition of a Royalty

Issue:

Foreign licenses may not label various payments as royalties but instead apply a more targeted withholding tax regime that applies solely to certain types of intellectual property. We do not believe that it is the intent of Treasury to define the term “royalty” narrowly.

Recommendation:

Treasury should clarify that the term “royalty”⁴ in the “reasonably similar source” and “single country license” rule includes any amount treated as a payment for the use of intellectual property under foreign law.

⁴ Prop. Reg. 1.903-1(c)(2)(iii)(B) and Treas. Reg. 1.901-2(b)(5)(i)(B)(2).

Single-Country Use Exception

Issue:

The single-country use exception in the proposed foreign tax credit regulations is a welcome change in the proposed regulations. It will, however, advantage vertically integrated companies (*i.e.*, ones that license IP to related-party manufacturers and distributors) and, consequently, disadvantage their competitors and other companies that are not. To comply with the single-country use rule, licensors will generally have to amend license agreements. If a licensor seeks to amend an agreement with an unrelated licensee, the licensee may either attempt to extract opportunistic concessions or refuse to amend the contract (for reasons wholly unrelated to U.S. tax). For example, the unrelated licensee may demand a reduced royalty rate, which would likely lower the amount of income included in the U.S. base. In many circumstances, the jurisdiction in which the licensee is resident sources royalty income based on the residence of the payor (otherwise, the licensor would not be seeking to apply the single-country use exception in the first place) and so is indifferent to this contractual modification from a tax perspective.

Related-party licensees, in contrast, are not likely to extract opportunistic concessions.

As a result, the proposed single-country use exception may also implicate antitrust/competition concerns by incentivizing vertical integration of transactions. The inclusion of a factual description of the underlying activity in a contract, on its face, reduces the burdens on taxpayers and the IRS. On the other hand, if parties apply §482-based sourcing principles to the underlying activity “behind the scenes” and then reflect the result in the contract only as an amount or formula, that lack of transparency will cause significant administrative burden on the IRS to audit any transaction and confirm that the legal analysis is reasonable.

Recommendation:

Both to reduce the administrative burden on the IRS (but not increase that burden on taxpayers) and to eliminate the disadvantage to non-vertically integrated companies, the single-country use exception should be modified. For example, the single-country use exception could instead require that:

- An agreement must include an adequate factual description of the relevant activity conducted by the licensee (*e.g.*, manufacturing and customer locations); and
- The taxpayer must maintain in its books and records documentation that reflects the application of §482-based sourcing principles.

This modification would not increase the burden on taxpayers and the IRS. Taxpayers are already required to perform, and the IRS to audit, this analysis. Indeed, through increased transparency it would likely reduce the burden on the IRS.

Issue:

The requirement in the “single country license”⁵ rule that the license include specific terms related to “in-country” use should be eliminated and replaced with a rule that permits using any reasonable documentation to substantiate “in-country” use. Relying on “reasonable documentation” to substantiate “in-country” use would align the single country license rule with rules for substantiating sourcing⁶ in general and with the documentation rules applicable to “foreign use” of intangible property for foreign derived intangible income (FDII).

Recommendation:

A substance-based “use” safe harbor ought to be drafted that provides that “use” within the country of the licensee is deemed to occur if the licensee has a sufficient threshold of assets or personnel within the country of the licensee. The 2021 Final Foreign Tax Credit regulations do not require exact symmetry between foreign and U.S. sourcing rules, and therefore the safe harbor does not need to line-up exactly with U.S. sourcing rules.⁷ Further, the “safe harbor” would be in the spirit of sourcing authorities that look to the place of productive activities such as *Sanchez*,⁸ and FSA 200222011, as well as the FDII manufacturing intangible rules in Treas. Reg. 1.250(b)-4(d)(2)(ii)(C). To ensure that foreign tax credit limitation, effectively connected income, and fixed, determinable, annual or periodical (FDAP) income determinations are not disturbed, we recommend that this “safe harbor” only apply for purposes of the single-country license rule and not more broadly to general sourcing determinations.

Issue:

⁵ Prop. Reg. 1.903-1(c)(2)(iii)(B).

⁶ Section 6001 and Treas. Reg. 1.6001-1(a).

⁷ Note that the 2021 Final Foreign Tax Credit regulations do not require that the foreign and U.S. “place of use” sourcing rules be identical. As such, a “substance-based” place of use “safe harbor” would be a reasonable expansion of “place of use” for creditability purposes. Treas. Reg. 1.901-2(b)(5)(i)(B) provides that “[a] foreign tax law’s application of such sourcing rules need not conform in all respects to the application of those sourcing rules for Federal income tax purposes.” Further, the preamble to the 2021 Final Foreign Tax Credit Regulations notes the following in respect of royalties:

the foreign tax law must impose tax on such royalties based on the place of use of, or the right to use, the intangible property. However, the final regulations do not require that the foreign law, in determining the place of use of an intangible in a particular transaction or fact pattern, reach the same conclusion as the IRS in a particular revenue ruling or a U.S. court in a particular case.

⁸ *Sanchez v. Commissioner*, 486 T.C. 1141 (1946), aff’d, 162 F.2d 58 (2d Cir. 1947);

The “cliff effect”⁹ should be eliminated from the “single country license” rule. An audit adjustment that decreases “in-country” use should not result in all of the withholding taxes on the license becoming noncreditable.

Recommendation:

The “single-country license” rule should provide that a royalty will only be treated as failing the “sourced-based attribution” requirement to the extent that “use” does not relate to the country of the licensee. Further, eliminating the “cliff effect” would align the single-country license rule with the “foreign use” rules applicable to FDI¹⁰ and sourcing in general.

Issue:

The proposed regulations also impose limitations on the scope of the single-country use exception where the taxpayer “knows, or has reason to know,” the agreement “misstates the territory” in which the intangible property is used. Presumably, the concern is that related-party agreements will be amended to “create” a single-country use under these proposed rules, and such a result would not be supportable under the principles of sections 482 and 861. This concern should be significantly lower in agreements with unrelated parties. However, the limitation applies equally in both the related and unrelated party contexts. The application of this limitation is likely intended to be different for related and unrelated party agreements. But, absent explicit language in the proposed regulations, the regulations do not provide enough certainty to taxpayers. This is especially true where the penalty for failing to meet the requirements of this limitation is disallowance of any foreign tax credits related to the transaction.

Recommendation:

The limitation on the single-country use exception should be modified in one of two ways, each of which would address the area of concern for related party agreements while also providing more certainty to taxpayers with unrelated party agreements:

- Either the limitation could be modified to include a limited presumption in favor of the taxpayer with respect to agreements with unrelated parties; or
- The penalty for failing to meet the limitation’s requirements could be modified to disallow only the “excess” foreign taxes.

⁹ Prop. Reg. 1.903-1(c)(2)(iv)(C) and Prop. Reg. 1.903-1(d)(11), Example 11.

¹⁰ Treas. Reg. 1.250(b)-4(d)(2)(iv)(B)(4) Example 4.

Extension of Tax Treaties to all “Covered Taxes” of Foreign Disregarded Entities owned by U.S. Entities

Issue:

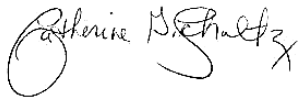
In certain instances, the “relief from double taxation” article of treaties between the U.S. and foreign countries does not apply to “foreign income taxes” imposed on disregarded entities owned by U.S. entities. Specially, some treaties (*e.g.*, the US-Australia, and US-India treaties) do not include “fiscal transparency” language that would treat the income of the disregarded entity as derived by an entity meeting the U.S. “residency” requirements of the treaty.

Recommendation:

We recommend that Treasury explicitly provide that all “covered taxes” under a treaty are creditable if the income subject to foreign tax is derived by a disregarded entity owned by a U.S. entity notwithstanding that “residency” or other requirements may not be met. Further, all taxes on controlled foreign corporations ought to also be treated as creditable if incurred by an entity in a treaty country.¹¹

Please let me know if you have any questions.

Sincerely,



Catherine G. Schultz
Vice President Tax and Fiscal Policy
Business Roundtable
cschultz@brt.org

¹¹ See Tax Treaties and Indirect Foreign Tax Credits (October 10, 2022), Tax Notes Today - Federal, by Ege Berber, Wade Sutton, Aaron Junge, and Kellen Yent.