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May 6, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Proposed Regulations Regarding the Section 901 Compulsory Payment Requirement

Dear Commissioner Shulman:

Enclosed are comments on proposed regulations regarding the section 901 compulsory payment requirement. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Stuart M. Lewis".

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William Wilkins, Chief Counsel, Internal Revenue Service
Joshua Odintz, Acting Tax Legislative Counsel, Department of the Treasury
Stephen E. Shay, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury
Manal Corwin, International Tax Counsel, Department of the Treasury
Michael Danilack, Deputy Commissioner, Large & Mid-Size Business Division (International), Internal Revenue Service

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**ABA SECTION OF TAXATION
COMMENTS ON PROPOSED REGULATIONS REGARDING
THE SECTION 901 COMPULSORY PAYMENT REQUIREMENT**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Dirk Suringa, Chair of the Foreign Tax Credit Subcommittee of the Foreign Activities of U.S. Taxpayers Committee of the Section of Taxation. Substantive contributions were made by William Harwood and Joseph Calianno, Committee Vice Chair. The Comments were reviewed by Mark Harris, Committee Chair. The Comments were further reviewed by Reuven Avi-Yonah of the Section’s Committee on Government Submissions and Joan C. Arnold, Council Director for the Foreign Activities of U.S. Taxpayers Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 6, 2010

EXECUTIVE SUMMARY

These Comments address the Proposed Regulations relating to whether a payment of tax to a foreign country or a possession of the United States is compulsory (the “Proposed Regulations”).¹ The Comments are a response to the solicitation for comments in the notice of proposed rulemaking issued on March 30, 2007.

The Proposed Regulations address foreign loss-sharing and joint tax settlements, as well as certain structured passive investment arrangements. The provisions of the Proposed Regulations regarding the treatment of structured passive investment arrangements were separately adopted as Temporary Regulations in 2008.² These Comments address only the portion of the Proposed Regulations that relate to foreign loss-sharing regimes and joint tax settlements.

The Proposed Regulations would amend the Regulations promulgated under section 901³ regarding the requirement that a payment to a foreign country or a possession of the United States must be compulsory to be considered a creditable tax for purposes of section 901 (the “compulsory payment requirement”). Existing Regulations, issued in 1983 (the “1983 Regulations”),⁴ appear to apply the compulsory payment requirement separately to each taxpayer. The Proposed Regulations would amend the 1983 Regulations to clarify that certain U.S.-owned foreign groups are treated as a single taxpayer for purposes of the compulsory payment requirement.

Our recommendations regarding the Proposed Regulations are summarized below:

1. We recommend that the Proposed Regulations provide that loss-sharing or joint tax settlements permitted under foreign law do not result in foreign tax payments being considered *per se* non-compulsory. If the Internal Revenue Service (the “Service”) and the Department of the Treasury (“Treasury”) believe that reliance on foreign law presents a significant risk of supporting tax avoidance transactions, we recommend that the final Regulations provide a targeted anti-abuse rule rather than relying on the “U.S.-owned group” definition contained in the Proposed Regulations. The anti-abuse rule could provide for distinguishing between timing differences and permanent differences in the amount of the foreign tax credit claimed.
2. If the Regulations, when finalized, restrict loss-sharing and joint tax settlements by reference to a defined U.S.-owned group, we recommend

¹ Notice of Proposed Rulemaking, REG-156779-06, 72 Fed. Reg. 15,081 (2007).

² See Temp. Reg. § 1.901-2T(e)(5)(iv); 73 Fed. Reg. 40,727 (2008).

³ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

⁴ Reg. § 1.901-2(e)(5).

that the final Regulations provide additional guidance concerning the implications of that definition.

3. We recommend that the final Regulations provide that a foreign tax payment does not fail to be compulsory solely because an entity with respect to which a domestic use election (“DUE”), as defined in Regulation section 1.1503(d)-6, has been filed did not share with the payor losses that would have reduced the payor’s foreign tax liability.

COMMENTS

I. History, Background, and Purpose of the Proposed Regulations

Courts first articulated the requirement that taxes must be compulsory to be deducted in cases in which the courts disallowed deductions for State taxes that taxpayers did not legally owe.⁵ The Service and Treasury expanded upon these decisions to require taxpayers seeking to claim the foreign tax credit first to attempt to reduce their foreign tax liability by exhausting all effective and practicable foreign administrative remedies.⁶

The 1983 Regulations contain the current formulation of the rule regarding the foreign tax credit. The 1983 Regulations define a tax as a compulsory payment assessed pursuant to the authority of a foreign country or possession of the United States to levy taxes.⁷ A payment is not compulsory to the extent the amount paid exceeds the amount of the foreign tax liability.⁸ The amount paid does not exceed the foreign tax 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.”⁹ The language of the 1983 Regulations suggests that the compulsory payment requirement applies on a taxpayer-by-taxpayer basis.

According to the preamble to the Proposed Regulations, commentators expressed concern that the compulsory payment requirement might not be satisfied if the foreign taxpayer had in a prior year transferred losses to another entity pursuant to a foreign loss-sharing regime.¹⁰ Similarly, one or more subsidiaries of a U.S. person might reach a settlement with a foreign taxing authority that results in an increase in the amount of one foreign subsidiary’s tax liability and a decrease in another subsidiary’s tax liability. Commentators were concerned that the compulsory payment requirement would not be satisfied with respect to the entity that could have reduced its own foreign tax liability by withholding its losses or refusing to participate in the joint settlement.¹¹

The preamble to the Proposed Regulations states that the purpose of the compulsory payment requirement is to “ensure . . . that a taxpayer will make reasonable efforts to minimize its foreign tax liability even though the taxpayer may be indifferent to

⁵ See, e.g., *Cooperstown Corp. v. Commissioner*, 144 F.2d 693, 696 (3rd Cir.), *cert. denied*, 323 U.S. 772 (1944); *Kenyon Instr. Co. v. Commissioner*, 16 T.C. 732, 741 (1951); *Hart Furniture Co. v. Commissioner*, 12 T.C. 1103, 1108 (1949), *rev’d on other grounds*, 188 F.2d 968 (5th Cir. 1950).

⁶ See Rev. Rul. 92-75, 1992-2 C.B. 197; Rev. Rul. 80-231, 1980-2 C.B. 219; Rev. Rul. 77-267, 1977-2 C.B. 243; Rev. Rul. 76-508, 1976-2 C.B. 225. These rulings generally have been superseded by Rev. Proc. 2006-54, 2006-2 C.B. 1035.

⁷ Reg. § 1.901-2(a).

⁸ Reg. § 1.901-2(e)(5).

⁹ *Id.*

¹⁰ 72 Fed. Reg. at 15,081.

¹¹ See *id.*

the imposition of the foreign tax due to the availability of the foreign tax credit.”¹² The Service and Treasury believe that the purpose of this requirement is served if all foreign entities owned by the U.S. person, in the aggregate, satisfy the compulsory payment requirement.¹³

II. Description of the Proposed Regulations

A. Negative Implication of the Proposed Regulations

For purposes of the compulsory payment requirement, the Proposed Regulations would treat as a single taxpayer all foreign “entities” in which the same U.S. person directly or indirectly owns an 80% ownership interest (a “U.S.-owned group”).¹⁴ The U.S. person must own directly or indirectly 80% or more of the vote and value of a foreign corporation, or 80% or more of the income interest in a non-corporate foreign entity, for it to belong to the U.S.-owned group.¹⁵ Based on this rule, tax payments by a member of a U.S.-owned group that shares losses with another member of the U.S.-owned group, or that participates in a joint tax settlement with another member of the U.S.-owned group, will not fail to be compulsory payments for that reason.

The Proposed Regulations do not state directly that the sharing of losses among non-members of a U.S.-owned group, or among members and non-members of a U.S.-owned group, would render non-compulsory the foreign tax payments by the entity or group that transfers its losses. Similarly, the Proposed Regulations do not state that joint tax settlements among non-members of a U.S.-owned group, or among members and non-members of a U.S.-owned group, would render non-compulsory subsequent foreign tax payments by the entity that shared a foreign tax benefit pursuant to the settlement. However, one example in the Proposed Regulations suggests that the Proposed Regulations would characterize such subsequent foreign tax payments as non-compulsory, and, as discussed below, the Service has recently confirmed this interpretation informally.

In the regulatory example, L, M, and N are foreign corporations that participate in a group relief regime. L owns 100% of the common stock of M, and M owns 100% of the stock of N. Domestic corporation O owns a hybrid equity interest in M, such that for U.S. tax purposes O is considered to own 99% of M. In Year 1, M loses \$10 million; N earns \$25 million; and L earns \$15 million. M chooses to surrender its \$10 million loss to L, rather than N. Based on a foreign corporate income tax rate of 30%, the sharing of the loss saves L \$3 million of foreign tax. According to the example, M and N are treated as a single taxpayer under the Proposed Regulations. However, L is treated as a separate

¹² 72 Fed. Reg. at 15,082.

¹³ *Id.*

¹⁴ See Prop. Reg. § 1.901-2(e)(5)(iii)(A).

¹⁵ For purposes of this test, all domestic corporations that are members of a consolidated group (as that term is defined in Regulation section 1.1502-1(h)) are treated as one domestic corporation for purposes of Regulation section 1.901-2(e)(5)(iii). Additionally, for purposes of Regulation section 1.901-2(e)(5)(iii), indirect ownership of stock or another equity interest (such as an interest in a partnership) is determined in accordance with the principles of section 958(a)(2), whether the interest is owned by a U.S. or foreign person. See Prop. Reg. § 1.901-2(e)(5)(iii)(B).

taxpayer because no U.S. person owns an interest in L. The example provides for the following result:

Accordingly, in testing whether M and N's reasonably expected foreign tax liability has been minimized over time, L is not considered the same taxpayer as M and N, collectively, and the \$3 million reduction in L's . . . tax liability through the surrender to L of M's \$10 million . . . loss in year 1 is not considered to reduce M and N's collective [foreign] tax liability.¹⁶

This example does not directly state that N's tax payment fails the compulsory payment requirement to the extent of \$3 million, but the Proposed Regulations strongly imply that conclusion. Under both the 1983 Regulations and the Proposed Regulations, the M-N group must take measures to reduce over time their reasonably expected liability under foreign law. If the sharing of losses with L is not taken into account, the M-N group would appear to have paid \$3 million too much in foreign taxes.

In Notice 2007-95,¹⁷ the Service stated that it had "determined that the proposed change to section 1.901-2(e)(5) relating to U.S.-owned foreign groups may lead to inappropriate results in certain cases." The Service therefore severed, for further study, the U.S.-owned group portion of the Proposed Regulations from the remainder of the Regulations. However, the Service stated that "[f]or taxable years ending on or after March 29, 2007, and beginning on or before the date on which the final regulations are published, taxpayers may rely on the portion of the proposed regulations addressing U.S.-owned foreign groups."

B. Subsequent Informal Guidance

The preamble to the Proposed Regulations states that "[t]he IRS and Treasury Department intend to monitor structures involving U.S.-owned foreign groups, including those that would be covered by the proposed regulations, to determine whether taxpayers are utilizing such structures to separate foreign taxes from the related income."¹⁸ The Proposed Regulations also note that the Service and Treasury may issue additional Regulations in the future to address arrangements that result in the inappropriate separation of foreign tax and income. The Proposed Regulations do not identify any such structures.

In a recent Chief Counsel Advice,¹⁹ however, the Service applied the compulsory-payment requirement of the 1983 Regulations to disallow the foreign tax credit claimed in connection with a foreign hybrid entity structure. This advice appears to confirm the negative implication of the Proposed Regulations and raises further questions about the

¹⁶ Prop. Reg. § 1.901-2(e)(5)(iii)(C), Ex. 2.

¹⁷ 2007-2 C.B. 1091.

¹⁸ 72 Fed. Reg. at 15,082.

¹⁹ C.C.A. 200920051 (Apr. 7, 2009).

conditions under which the sharing of losses or foreign tax liability among commonly controlled entities will result in non-compulsory payments.

According to the advice, a U.S. parent corporation (“USP”) owned all the stock of two Italian companies that elected to be disregarded for U.S. tax purposes. The two Italian disregarded entities (“DEs”), in turn, owned all the stock of two Italian corporations, which elected under Italian law to be disregarded for Italian tax purposes. For U.S. tax purposes, the lower-tier Italian corporations were controlled foreign corporations (“CFCs”) as defined in section 957. For Italian tax purposes, the income of the Italian CFCs flowed up to the Italian DEs, where the Italian tax liability was imposed. For U.S. tax purposes, however, the Italian tax liability was treated as imposed directly on USP. As a result, the advice notes, USP claimed “a significant amount of foreign tax credits for the Italian taxes paid by the Italian DEs without reporting any of the corresponding income from the Italian CFCs.”²⁰

The advice concludes that the claimed foreign tax credits should be disallowed on the ground that they were voluntary payments. The Italian entity classification election required the consent of the owners of the Italian CFCs, which were the Italian DEs. The advice therefore considered the election to be a joint election by the Italian CFCs and the Italian DEs. The Italian DEs were disregarded for U.S. tax purposes, and so the advice argued that the election was in effect a joint election by the Italian CFCs and USP. Because the compulsory payment requirement applies taxpayer-by-taxpayer, the advice argued, USP was required to reduce its Italian tax liability separately from the Italian CFCs. The effect of the Italian entity classification election was to decrease the Italian CFC’s tax liability at the expense of increasing USP’s tax liability. For this reason, the advice concluded, USP’s Italian taxes were voluntary payments.

The advice discussed the Proposed Regulations and expressed the view that the liability was not shared among members of the same U.S. owned group. Because the Italian DEs were disregarded for U.S. tax purposes, the foreign tax liability was shifted from the Italian CFCs to USP, and USP, as a U.S. person, cannot be a member of the U.S.-owned group. The advice did not address whether the Italian DEs should be considered foreign “entities” included in the U.S.-owned group. The effect of the advice was to disallow permanently the foreign tax credit for the taxes paid by the Italian CFCs.

III. Response to Request for Comments

A. Elimination of Negative Implication of the Proposed Regulations

As discussed above, the Proposed Regulations imply that sharing of losses among non-members of a U.S.-owned group, or among members and non-members of a U.S.-owned group, will *in all cases* render non-compulsory the foreign tax payments by the entity or group that transfers its losses. The Proposed Regulations also contain the same

²⁰ *Id.*

negative implication with respect to joint tax settlements. Notice 2007-95²¹ did not discuss this issue, and the recent Chief Counsel Advice does nothing to dispel the negative implication.

We recommend that the Proposed Regulations be revised to eliminate this implication and provide instead that loss-sharing and joint tax settlements that are authorized by foreign law will not render a foreign tax payment *per se* voluntary or non-compulsory. If the Service and Treasury determine that this rule could lead to abusive transactions involving the systematic transfer of losses or other tax benefits away from U.S.-owned entities, we recommend that the Proposed Regulations, when finalized, instead add a targeted anti-abuse rule with examples identifying particular transactions of concern.

If the Proposed Regulations contain the negative implication stated above, we believe the structure of the Proposed Regulations would create discontinuities that are difficult to justify in light of the overall purpose of the Proposed Regulations and the compulsory payment requirement. The reliance of the Proposed Regulations on the U.S.-owned-group concept to define the permissible scope of loss-sharing and joint tax settlements might lead to instances of double taxation and might actually discourage taxpayers in certain cases from attempting to minimize their foreign taxes over time.

Other commentators have pointed out examples of situations in which structural differences in U.S. ownership of foreign entities—differences which bear no relation to the foreign tax minimization efforts of the U.S. taxpayers involved—nonetheless may create non-compulsory tax payments under the Proposed Regulations.²²

For example, if two U.S. corporations each own 50% of a foreign corporation that is the parent of a foreign affiliated group, loss sharing among the foreign group members apparently would create non-compulsory payments because there is no U.S.-owned group, as defined in the Proposed Regulations. Similarly, if a foreign parent corporation owns a chain of foreign corporations through a U.S. corporation, loss sharing among the foreign parent and the lower-tier foreign subsidiaries apparently would create non-compulsory payments because the foreign parent and subsidiaries are not members of the same U.S.-owned group. We suggest that whether a taxpayer has this type of ownership structure, rather than a U.S.-owned group, should not affect the determination of whether the taxpayer over time has reasonably attempted to reduce its foreign taxes.

Even when a U.S.-owned group exists, the failure of a group member to share its loss currently with a non-member, to avoid making a subsequent tax payment voluntary, may actually increase over time the amount of creditable foreign taxes paid and claimed

²¹ 2007-2 C.B. 1091.

²² See, e.g., Caren Shein & Kevin Glenn, *Proposed Noncompulsory Payment Regulations: IRS and Treasury Take a New Approach to Foreign Tax Credit “Abuse,”* 36 Tax Mgmt. Int’l J. 411, 417-21 (2007); James J. Tobin, *Foreign Tax Credit Anti-Abuse Regulations Also Impact Loss Sharing,* 36 Tax Mgmt. Int’l J. 326, 326 (2007); Joseph M. Calianno, *Loss Sharing Among Members of a Foreign Group—The “Compulsory” Requirement and Related Issues,* 18 J. Int’l Tax’n No. 6 (June 2007).

by U.S. taxpayers. To avoid creating a non-compulsory payment, for example, a foreign loss-making entity may avoid sharing losses with a non-member of its U.S.-owned group, which may result in a higher current tax payment by that non-member and a larger indirect foreign tax credit claimed by its section 902 shareholder (assuming it has one). The loss-making entity, however, may never turn a profit against which to offset its foreign losses. Thus, the net effect of the Proposed Regulations over time may be to increase the amount of foreign taxes paid and correspondingly reduce the amount of U.S. tax paid by the multinational.

In our view, the foregoing technical issues arise because the Proposed Regulations limit permissible loss-sharing and joint tax settlements by reference to a U.S. legal standard—the 80% vote-and-value test. The compulsory payment requirement asks whether a taxpayer over time has reasonably attempted to minimize its foreign taxes. The answer to that question requires an examination of foreign law and how the taxpayer has applied it. The Proposed Regulations instead test the U.S. ownership percentage in the foreign entity, a data point that we believe is not relevant beyond the basic ownership requirements set forth in section 902. Stated differently, allowing loss-sharing among 79% U.S.-owned foreign entities does not appear to reflect any less the policy of reducing foreign taxes over time than allowing loss-sharing among 80% U.S.-owned foreign entities. In our view, it is unnecessary for the Service and Treasury to overlay U.S. tax requirements for affiliated group status on top of foreign-law requirements for purposes of loss-sharing and joint tax settlements. We recommend that the Proposed Regulations be revised to eliminate this ownership test and instead provide that loss-sharing or joint tax settlements permitted under foreign law do not result in foreign tax payments being considered *per se* non-compulsory.

In informal guidance, the Service generally has disregarded foreign group relief regimes and instead has given U.S. tax effect only to the movements of cash that effectuate foreign tax planning under such regimes.²³ Our recommendation would be consistent with this informal guidance. Our recommendation also would be consistent with Proposed Regulation section 1.901-2(f), which would require an examination of foreign law to determine whether a foreign tax is imposed on the combined income of two or more persons.²⁴ Those Proposed Regulations include an exception from this rule for group relief regimes, in further reliance on foreign law.²⁵

Concerns that reliance on foreign law would lead to abusive trafficking in foreign tax benefits might be addressed by the inclusion of a targeted anti-abuse rule in the final Regulations. Such an anti-abuse rule, for example, might target situations in which over a multi-year period foreign tax benefits such as losses are systematically transferred out of a U.S.-owned group and into a foreign-owned group. If the Service and Treasury were to use this approach, we believe the final Regulations should specify particular fact

²³ See, e.g., G.C.M. 39367 (June 3, 1985); P.L.R. 200515004 (Dec. 9, 2004); P.L.R. 8524043 (Mar. 18, 1985).

²⁴ See Prop. Reg. § 1.901-2(f)(2)(ii), 71 Fed. Reg. 44,240, 44,244 (2006).

²⁵ See Prop. Reg. § 1.901-2(f)(2)(ii)(A), 71 Fed. Reg. at 44,244.

patterns that would lead the Service to conclude that the foreign tax payments resulting from such schemes are non-compulsory.

In summary, we recommend that the Proposed Regulations, when finalized, be revised to eliminate the U.S.-owned group definition and to provide that loss-sharing and joint tax settlements permitted under foreign law do not result in foreign tax payments being considered *per se* non-compulsory.

B. Clarification of the “U.S.-Owned Group” Definition

If the U.S.-owned group definition is retained in the Proposed Regulations when finalized, we recommend that the Service and Treasury clarify the broader implications of that definition.

For example, if one U.S. corporation owns 85% of the vote and value of a foreign group parent and an unrelated U.S. corporation owns the remaining 15%, the Proposed Regulations would appear to count loss-sharing payments among foreign group members as a bona-fide reduction of foreign taxes with respect to the 85% owner but not the 15% owner. On its surface, this rule would appear to make the same tax payment simultaneously voluntary and compulsory. We recommend that the Proposed Regulations be revised to clarify that the U.S.-owned group exists in this circumstance for both the 85% and the 15% shareholder.²⁶

We also recommend that the Proposed Regulations, when finalized, indicate whether members of the U.S.-owned group are *required* to share losses in a given year to provide certainty as to whether a profitable company in a U.S.-owned group satisfies the compulsory requirement with respect to its foreign tax payment. The Proposed Regulations, as drafted, support this inference. A U.S.-owned group is treated as a single entity, and that single entity must take reasonable steps to reduce its foreign income taxes over time, which presumably includes the current sharing of available tax losses. The Proposed Regulations protect only the loss-sharing entity, and only foreign taxes paid or accrued “in a different year,” from the voluntary payment rule.²⁷ Taxes paid in the same year by a profit making member of the U.S.-owned group would appear to be non-compulsory to the extent they could have been offset by losses of other group members. The Proposed Regulations do not address this implicit requirement. When finalized, we recommend that the Regulations eliminate the implication that members of a U.S.-owned group are required annually to share losses.

The Proposed Regulations also appear to require members of a U.S.-owned foreign group to use reasonable efforts to secure any available losses of *non*-members of the U.S.-owned group. A payment of taxes by a foreign corporation would appear no less voluntary if the foreign corporation could have obtained a loss from a non-member of its

²⁶ This solution is likely to be imperfect, however. Even if the 15% shareholder may rely on the existence of the U.S.-owned group created by the 85% shareholder, the 15% shareholder may encounter practical difficulties in verifying that status.

²⁷ Prop. Reg. § 1.901-2(e)(5)(iii)(A).

U.S.-owned group and failed to do so than if the foreign corporation shared its loss with the same non-member and consequently paid more foreign taxes. For instance, if L in the example above incurred a \$10 million loss and M had \$15 million of income, the Proposed Regulations could be read to require the M-N group to seek L's loss to offset their own income. If the U.S.-owned group definition is retained, we recommend that the final Regulations clarify whether reasonable efforts must be made to secure available losses of non-members of the U.S.-owned group.

It is unclear from the Proposed Regulations whether a permanent establishment may be a member of a U.S.-owned group. The Proposed Regulations appear to treat fiscally transparent "entities" as eligible for inclusion, but the Proposed Regulations do not specifically include non-entity permanent establishments.²⁸ However, the recent Chief Counsel Advice appeared to contradict this interpretation by excluding the Italian DEs from the U.S. owned group. If disregarded entities and permanent establishments are excluded, then loss sharing between them and a foreign corporation presumably would give rise to non-compulsory foreign tax payments under the Proposed Regulations. It is unclear as a general policy matter why loss sharing of this type is *per se* objectionable. We recommend that the Service and Treasury clarify this issue in the final Regulations by affirming that such loss sharing is permissible.

C. Clarification of Interaction with Dual Consolidated Loss Regulations

Under section 1503(d)(1), the domestic use of a dual consolidated loss (a "DCL"), as defined in section 1503(d)(2), is not permitted.²⁹ Domestic use of a DCL occurs whenever the DCL is made available to offset, directly or indirectly, the income of a domestic affiliate of a separate unit or a dual resident corporation.³⁰ The term separate unit includes a foreign permanent establishment.³¹

In certain cases, however, a taxpayer may file a DUE to use a DCL in the United States, notwithstanding the domestic use prohibition.³² If a taxpayer violates the terms of the DUE by making a "foreign use" of the DCL, then the taxpayer must recapture its DCL, plus an interest charge.³³ Foreign use occurs whenever any part of the deduction or loss item that went into the DCL is made available under foreign law to offset, directly or indirectly, the income (as defined under foreign law) of a foreign corporation separate and apart from the loss creating entity, as well as in other situations.³⁴ Foreign use does

²⁸ See *id.*

²⁹ See Reg. § 1.1503(d)-4(b).

³⁰ See Reg. § 1.1503(d)-2.

³¹ See Reg. § 1.1503(d)-1(b)(4). A permanent establishment also may be considered to be a member of a U.S.-owned group under the Proposed Regulations, but as noted this issue is unclear. See Prop. Reg. § 1.901-2(e)(5)(iii)(A).

³² See Reg. § 1.1503(d)-6(d).

³³ See Reg. § 1.1503(d)-6(e)(1).

³⁴ See Reg. § 1.1503(d)-3(a)(1).

not occur if foreign law requires a particular election to be made for losses to carry over to another person and no such election is made.³⁵

As discussed above, the Proposed Regulations imply that loss sharing among members of a U.S.-owned group may be required to preclude a foreign tax payment from being considered non-compulsory. However, if a taxpayer has made a DUE with respect to the entity with the losses, then electing to share those losses, for example through a group relief payment, could trigger a violation of the DUE and require recapture by the taxpayer of its DCL, plus an interest charge.

If, for example, USP, a domestic corporation, does business in Country X through a permanent establishment and separately through a subsidiary (“FS”), a net loss attributable to the permanent establishment ordinarily would be a DCL. If Country X law requires an affirmative election for FS to use the permanent establishment’s loss to offset its own income, then the Regulations generally would permit USP to file a DUE with respect to that loss and use the loss to offset USP’s income. Assuming that the permanent establishment also is a member of the U.S.-owned group, however,³⁶ the Proposed Regulations would appear to require the permanent establishment to share its losses with FS for any payment of foreign tax by FS to be considered compulsory. If this is the case, then USP would be required in effect to choose between making FS’s tax payment non-compulsory and relinquishing the ability to make a DUE.

We do not believe that this result was intended by the Proposed Regulations. We recommend that the Proposed Regulations, when finalized, provide that a foreign tax payment does not fail to be compulsory solely because an entity with respect to which a DUE under Regulation section 1.1503(d)-6(d) has been filed did not share with the foreign taxpayer losses that would have reduced its foreign tax liability.

³⁵ See Reg. § 1.1503(d)-3(c)(2).

³⁶ See Section III.B, above.